

SuPrabha Academy



MPSC

ENGLISH MEDIUM

INDIAN

ECONOMY



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1. INTRODUCTION

Inflation is the sustained rise in the general price level of goods and services in an economy over a period of time. It reduces the purchasing power of money.

Importance: Moderate inflation indicates healthy demand and growth, but high or uncontrolled inflation destabilizes the economy.

TYPES OF INFLATION

1.1 based on intensity

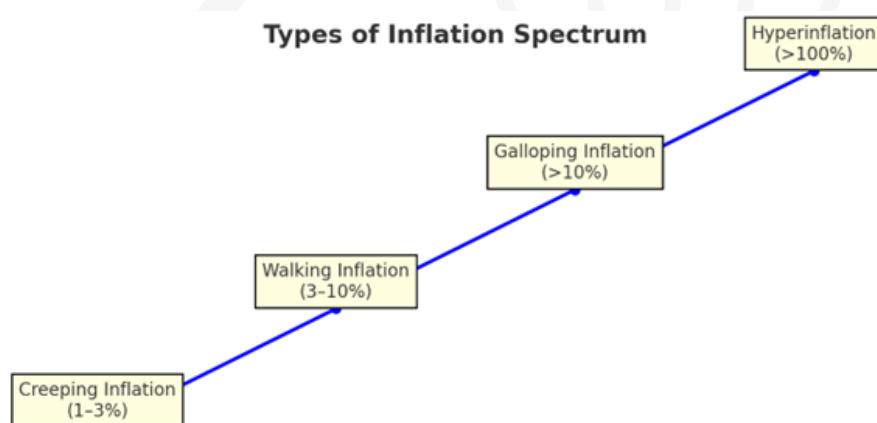


Fig. 1.1 types of inflation

Type of Inflation	Definition	Rate/Range	Features	Examples
Creeping Inflation	A mild and gradual rise in prices.	1-3% annually	Stable; healthy; encourages investment and consumption	India 1950s-60s (moderate growth).
Walking Inflation	Moderate but noticeable increase in prices.	3-10% annually	Warning signal; may lead to galloping inflation	India late 2000s (6-9% CPI).
Galloping Inflation	Very high inflation, rapid double/triple-digit rise.	>10% up to 100% annually	Money loses value fast; hoarding, speculation rise	India 1970s (20%+ during oil crisis).
Hyperinflation	Extremely high, uncontrollable inflation.	>50% per month (IMF definition)	Money loses value; shift to barter or foreign currency	Germany 1923; Zimbabwe 2008; Venezuela 2018.
Deflation	Continuous fall in general price levels.	Negative inflation rate	Reduces demand; increases debt burden; slows economy	Great Depression (1930s); Japan 1990s.

Disinflation	Decline in the rate of inflation (still positive).	Inflation positive but declining	Healthy stabilization; inflation curve flattens	India 2020 (7.6%) → 2021 (4.9%).
Stagflation	High inflation + low growth + high unemployment.	High inflation with low/negative GDP growth	Most dangerous condition; policies worsen trade-off	1970s Oil Crisis; India 2022 (food + fuel inflation with slowdown).

1.2 Based on reason : Demand-pull vs Cost-push inflation:

Aspect	Demand-Pull Inflation	Cost-Push Inflation
Definition	Inflation caused by excess demand for goods and services, when aggregate demand > aggregate supply.	Inflation caused by rising production costs, even when demand is not rising.
Cause	Too much money chasing too few goods.	Increase in cost of inputs like wages, raw materials, fuel, electricity.
Key Drivers	High government spending; Credit expansion; Rising private investment; Higher disposable income.	Oil price shocks; Wage hikes; Import cost increase; Supply chain disruptions.
Nature	Demand-side phenomenon.	Supply-side phenomenon.
Effect on Output	Initially, output may rise along with prices (short-term growth).	Output often falls while prices rise → stagflation risk.
Policy Response	Controlled by monetary & fiscal tightening (reduce demand).	Controlled by supply-side measures (productivity boost, subsidies, reduce input taxes).
Examples (India)	2009–11: Post-global crisis demand stimulus → food inflation; Real estate boom → rising prices.	1970s OPEC oil crisis (global); 2022 Russia-Ukraine war → crude oil, fertilizer, wheat prices.

1. Demand-Pull Inflation

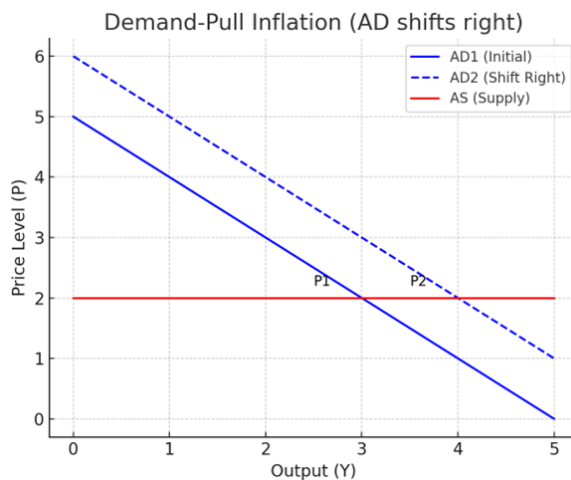


Fig. no. 1.2 Demand-Pull Inflation

In Demand-Pull Inflation, the Aggregate Demand (AD) curve shifts rightward from AD1 to AD2, leading to a higher price level ($P1 \rightarrow P2$) and higher output.

2. Cost-Push Inflation

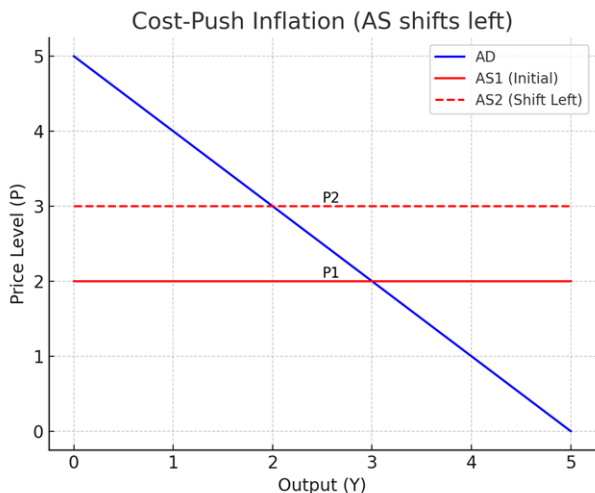


Fig. no. 1.3 Cost-Push Inflation

In Cost-Push Inflation, the Aggregate Supply (AS) curve shifts leftward from AS1 to AS2, leading to a higher price level ($P1 \rightarrow P2$) but reduced output, often causing stagflation

1.3 Headline vs core inflation

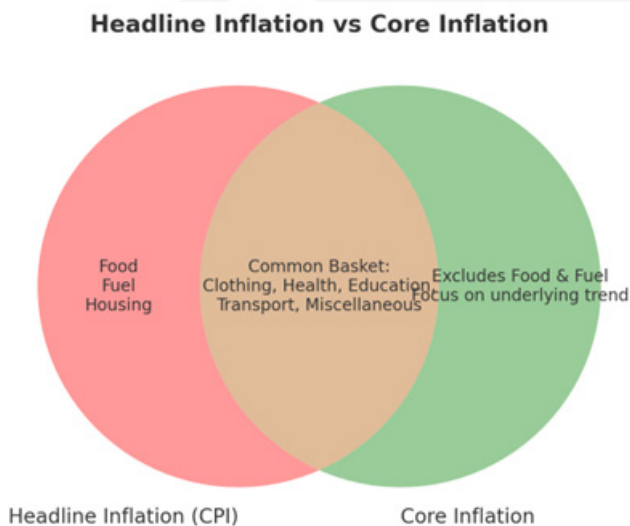


Fig nol, 1.3 headline vs core inflation

Aspect	Headline Inflation	Core Inflation
Definition	Overall inflation measured by CPI/WPI, including all items (food, fuel, services).	Excludes food and fuel prices (volatile components); captures underlying price trends.
Coverage	Broad measure including volatile and stable components.	Narrower measure; includes housing, clothing, education, transport (ex-fuel).

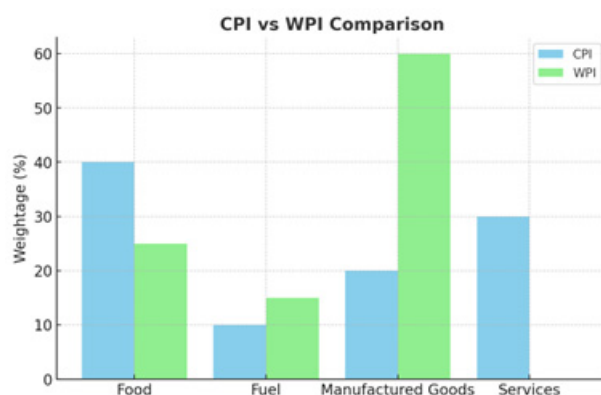
Volatility	Highly volatile due to seasonal food/fuel shocks.	Stable, reflects long-term demand-side inflation.
Usefulness	Shows short-term shocks affecting common people.	Useful for monetary policy as it reflects controllable demand-side inflation.
Example (India)	Onion/tomato price rise or crude oil spike → headline CPI shoots up.	Core CPI remains ~6% even if food inflation fluctuates (2022-23).
Global Practice	Countries report both, but headline is for public impact.	Central banks (RBI, US Fed, ECB) rely more on core for policy.
Policy Implication	Food/fuel inflation cannot be controlled easily by monetary policy.	Repo rate decisions depend more on core inflation trends.
Exam Trap	Headline = all items (food+fuel+core).	Core = CPI minus food & fuel.

1.4 Other types

Type of Inflation	Definition	Key Features	Examples
Bottleneck Inflation	Inflation caused due to supply-side bottlenecks in production and distribution.	Occurs even when demand is not excessive; due to infrastructure / logistics issues.	India 2010-13 : High food inflation due to poor cold storage & transport.
Sticky Inflation	Inflation that remains high and does not fall easily even after demand pressures reduce.	Persistent; due to wage contracts, expectations, administered prices.	India: Sticky food inflation in cereals/pulses even after bumper harvests.
Imported Inflation	Inflation transmitted from rising global prices to domestic economy.	Common in fuel-importing nations; worsens with currency depreciation.	India: Crude oil & fertilizer imports pushing CPI/WPI higher.
Open Inflation	Price rise visible in the open market without government interference.	Transparent; reflects market conditions directly.	India post-1991 reforms, liberalized prices of many commodities.
Suppressed Inflation	Inflation hidden due to government price controls, rationing, subsidies.	Demand exists but prices kept artificially low; leads to shortages & black markets.	India pre-1991 licensing era; USSR planned economy.
Built-in Inflation (Wage-Price Spiral)	Continuous price rise caused by wages chasing prices and prices chasing wages.	Self-reinforcing loop; expectations-driven.	Labour strikes in 1970s UK/US; India wage-hike linked inflation in public sector.

2. Measurement of Inflation

Inflation in India is measured mainly through CPI and WPI.



2.1 Consumer Price Index (CPI)

- Tracks retail prices of a fixed basket of goods and services consumed by households.
- Considered the most relevant measure for cost of living and adopted as the official 'headline inflation' in India since 2012
- Types of CPI compiled in India:

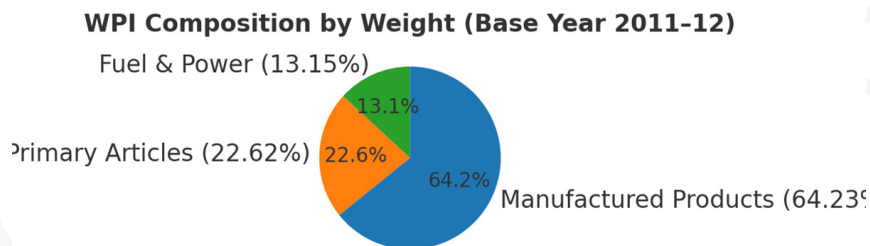
Index	Population Covered	Purpose / Use	Compiled By	Base Year	Special Notes
CPI-Combined (Headline CPI)	Entire population (rural + urban households)	Official headline inflation; used for RBI's inflation targeting (4% ± 2%)	CSO (MoSPI)	2012	Adopted in 2012 as the main measure of inflation in India.
CPI-Rural	Rural households	Captures price rise in rural consumption basket	CSO (MoSPI)	2012	Higher weight of food items due to rural consumption pattern.
CPI-Urban	Urban households	Captures price rise in urban consumption basket	CSO (MoSPI)	2012	Higher weight of housing, transport, and services compared to rural.
CPI-Industrial Workers (CPI-IW)	Industrial workers in organised sector	Used for wage indexation, Dearness Allowance (DA) revision of central/state govt. employees, PSU workers	Labour Bureau, Ministry of Labour	2016 (latest)	Crucial for salary and pension revisions.

CPI-Agricultural Labourers (CPI-AL)	Agricultural labour households	Used for rural poverty studies and welfare programmes	Labour Bureau	1986–87	Outdated base year, needs revision.
CPI-Rural Labourers (CPI-RL)	Rural labour households (including non-agricultural workers)	Used for rural development schemes and research	Labour Bureau	1986–87	Outdated base year similar to CPI-AL.

- Food and beverages carry the largest weight (~46% in CPI-Combined), making it highly sensitive to food price fluctuations.
- Base year: 2012; compiled by the Central Statistics Office (CSO) under MoSPI.
- Used by the Reserve Bank of India for its inflation targeting framework (4% ± 2%).
- Limitation: High volatility due to sharp movements in food and fuel prices.

2.2 Wholesale Price Index (WPI)

- Measures the average change in wholesale prices of goods traded between businesses before reaching the retail level.
- Major components:



- Base year: 2011–12; compiled by the Office of Economic Adviser, Ministry of Commerce & Industry.
- Until 2014, WPI was India’s main measure of inflation, but it is now considered less relevant for analysing consumer cost of living.
- Limitation: Does not cover services sector, hence incomplete picture of overall inflation.

2.3 GDP Deflator

- Represents inflation across the entire economy by comparing nominal GDP with real GDP.
- Calculated as:
 - ◆ $\text{GDP Deflator} = (\text{Nominal GDP} \div \text{Real GDP}) \times 100$.
- Covers all goods and services produced domestically, unlike CPI and WPI which are based on fixed baskets.
- Base year: 2011–12; compiled by MoSPI.
- Strength: Considered the broadest measure of inflation.
- Limitation: Available only quarterly or annually, not monthly, limiting its utility for short-term policy.

2.4 Producer Price Index (PPI)

- Shows inflation from the producer's perspective by measuring average changes in prices received by producers of goods and services.
- Excludes indirect taxes and subsidies, making it a more accurate reflection of producer income.
- Widely used in developed economies such as the United States and the European Union.
- India has not officially adopted PPI yet, though proposals have been made to replace or complement WPI.

2.5 Personal Consumption Expenditure (PCE) Index - Global Context

- Used in the United States to measure inflation through consumer spending behaviour.
- Takes into account changes in consumer preferences and substitution between goods.
- Preferred by the US Federal Reserve over CPI as it better reflects actual spending patterns.
- Not used in India, but important for comparative understanding in global context.

2.6 Comparison on CPI WPI AND GDP deflator

Aspect	CPI	WPI	GDP Deflator
Meaning	Retail inflation; cost of living.	Wholesale inflation; business-level prices.	Broad measure; inflation in entire economy.
Coverage	Goods + services.	Only goods.	All goods and services in GDP.
Weightage Pattern	Food-heavy (~46%).	Manufacturing-heavy (~64%).	No fixed basket; dynamic.
Base Year	2012 (CPI-Combined).	2011-12.	2011-12 (same as GDP).
Compiled By	MoSPI (CSO) + Labour Bureau (CPI-IW/AL/RL).	Office of Economic Adviser, Ministry of Commerce & Industry.	MoSPI (National Accounts).
Usefulness	Used for monetary policy (RBI targeting).	Used by industry, contracts, policy monitoring.	Broadest measure; used in GDP analysis.
Limitations	Volatile due to food/fuel.	Excludes services; less relevant to cost of living.	Not monthly; only quarterly/annual.

3. Causes of Inflation

3.1 Demand-Pull Inflation

- Excess money supply → Example: Post-2008 global financial crisis stimulus led to increased liquidity, pushing up demand.
- High government spending → Example: Subsidy programmes, MNREGA, and welfare schemes raising rural demand.

- Easy credit and loans → Example: Housing and real estate boom in India during 2003–08 due to cheaper loans.
- Rising disposable incomes → Example: Expanding middle class with higher salaries leading to higher consumption.
- Export boom → Example: IT and services exports increasing wages in India's tech sector.

3.2 Supply-Side (Cost-Push) Inflation

- Rising input costs → Example: Wage hikes and higher raw material prices (steel, cement) raising production costs.
- Global crude oil shocks → Example: 1970s OPEC oil crisis; 2022 Ukraine war caused global crude prices to spike.
- Supply chain disruptions → Example: COVID-19 lockdowns disrupted logistics, raising essential goods prices.
- Natural calamities → Example: Droughts and floods reducing agricultural output, pushing food inflation.
- Infrastructure bottlenecks → Example: Lack of cold storage and transport facilities for vegetables leading to wastage.

3.3 Imported Inflation

- Global commodity price rise → Example: International wheat and edible oil price rise in 2022.
- Exchange rate depreciation → Example: Weak rupee makes imports costlier, raising domestic prices.
- Crude oil and fertilizer imports → Example: India imports >80% of its crude oil; higher global prices directly fuel domestic inflation.

3.4 Structural Inflation

- Agriculture dependence → Example: India's heavy reliance on monsoon causes seasonal price fluctuations in food.
- Rigidities in supply → Example: Fragmented farmer markets and APMC restrictions limit free movement of produce.
- Low productivity → Example: Poor irrigation facilities and outdated farming techniques.
- Poor storage and transport → Example: FCI grain wastage due to inadequate godowns and logistics.

4. Effects of Inflation

4.1 Effects on Individuals & Households

- Purchasing power declines → Example: A salaried employee finds monthly expenses rise faster than income.
- Redistributive effect: Debtors gain (repay in cheaper money), while creditors lose as real value of repayments falls.
- Fixed-income groups such as pensioners, salaried employees, and wage labourers suffer the most.
- Speculators, traders, and hoarders often benefit by stockpiling goods and selling them at higher prices later.

4.2 Effects on Businesses & Industry

- Uncertainty in planning and investment due to volatile input costs → discourages long-term projects.
- Profit margins may initially rise if firms can pass on higher prices to consumers, but cost-push inflation erodes competitiveness.
- Resource misallocation: Investment often shifts to unproductive speculative assets such as gold and real estate.
- Menu costs: Frequent price changes increase administrative costs for firms.

4.3 Effects on the Economy (Macroeconomic Impact)

- Growth: Mild inflation may encourage production, but persistent high inflation reduces savings and investment.
- Employment: In the short-run, demand-pull inflation may reduce unemployment; but stagflation (e.g., 1970s oil shock) shows inflation and unemployment can coexist.
- Balance of Payments: Exports lose competitiveness due to higher domestic costs, while imports rise, worsening trade deficit.
- Wealth distribution: Inflation hurts rural poor and middle class most; asset owners (real estate, land, equities) often gain.

4.4 Effects on Government & Policy

- Fiscal effect : Government's nominal tax revenue increases automatically as prices and incomes rise.
- Monetary policy : Central banks (RBI) respond by tightening monetary policy, raising repo/reverse repo rates to control demand.
- Public debt : Borrowers (including government) benefit as real burden of debt falls, but future borrowings become costlier due to higher interest rates.

4.5 Effects on Society

- Inequality increases : Poor households spend larger share of income on essentials like food, making them more vulnerable.
- Social unrest : Persistent inflation often triggers strikes, protests, and political instability.
- Erosion of trust in currency : In cases of hyperinflation (e.g., Zimbabwe 2008, Germany 1923), people reject domestic money in favour of barter or foreign currency.

5. Control of Inflation

5.1 Monetary Measures (RBI)

a) Repo Rate

- ◆ Explanation : Rate at which RBI lends to commercial banks. Higher repo makes loans costlier and reduces borrowing.
- ◆ Example : RBI hiked repo rate from 4% (2022) to 6.5% (2023) to control high CPI inflation.

b) Reverse Repo Rate

- ◆ Explanation : Rate at which banks park funds with RBI. Higher reverse repo attracts deposits and reduces liquidity.

◆ Example: In 2020, RBI cut reverse repo to encourage banks to lend more.

c) Cash Reserve Ratio (CRR)

◆ Explanation: % of deposits banks must keep with RBI. Higher CRR reduces lending capacity.

◆ Example: If CRR rises from 4% to 5%, banks have less money to lend, reducing inflationary pressure.

d) Statutory Liquidity Ratio (SLR)

◆ Explanation: Share of deposits banks must invest in government securities. Higher SLR lowers credit flow.

◆ Example: Used heavily before liberalisation; now less common.

e) Open Market Operations (OMO)

◆ Explanation: RBI sells/purchases government securities to adjust liquidity.

◆ Example: RBI selling ₹50,000 crore bonds in 2022 absorbed excess money.

f) Inflation Targeting (MPC)

◆ Explanation: Since 2016, RBI targets CPI inflation at $4\% \pm 2\%$ using repo rate changes.

◆ Example: MPC increased repo in 2022 when inflation exceeded 7%.

5.2 Fiscal Measures (Government)

● Reduce Fiscal Deficit: Government cuts wasteful spending and borrowing to reduce demand.

◆ Example: FRBM Act sets targets for fiscal discipline.

● Rationalize Subsidies: Shifting to Direct Benefit Transfers reduces excess demand.

◆ Example: Fertilizer subsidies moved to DBT system.

● Increase Taxation: Higher taxes reduce disposable income, lowering consumption.

◆ Example: Higher excise duty on petrol/diesel in 2018 to curb demand.

● Public Borrowing: Borrowing from public absorbs liquidity without creating new money.

◆ Example: Issuance of savings bonds during high inflation periods.

5.3 Supply-Side Measures

● Boost Agricultural Production: More food supply reduces inflation.

◆ Example: Irrigation projects and PM-KISAN support.

● Maintain Buffer Stocks: Release grains to control food prices.

◆ Example: FCI released wheat & rice in 2022 to stabilise prices.

● Import Essential Goods: Allows imports to reduce shortages.

◆ Example: Duty-free edible oil imports in 2021–22.

● Improve Logistics & Storage: Prevent wastage and reduce transport bottlenecks.

◆ Example: Cold storage reduces onion price spikes.

● Control Hoarding & Speculation: Prevent artificial shortages.

◆ Example: Essential Commodities Act applied to onions.

5.4 Other Measures

- Wage & Income Policy: Avoid excessive wage indexation which creates wage-price spiral.
 - ◊ Example: Govt avoids full automatic linking of wages to CPI.
- Price Control Mechanisms: Fix MRPs for essential commodities.
 - ◊ Example: Capping stent and LPG prices.
- Dual Pricing: Subsidised goods for poor, market price for others.
 - ◊ Example: PDS for rice/wheat.

5.5 Role of RBI vs Government

- RBI focuses on monetary side (repo, CRR, liquidity), while Government controls fiscal deficit, imports, subsidies, and supply chains.
 - ◊ Example: RBI hiked repo rate in 2022 while Government cut import duties on edible oils.

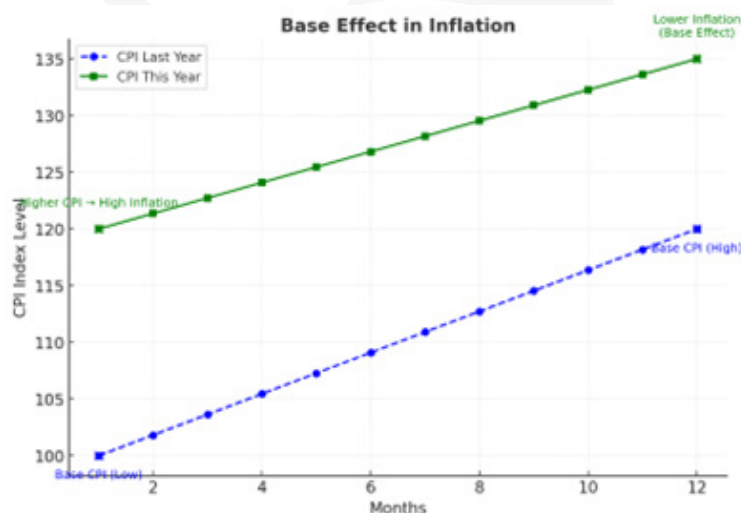
6. IMPORTANT CONCEPTS RELATED TO INFLATION

6.1 Base effect :

- The Base Effect refers to the impact of the previous year's price level (base year or month) on the current year's inflation rate. Inflation is calculated on a year-on-year (YoY) basis, so if the base year prices were unusually high or low, it can distort the interpretation of current inflation trends.

$$\text{Inflation} = \frac{(\text{CPI}(\text{Current Year}) - (\text{CPI}(\text{Last Year})))}{\text{CPI}(\text{last year}) \times 100}$$

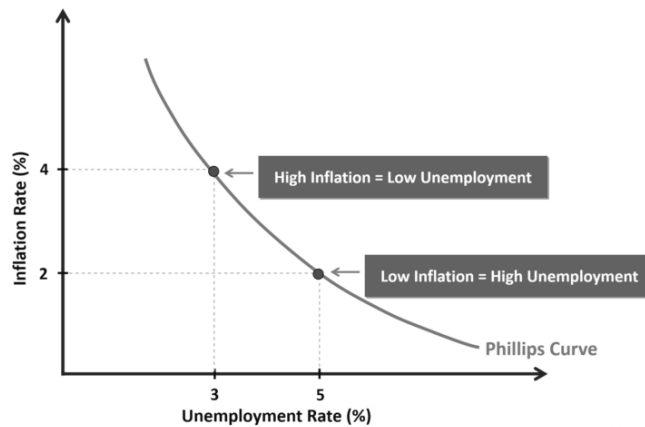
- If the base value (last year's CPI) is very high → Current inflation appears artificially lower.
- If the base value (last year's CPI) is very low → Current inflation appears artificially higher.



- For Example: In 2020, inflation was low during the pandemic; in 2021, small price rises looked large.

6.2 Philip curve

- The Phillips Curve shows the inverse relationship between inflation and unemployment. Proposed by A.W. Phillips (1958) based on UK data (1861–1957).



- Lower unemployment was associated with higher wage inflation, and higher unemployment was associated with lower wage inflation
- Low unemployment → higher wage inflation → higher price inflation, while high unemployment → lower wage inflation → lower price inflation.

6.3 Inflationary Gap

- An inflationary gap occurs when an economy's actual real GDP exceeds its potential GDP (the maximum sustainable output at full employment).
- This situation signifies that the economy is operating beyond its capacity, leading to excess aggregate demand, insufficient supply, and upward pressure on prices.
- Factors like increased government spending, heightened consumption, or strong net exports can cause an inflationary gap.

Key Characteristics

- **Actual GDP > Potential GDP** : The most fundamental characteristic is that the economy is producing more than it sustainably can.
- **Aggregate Demand Exceeds Aggregate Supply** : Demand for goods and services outpaces the economy's ability to produce them.
- **Rising Prices** : Since supply cannot keep up with demand, prices for goods and services tend to increase, a phenomenon known as demand-pull inflation.
 - ◆ **Overheated Economy** : The economy is essentially "overheating," consuming resources at an unsustainable rate.
- **Causes** :
 - ◆ Expansionary fiscal policy (higher government expenditure).
 - ◆ Easy credit and low interest rates.
 - ◆ High private investment.
 - ◆ Rise in exports or remittances.

- **Effects :**

- ◆ Demand-pull inflation (too much money chasing too few goods).
- ◆ Overheating of the economy, erosion of purchasing power.
 - ◆ Example: If full employment output = ₹1000 crore and AD = ₹1200 crore, the gap = ₹200 crore (Inflationary Gap).

6.4 Deflationary Gap

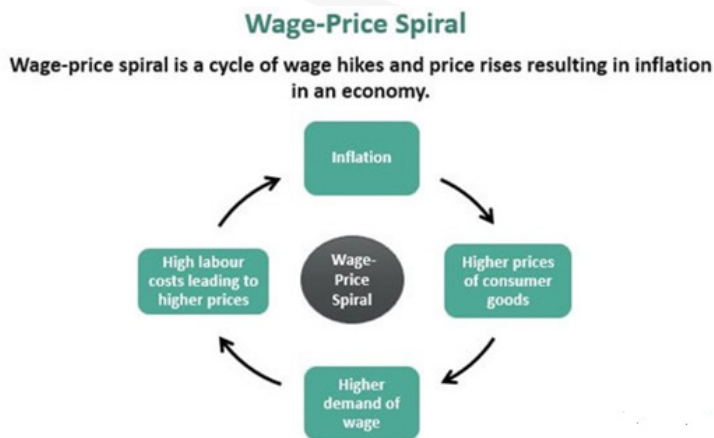
A deflationary gap, also known as a recessionary gap, occurs when an economy's aggregate demand is insufficient to purchase its potential output at full employment, resulting in a gap between actual and potential output. This leads to underutilized resources, high unemployment, and downward pressure on prices, creating a deflationary spiral where lower spending and investment further reduce economic growth.

Key Characteristics

- Insufficient Aggregate Demand:
 - ◆ The core issue is that the total demand for goods and services in the economy is too low.
- Potential vs. Actual Output:
 - ◆ The economy is producing less than it could if all its resources were fully employed.
- Underutilized Resources
 - ◆ Factories may be idle, and a significant portion of the labor force is unemployed because there isn't enough demand for the goods and services they can produce.
- Downward Pressure on Prices:
 - ◆ With unsold goods and less spending power, businesses may be forced to lower prices to attract customers, leading to deflation.

6.5 Inflationary Spiral

- A self-reinforcing cycle of rising prices and wages, where each increase feeds the next.

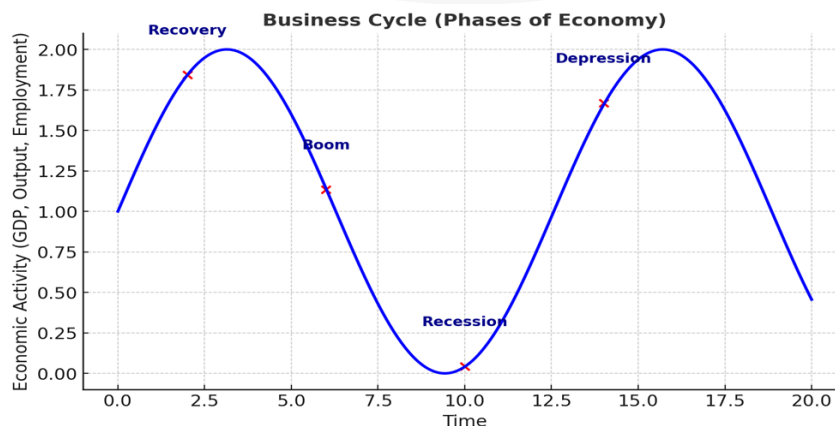


● **Comparison on deflation ,disinflation ,reflation and stagflation**

Aspect	Deflation	Disinflation	Reflation	Stagflation
Meaning	Persistent fall in general price level (negative inflation).	Fall in the rate of inflation (prices still rising but slower).	Policy-induced rise in prices to revive demand after slump.	High inflation + low growth + high unemployment.
Price Movement	Prices fall continuously (CPI ↓).	Prices rise but at slower pace (e.g., 6% → 4%).	Prices rise intentionally from below-normal to normal.	Prices rise despite falling output and jobs.
Economic Condition	Weak demand, excess supply, depression risk.	Economy still growing but inflation cooling.	Boosting economy after slowdown/ recession.	Worst-case: Inflation + stagnation + unemployment.
Causes	Sharp fall in demand, tight money policy, depression.	Tight policies, lower oil prices, demand moderation.	Govt/RBI stimulus (low taxes, high spending, easy credit).	Supply shocks (oil crisis, food shortage) + policy failure.
Effects	Unemployment ↑, production ↓, debt burden ↑.	Stabilises overheating economy, avoids hyperinflation.	Stimulates demand, raises jobs & output.	Cost-push inflation + unemployment + low growth.
Examples	Great Depression (1930s); 2008 global crisis (some sectors).	India 2014–16: CPI inflation fell from ~11% (2013) to ~4%.	Post-COVID 2020–21: Govt stimulus to revive economy.	1970s Oil Crisis (USA): High inflation + high unemployment.
Policy Response	Expansionary (reduce repo, increase spending).	Controlled tightening by RBI/Govt.	Expansionary fiscal & monetary stimulus.	Difficult: Needs supply reforms + monetary control.

7. Business Cycle phases

1. Recession



- Decline in economic activity for two consecutive quarters (negative GDP growth).
- Features:
 - Output and investment fall.
 - ◆ Unemployment rises. – Consumer demand slows.
 - ◆ Inflation moderates (sometimes disinflation/deflation)
 - ◆ Causes: Tight monetary policy, global slowdown, financial crisis, supply shocks.
 - ◆ Examples:
- India: GDP contracted by –23.9% in Q1 2020–21 (COVID-19 shock).
- USA: Recession during 2008 Global Financial Crisis.

2. Depression

- Severe and prolonged recession lasting several years.
- Features:
 - ◆ Long-term negative GDP growth.
 - ◆ Very high unemployment (20–25%).
 - ◆ Widespread bankruptcies.
 - ◆ Persistent deflation.
- Duration: Longer than a recession, may last a decade.
- Examples:
 - ◆ Great Depression (1929–39) in USA & Europe → 25% unemployment, collapse in output.
 - ◆ India: No depression post-independence, though colonial famines had depression-like impact.

3. Recovery

- Phase when economy begins to improve after a recession or depression.
- Features:
 - ◆ Investment picks up.
 - ◆ Consumer demand improves.
 - ◆ Employment rises gradually.
 - ◆ Prices stabilise with mild inflation.
 - ◆ Policy Measures: Fiscal stimulus, monetary easing (repo rate cuts, liquidity injection).
- Examples:
 - ◆ India: Post-COVID recovery (2021–23) with GDP growth ~7%.
 - ◆ USA: Recovery post-2008 crisis through stimulus & Federal Reserve's Quantitative Easing.

4. Boom (Expansion/Prosperity)

- Peak of the cycle, characterised by high economic growth and prosperity.
- Features:
 - ◆ High GDP growth and investment.
 - ◆ Low unemployment.
- Rising wages and standard of living.
- Risk of overheating → Inflationary Gap.

5. Comparison Table of Business Cycle Phases

Aspect	Recession	Depression	Recovery	Boom
Meaning	GDP contracts for 2 consecutive quarters	Severe, prolonged recession	Growth resumes after slump	Peak phase, rapid growth
Duration	Months to 1-2 years	Several years to a decade	Medium phase	Medium, ends with overheating
Output	Falling	Very low	Rising	At/beyond capacity
Unemployment	Rising	Very high (20-25%)	Falling	Very low
Prices	Stable or falling	Deflation	Stable/mild inflation	Rising (inflationary gap)
Examples	India 2020-21 (COVID), US 2008 Crisis	Great Depression 1929-39	India 2021-23, US post-2008 recovery	India 2003-08, US post-WWII expansion

8. TERMS IN NEWS (related to inflation exams favorite topic)

1. Goldilocks Economy

- Definition: Economy growing at a pace that is 'just right'
- not too hot (inflation) and not too cold (recession).
- Significance: Indicates stable growth with controlled inflation.
- Current Affairs: India described as approaching a Goldilocks scenario in 2025.

2. Base Effect

- Definition: Distortion in inflation rates due to comparison with an unusually high/low base period.
- Example: If last year CPI was very high, current inflation appears low.
- Current Affairs: RBI & NSO reports often mention 'base effect' in monthly CPI/WPI releases.
- Exam Angle: PYQ-theme, concept-based MCQs likely.

3. Greedflation

- Definition: Inflation driven by firms raising prices to increase profits, not due to higher costs.
- Global Usage: Term popular post-COVID in Europe & US.
- Significance: Shows profit-led inflation, not demand/supply-led.
- Exam Angle: New term - high chance as 'match the following' or 'statement-based question'.

4. Shrinkflation and Skimpflation

- Shrinkflation: Reduction in product size/quantity while keeping price same.
- Example: 100g chips packet → 80g at ₹10.
- Skimpflation: Reduction in quality/service at same price.

- Example: Airlines reducing free meals but keeping fares constant.
- Current Affairs: Reported in FMCG products in India in 2024.

5. Biflation

- Definition: Simultaneous inflation and deflation in different sectors.
- Example: Food prices ↑, luxury goods ↓.
- Significance: Shows uneven recovery in economy.
- Exam Angle: Miscellaneous economy term, can be asked in Prelims.

6. Vibecession

- Definition: A 'recession by perception' – when people feel economy is in bad shape despite growth.
- Cause: Inflation anxiety, high cost of living.
- Usage: Popular in US media during 2023-24.

7. Raging Twenties

- Definition: Phrase describing the 2020s decade with inflation shocks, trade wars, tech disruptions.
- Features: High inflation, supply chain crises, geopolitical tensions.
- Significance: Unique compared to earlier decades.
- Exam Angle: Can be asked in context of 'global inflationary trends'.

Previous Years Questions

Q1. Prelims (PSI/STI/ASO) – 2022

Consider the following statements:

- Creeping inflation is conducive to economic growth and may have favorable effects.
- During inflation, the value of money increases.
- Inflation benefits debtors.
- Inflation decreases the inequality of income.

Which of the statements is/are correct?

- a) a. and b. b) a. and c. c) b. and d. d) c. and d.

Correct Answer : b) (a) and (c)

Q2. MPSC Prelims – 2015

Annual rate of inflation during the 9th and 10th Five-Year Plans in India was ___?

- a) 4% and 5% b) 5% and 6% c) 3% and 4% d) 6% and 7%

Correct Answer: a) 4% and 5%

Q3. SSC CGL (Tier I) – 2011

Inflation redistributes income and wealth in favour of:

- The poor
- The middle class
- The rich
- None

Correct Answer: c) The rich

Q4. SSC CGL (Tier I) – 2010

During periods of inflation, tax rates should:

- a) Decrease
- b) Increase
- c) Remain the same
- d) Be abolished

Correct Answer: b) Increase

Q5. SSC CGL (Tier I) – 2015

In the national context, which of the following indicates a macro approach?

- a) Study of individual household budgets
- b) Inflation in India
- c) Sales of a company
- d) Expenditure of a person

Correct Answer: b) Inflation in India

Q6. SSC CPO (Paper I) – 2019

Which of the following statements is true regarding disinflation?

- a) It is a scenario when inflation is limited to a few commodities
- b) It refers to a sudden sharp decrease in prices
- c) It is a decrease in the rate of inflation in a specific period
- d) It refers to an overall decrease in prices

Correct Answer: c) It is a decrease in the rate of inflation in a specific period

Q7. SSC CPO (Paper I) – 2018

For controlling inflation, the central bank should:

- a) Sell government securities in the open market
- b) Lower the bank rate
- c) Purchase government securities in the open market
- d) Lower the reserve ratio

Correct Answer: a) Sell government securities in the open market

Q8. SSC CPO (Paper I) – 2021

Which bond adjusts coupon payments according to inflation indicators like CPI?

- a) Covered bond
- b) Strip bond
- c) Inflation-Indexed Bond
- d) Perpetual bond

Correct Answer: c) Inflation-Indexed Bond

Q9. SSC CPO (Paper I) – 2022

Headline inflation refers to:

- a) Inflation excluding food items
- b) Inflation including all items (food, fuel, others)
- c) Inflation excluding fuel items
- d) None of the above

Correct Answer: b) Inflation including all items (food, fuel, others)

Q10. SSC (Various) – —

A rapid increase in the rate of inflation is sometimes attributed to the “base effect”. What does it mean?

- a) Impact of current year's prices on next year's inflation
- b) Impact of previous year's price level on the current year's measured inflation
- c) Impact of base interest rate on inflation
- d) None of the above

Correct Answer: b) Impact of previous year's price level on the current year's measured inflation

Q11. CDS (Paper I, GK) – 2017

Stagflation refers to:

- a) Inflation and unemployment both are low
- b) Inflation is high but unemployment is also high
- c) Inflation is low and employment is high
- d) Inflation is high but employment is also high

Correct Answer: b) Inflation is high but unemployment is also high

Q12. CDS (Paper I, GK) – 2018

Disinflation means:

- a) Continuous fall in prices
- b) Fall in the rate of inflation
- c) Rise in general price level
- d) Increase in fiscal deficit

Correct Answer: b) Fall in the rate of inflation

Q13. NDA (Paper I, GK) – 2016

Which of the following is NOT a measure to control inflation?

- a) Increasing repo rate
- b) Reducing CRR
- c) Selling government securities in open market
- d) Reducing fiscal deficit

Correct Answer: b) Reducing CRR

Q14. NDA (Paper I, GK) – 2020

Which of the following is used as the official measure of inflation in India?

- a) Wholesale Price Index (WPI)
- b) GDP Deflator
- c) Consumer Price Index (CPI-Combined)
- d) Producer Price Index (PPI)

Correct Answer: c) Consumer Price Index (CPI-Combined)

Q15. IBPS Clerk (GA Section) – 2022

Under India's Flexible Inflation Targeting Framework, the inflation target set for RBI is:

- a) 2%
- b) $3\% \pm 1\%$
- c) $4\% \pm 2\%$
- d) $5\% \pm 1\%$

Correct Answer: c) $4\% \pm 2\%$

Q16. RBI Grade B (GA) / Banking Exams – 2021

Core inflation is different from headline inflation because it:

- a) Includes food and fuel
- b) Excludes food and fuel
- c) Includes only primary articles
- d) Measures only services inflation

Correct Answer: b) Excludes food and fuel

Q17. SBI PO (Banking Awareness) – —

Which of the following would be an appropriate monetary policy step to curb high inflation?

- a) Reduce Cash Reserve Ratio (CRR)
- b) Reduce Repo Rate
- c) Conduct OMO sale of G-secs
- d) Announce loan melas

Correct Answer: c) Conduct OMO sale of G-secs

Q18. SBI Clerk (Banking Awareness) – —

Which index is the current official measure of retail inflation in India?

- a) CPI-Combined
- b) WPI
- c) PPI
- d) GDP Deflator

Correct Answer: a) CPI-Combined

Q19. IBPS PO (Banking Awareness) – —

If CPI inflation is 6% and a bank offers 5% interest on a deposit, the approximate real interest rate is:

- a) +11%
- b) +1%
- c) -1%
- d) -11%

Correct Answer: c) -1%

Q20. IBPS/SBI (Banking Awareness) – —

'Inflation tax' primarily hurts:

- a) Fixed-income savers
- b) Equity investors
- c) Exporters
- d) Government employees only

Correct Answer: a) Fixed-income savers

Q21. IBPS Clerk (GA) – —

Which of the following best describes 'stagflation'?

- a) Rising inflation with rising output
- b) Rising inflation with falling output/employment
- c) Falling inflation with rising output
- d) Falling inflation with falling output

Correct Answer: b) Rising inflation with falling output/employment

Q22. SBI PO (GA) – —

When RBI increases the policy repo rate, the immediate effect on inflation is expected to be:

- a) Upward pressure via cheaper credit
- b) Downward pressure via costlier credit
- c) No effect at all
- d) Higher fiscal deficit

Correct Answer: b) Downward pressure via costlier credit

Q23. IBPS PO (GA) – —

Which of the following statements about 'Headline inflation' is correct?

- a) It measures only food and fuel
- b) It measures all items in the CPI basket
- c) It measures only core items
- d) It is same as WPI

Correct Answer: b) It measures all items in the CPI basket

Q24. SBI Clerk (GA) – —

The 'base effect' can make year-on-year CPI inflation appear:

- a) Lower if last year's base was high
- b) Higher if last year's base was high
- c) Unchanged regardless of base
- d) Ill-defined

Correct Answer: a) Lower if last year's base was high

Q25. Banking Exams (GA) – —

Which inflation concept is most relevant for setting monetary policy in India?

- a) WPI inflation
- b) CPI-Combined (Headline CPI)
- c) GDP Deflator
- d) PPI

Correct Answer: b) CPI-Combined (Headline CPI)

Q26. SSC CGL (Tier I) – 2017

If the price index was 200 at the start of 2015 and annual inflation was 2% in 2015 and 5% in 2016, what is the index at end-2016?

- a) 210.0
- b) 212.0
- c) 214.2
- d) 215.0

Correct Answer: c) 214.2

Q27. MPSC (State Service Prelims) – —

'Imported inflation' in India can be driven primarily by:

- a) A fall in global commodity prices
- b) Depreciation of the rupee and rise in crude oil prices
- c) A bumper domestic harvest
- d) Productivity gains in manufacturing

Correct Answer: b) Depreciation of the rupee and rise in crude oil prices

