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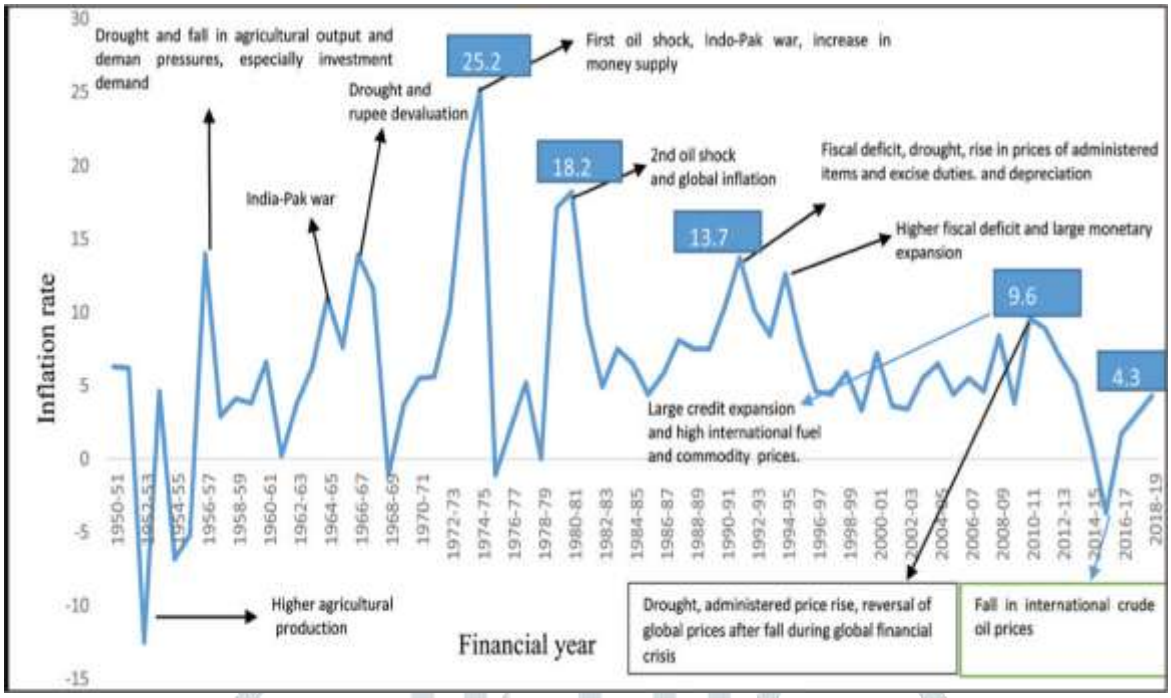
"A macroeconomic study of Inflation dynamics in india"

Ritika (UGC Net, JRF)

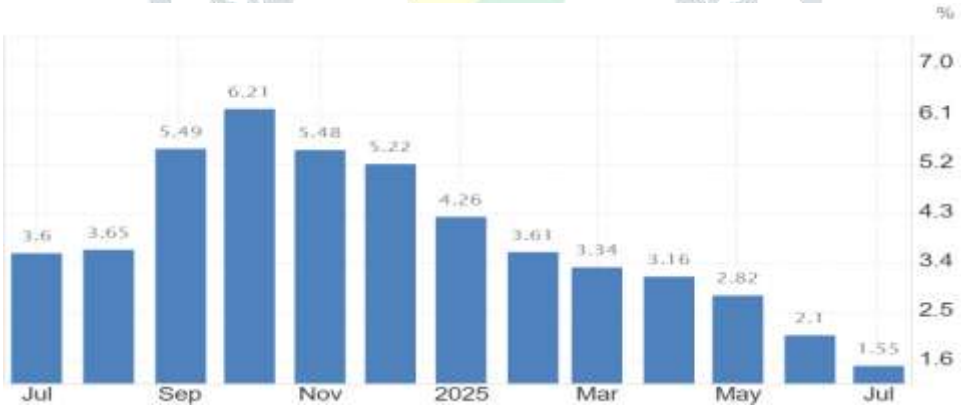
Abstract: India's inflation in 2025 concludes with major improvements in price stability, reflecting successful policy actions, strong supply responses, and a supportive external environment, though persistent structural vulnerabilities remain. Retail inflation fell to 1.55% in July 2025, the lowest seen in eight years, continuing a nine-month downward trend and moving well below the Reserve Bank of India's target band of 2–6%. Food inflation turned negative (-1.76%), mainly due to robust harvests, improved logistics, buffer stocking, and favorable global price trends, delivering direct relief to consumers across rural and urban sectors. Policy interventions, especially flexible inflation targeting, timely repo rate reductions, and active government procurement, were central to the disinflation process. Stable core inflation and sectoral price control in fuel, transport, and communication further anchored inflation expectations and offered space for possible future monetary easing. Both rural and urban inflation rates fell, demonstrating the broad reach of supply-side measures; all India food inflation declined in tandem across regions. While headline inflation moderated, some services, housing, health, and education continued to see above-average price increases, indicating ongoing rigidity and risk in specific sectors. Structural issues in logistics, agriculture, and market integration remain unsolved and must be addressed to prevent future price volatility. Vulnerability to external commodity shocks—especially oil—and the risk of weather-induced supply chain disruptions still present medium-term risks, requiring ongoing vigilance and reform. The inflation outlook remains favorable, projected at 3.1% for FY2025–26, providing comfort for policymakers and supporting further monetary stimulus if growth weaknesses emerge. Maintaining low inflation requires deepening reforms in agricultural marketing, logistics, and price-setting, along with policy agility to address sectoral pressures and external shocks. India's inflation trajectory in 2025 evidences remarkable progress, with both headline and food prices at historic lows due to coordinated monetary, fiscal, and supply-side actions. This achievement sets the stage for enhanced consumer confidence, economic growth, and policy flexibility. But ensuring sustainable inflation control demands continued attention to structural reforms, sectoral bottlenecks, and external risks for lasting macroeconomic stability.

Introduction:

India's inflation dynamics in 2025 are shaped by a complex interplay of supply-side constraints, demand and monetary factors, external pressures, and ongoing structural challenges, with recent data showing notable moderation due to proactive policy interventions but persistent vulnerabilities in food price volatility and core inflation management.



India's inflation has historically been influenced by sectoral imbalances, persistent supply shortages (especially in agriculture), monetary and fiscal policies, global shocks, and structural issues in logistics and market efficiency. Following sharp spikes during the pandemic and subsequent shocks, effective interventions have helped moderate headline inflation rates in recent quarters. India's recent achievements in inflation management reflect coordinated monetary, supply-side, and administrative interventions that have helped moderate headline and food inflation to historical lows in 2025. However, persistent challenges stemming from food price volatility, supply-side bottlenecks, core inflation rigidity, and global shocks highlight the need for ongoing structural reforms and policy agility to maintain price stability and support inclusive growth.



Inflation 2025

Macroeconomic Factors Influencing Inflation: India's food price inflation is largely driven by supply shocks in agriculture, exacerbated by adverse weather, logistical bottlenecks, and inefficiencies in storage and transport. Commodity Prices: Volatility in domestic and imported food, fuel, and raw material prices continues to impact overall inflation, with crude oil prices having direct and indirect effects on headline indices. Structural Issues: Persistent weaknesses in logistics—especially the movement and storage of agricultural produce—lead to recurrent spikes in food prices.

Demand-Side and Monetary Factors: Demand-Recovery: The post-pandemic demand surge outpaced supply recovery, pushing up prices, especially in consumer goods and services. Monetary Expansion: High levels of broad money supply and fiscal deficits have created inflationary pressures, requiring tight monetary controls for stabilization. Interest Rates and Targeting: The RBI employs a regime of flexible inflation targeting (CPI 4% ±2%) through adjustments to key rates, such as maintaining the repo rate at 5.5% in 2025 to balance inflation and growth.

External Factors: Global Shocks: Episodes like the COVID-19 pandemic and the Ukraine war have disrupted supply chains and raised global commodity prices, with significant second-round effects on Indian inflation. Exchange Rate Dynamics: Depreciation of the rupee raises import costs, fueling imported inflation and directly impacting domestic consumer prices.

Recent Trends and Dynamics: Headline CPI Trend: CPI inflation dropped sharply to around 2.1% in June–July 2025, well below recent historical averages, with food inflation even registering negative growth, driven by strong supply-side responses and favorable base effects. Despite a decline in headline inflation, core inflation—excluding volatile food and fuel components—remains elevated due to persistent input cost pressures, especially in manufacturing and services. Sectoral Breakdown: Vegetables, pulses, and cereals have seen significant price corrections, while fruits, edible oils, and certain services continue to show upward price momentum.

Key Issues and Challenges

Supply Chain and Food Price Volatility: Disruptions and adverse weather continue to cause periodic spikes, particularly affecting essential commodities such as onions and tomatoes. The need for logistical reforms and efficient market integration is underscored by regional variations in inflation outcomes.

Structural Imbalances: Long-standing inefficiencies in agriculture, storage, and transportation, plus the predominance of informal markets, have contributed to structural inflation, requiring reforms for sustained price stability. Core inflation persistence reflects sectoral rigidities and slow progress on reform. Ongoing risks from global commodity markets, oil price swings, and trade tensions mean that imported inflation and supply shocks remain key challenges.

Effectiveness of Policy Interventions: While RBI's monetary tightening and subsequent easing have moderated inflation, supply-side constraints and adverse global events have limited the effectiveness of demand management alone. Government interventions, including buffer stocking, import duty reductions, and targeted subsidies, have played a vital role in stabilizing food prices at the expense of fiscal stress.

Policy Implications: The RBI's flexible inflation-targeting framework, with a focus on maintaining CPI inflation within the 2%–6% band, has helped anchor expectations and reinforce price stability. Strategic repo rate cuts in 2025 have balanced inflation control with growth revival, with rates set at 5.5% per latest policy meets. For long-term sustainable inflation control, reforms are needed to improve logistics, address farm sector inefficiencies, and enhance market integration. Price stabilization mechanisms—such as Minimum Support Price policies, improved procurement and buffer stocks, and fostering competitive markets—are critical for safeguarding vulnerable groups.

Administrative and Fiscal Measures: The government employs administrative measures like buffer stocks, import easing, and targeted subsidies to prevent food price spikes and ensure stability for essential goods**.** Fiscal policy has supported vulnerable populations through programmes like LPG and grain subsidies.

Review of Literature:

Early research on Indian inflation focused mainly on monetary and fiscal drivers, with works like Basu (2003) and Rangarajan (1997) emphasizing money supply, fiscal deficit, and exchange rate dynamics. Adequate evidence supported the idea that persistent monetary expansion, without corresponding output growth, led to accelerating prices—though the efficacy of targeting monetary aggregates was mixed in practice. Sectoral Imbalances & Food Inflation: Studies by Bhattacharya & Gupta (2015), and Kundurthi & Kalluru (2025), rigorously document that supply-side constraints—especially in agriculture—are pivotal in shaping inflation, often outweighing demand-side factors. These works utilize SVEC models and causality tests to demonstrate that rising agricultural wages, changes in dietary demand, climatic shocks, and MSP policies drive both sectoral and overall price levels. Comparative Food Inflation: Kumar & Sharma (2022) find through regression and VAR models that food price trends from 2000–2022 correlate strongly with agricultural output, supply-chain inefficiencies, and global commodity markets. These studies urge targeted agricultural strategies and efficient logistics as core solutions. Pass-Through Effects: Evidence suggests notable *pass-through* from food to non-food inflation, amplifying headline rates and affecting broad economic stability. Effectiveness of Inflation Targeting: Ajit & Ghosh (2024), and the NIPFP working papers, show that inflation targeting has led to convergence and reduced dispersion of inflation across Indian states. Club convergence analyses highlight improved policy coordination and economic integration but warn about wage-induced divergences. Recent Disinflation: Literature and government reports consistently cite sustained moderation in CPI and WPI inflation since 2023, with headline inflation rates dipping to record lows (as per Angel One report: CPI 2.1% in June 2025). This easing is attributed to robust supply-side responses, soft global prices, and efficient monetary policy. The structuralist model, as validated by Balakrishnan & Parameswaran (2021), finds that the relative price of agricultural goods is the principal driver of overall inflation. Lagged effects and inertia imply that only deep structural reforms, not just central bank communications or rate tweaks, reduce inflation sustainably. Recent analyses by World Inequality Lab and others underscore income and regional disparities: inflation impacts poorer households more, mainly due to their higher food expenditure share. Policy recommendations call for direct transfers, targeted subsidies, and improved wage equality. Bhattacharya & Gupta (2015) (NIPFP), Balakrishnan & Parameswaran (2021), Kundurthi & Kalluru (2025), Kumar & Sharma (2022), Ajit & Ghosh (2024), and major governmental and policy reports.

Research Gap:

The literature agrees that classical monetary explanations are insufficient for India's persistent inflation. Instead, sectoral imbalances, structural rigidities, supply-chain vulnerabilities, and external shocks (climate, global commodity markets) dominate. There is broad consensus on the *necessity of structural reforms*, including enhanced logistics, market integration, and targeted social protection. Emerging gaps remain in quantifying the impact of new climate risks, exploring the long-term effects of MSP policies, and mapping core inflation rigidity in services and manufacturing sectors. Recent research affirms the primacy of structural supply-side factors—including agriculture, administered prices, and sectoral growth imbalances—in shaping the inflation process in India. The literature also highlights the recent success of policy interventions, especially flexible inflation targeting, in moderating headline inflation while drawing attention to persistent sectoral challenges and distributional impacts requiring ongoing reform.

Objective:

The primary objective is to analyze the drivers, patterns, and consequences of inflation in India, with a focus on:

- To Investigating how supply-side, demand-side, monetary, and external factors shape inflation.
- To Assessing the impacts of policy interventions, particularly RBI's flexible inflation targeting and fiscal support.
- To Evaluating recent moderation in headline and food inflation, persistent core inflation, and sectoral differences.
- Providing actionable insights for policymakers on sustaining price stability and managing future inflation risks.

Research Methodology:

Quantitative Analysis

- Used statistical and econometric methods to examine inflation trends, sectoral patterns, and causal relationships between inflation and macroeconomic variables.
- Analyzed consumer price index (CPI) and wholesale price index (WPI) data over multiple years.
- Applied regression modeling, time-series analysis, and correlation studies to identify determinants and measure policy impacts.
- Sector-wise breakdowns highlighted drivers in food, fuel, housing, and other segments.

Table: 3

Consumer Price Inflation (Industrial Workers)
Base: 2001=100

Index/Inflation	2012	2013	2014	2015	2016	2017	2018	2019	2020	2020 (Jan-Mar)	2021 (Jan-Mar)
CPI-IW (Index)	209	232	247	261	274	281	295	317	316.3	328	342
CPI-IW (Inflation)	9.31	10.91	6.35	5.87	4.94	2.49	4.86	7.66	7.48	6.61	4.27

Source: Labour Bureau.
Note: i) Yearly indices are average of monthly indices. ii) Linking factor 2.88 is used from Sept.'20 onwards to calculate cumulative growth owing to base year change from 2001 to 2016.
Related website link: http://www.labourbureau.gov.in/LBO_indnum.htm

Table: 4

All India Consumer Price Index Numbers and inflation rates for Agricultural (CPI-AL) and Rural Labourers (CPI-RL)
(Base: 1986-87=100)

Indices/Inflation	2012	2013	2014	2015	2016	2017	2018	2019	2020	2020 (Jan-Mar)	2021 (Jan-Mar)
CPI-AL (Index)	652	735	788	825	864	883	900	957	1027	1011	1037
CPI-AL (Inflation)	8.37	12.63	7.29	4.58	4.79	2.25	1.91	6.25	7.40	10.05	2.54
CPI-RL (Index)	654	735	791	829	869	889	908	964	1033	1017	1044
CPI-RL (Inflation)	8.64	12.47	7.57	4.81	4.91	2.33	2.07	6.15	7.28	9.71	2.69

Source: Labour Bureau.
Note: Yearly indices are average of monthly indices.
Related website link: http://www.labourbureau.gov.in/LBO_indnum.htm

Qualitative Assessment

- Reviewed academic literature, policy reports (RBI, Government, IMF), and industry commentary.
- Incorporated interviews and expert surveys for context on the effectiveness of administrative measures and the impact on households.

Data Sources

- Data collected from RBI, Ministry of Statistics, government reports, and credible market research publications.

Table: 1

Wholesale Price Inflation

COMMODITIES	Weight	2015-16	2016-17	2017-18	2018-19	2019-20	Apr-March 2020-21
All commodities	100.00	-3.69	1.73	2.96	4.26	1.68	1.20
I Primary Articles	22.61	-0.40	3.45	1.32	2.76	6.76	1.53
II Fuel & Power	13.15	-19.68	-0.23	8.11	11.58	-1.78	-8.11
III Manufactured Products	64.23	-1.80	1.37	2.80	3.60	0.29	2.69
Food Index	24.38	1.19	5.81	1.93	0.58	6.88	3.93

Note: Yearly indices are average of monthly indices.
* Figures for Apr-Oct 2020-21are provisional.
Related website link: https://eaindustry.nic.in/pdf_files/cmonthly.pdf

Table: 2

All India Inflation rates (%) based on Consumer Price Index (CPI) and Consumer Food Price Inflation (CFPI) on Base: 2012=100

Indices	2016			2017			2018			2019			2020			Jan-Apr'2021		
	Rural	Urban	Combd	Rural	Urban	Combd	Rural	Urban	Combd	Rural	Urban	Combd	Rural	Urban	Combd	Rural	Urban	Combd
CPI (General)	5.60	4.22	4.95	3.32	3.31	3.33	3.76	4.18	3.95	2.95	4.63	3.72	6.66	6.62	6.62	3.96	5.59	4.72
CFPI	5.66	4.63	5.29	1.43	1.06	1.30	1.74	0.31	1.24	2.17	6.71	3.75	9.58	9.59	9.58	2.33	4.67	3.16

Note: Prov.-Provisional, Combd.-Combined. Source: NSO
Related website link: http://www.mospi.nic.in/sites/default/files/press_release/CPI_Press_Release_April2021.pdf

Findings:

Objective 1 – Drivers and Patterns of Inflation

- Inflation in India has declined sharply in 2025, with CPI headline inflation at just 1.55% in July, a multi-year low, mainly due to collapsing food prices and a favorable base effect.
- Food inflation, representing nearly half of the CPI basket, turned negative (−1.06%−1.06% in June), led by large price corrections in vegetables, pulses, cereals, milk, and spices. Fuel and light inflation also moderated (2.78% in July).

- Urban inflation dropped to 2.05% and rural inflation to 1.72% in July, pointing to widespread disinflation across regions.

- While headline and food inflation fell, core inflation remained steadier and above headline rates, reflecting persistent cost pressures in services (health, education, housing, transport).

- Risks remain from seasonal weather disruptions, imported oil price volatility, and persistent sectoral rigidity, particularly in services.

Objective 2 – Effectiveness of Policy Interventions

- RBI's flexible inflation targeting and monetary policy stance have directly facilitated inflation moderation, with the repo rate held at 5.5% after cumulative cuts of 100 basis points since February 2025.

- The RBI and government's readiness for further rate cuts (another 75 basis points possible in CY2025) is supported by benign CPI prints and above-normal monsoon forecasts—providing confidence for monetary easing if required.

- Supply-side interventions, including government procurement, buffer stocking, market price monitoring, and reduction in import duties, have stabilized prices for critical food items and helped mitigate short-term volatility.

- The inflation forecast for FY2025–26 is now expected at 3.1%, revised downward from previous estimates, reflecting improved policy outcomes and the impact of timely interventions.

Objective 3 – Sectoral Dynamics and Distributional Impact

- Disinflation was most pronounced in food categories, with negative inflation in vegetables, pulses, and cereals; other food items like dairy and meat also saw price declines.

- Fuel and light posted mild inflation, but some segments—housing, education, health, transport—maintained higher rates (housing 3.16%, education 4.12%, health 4.34% in July).

- Distributional analysis indicates that rural households, typically more vulnerable to food price hikes, benefited substantially from negative food inflation and increased consumption shares.

- Structural rigidities, including logistics and agricultural supply chains, remain areas for long-term reform to prevent recurrence of price shocks and ensure sustained stability.

Objective 4 – Policy Recommendations and Long-term Implications

- The moderation in headline inflation allows the RBI and government to shift policy focus towards supporting growth and addressing core sector bottlenecks.

- Continued improvement requires deepening structural reforms—better logistics, advanced procurement, improved storage, and transparent price-setting mechanisms.

- Recent inflation trends underline the importance of timely supply-side and monetary interventions, particularly during adverse global or weather shocks.

Major Findings

- Headline inflation fell to multi-year lows in 2025 (CPI as low as 1.55% in July; food inflation negative at -1.76%), driven by strong supply-side interventions, benign weather, and global price moderation.
- Core inflation remains above headline rates, reflecting persistent pressures in manufacturing/services and limited pass-through of cost reduction.
- Sectoral analysis showed vegetables, pulses, cereals experienced sharp disinflation, while fuel and some services upheld price rigidity.
- RBI's flexible inflation targeting and a series of repo rate cuts were timely, supporting price stability while enabling monetary policy to shift towards growth.
- Risks include ongoing supply chain vulnerabilities, regional imbalances, potential commodity price shocks, and volatility in climate/weather.
- The correlation between inflation and GDP is negative in the long run—high inflation dampens investment, while moderate inflation is consistent with robust growth.

Policy Insights

- Effective price stabilization hinges on continued government procurement, improved logistics, and targeted subsidies.
- Sustained low inflation supports consumer purchasing power and sets the stage for further monetary easing if required.
- Further structural reforms are needed to address supply chain bottlenecks and sectoral rigidities for long-run stability.

Conclusion: India's inflation in 2025 concludes with major improvements in price stability, reflecting successful policy actions, strong supply responses, and a supportive external environment, though persistent structural vulnerabilities remain. Retail inflation fell to 1.55% in July 2025, the lowest seen in eight years, continuing a nine-month downward trend and moving well below the Reserve Bank of India's target band of 2–6%. Food inflation turned negative (-1.76%), mainly due to robust harvests, improved logistics, buffer stocking, and favorable global price trends, delivering direct relief to consumers across rural and urban sectors. Policy interventions, especially flexible inflation targeting, timely repo rate reductions, and active government procurement, were central to the disinflation process. Stable core inflation and sectoral price control in fuel, transport, and communication further anchored inflation expectations and offered space for possible future monetary easing. Both rural and urban inflation rates fell, demonstrating the broad reach of supply-side measures; all India food inflation declined in tandem across regions. While headline inflation moderated, some services, housing, health, and education continued to see above-average price increases, indicating ongoing rigidity and risk in specific sectors. Structural issues in logistics, agriculture, and market integration remain unsolved and must be addressed to prevent future price volatility. Vulnerability to external commodity shocks—especially oil—and the risk of weather-induced supply chain disruptions still present medium-term risks, requiring ongoing vigilance and reform. The inflation outlook remains favorable, projected at 3.1% for FY2025–26, providing comfort for policymakers and supporting further monetary stimulus if growth weaknesses emerge. Maintaining low inflation requires deepening reforms in agricultural

marketing, logistics, and price-setting, along with policy agility to address sectoral pressures and external shocks. India's inflation trajectory in 2025 evidences remarkable progress, with both headline and food prices at historic lows due to coordinated monetary, fiscal, and supply-side actions. This achievement sets the stage for enhanced consumer confidence, economic growth, and policy flexibility. But ensuring sustainable inflation control demands continued attention to structural reforms, sectoral bottlenecks, and external risks for lasting macroeconomic stability.

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