

CONSUMER PRICE INDEX

FIRST THING FIRST, WHAT IS A PRICE INDEX?

A price index is a statistical measure that tracks the changes in the prices of a set of goods and services over time. Price indexes are used to measure inflation and to track changes in the cost of living.

Types: Consumer Price Index (CPI), Producer Price Index (PPI), and the Gross Domestic Product (GDP) Deflator.

WHAT IS CPI

Measures the overall change in consumer prices based on a representative basket of goods and services over time.



HOW IS IT CALCULATED?



Suppose

- Total Price of the basket= 850
- Base year Price=200

Formula:

$$\frac{\text{Cost of the Market Basket in Given Year}}{\text{Cost of the Market Basket in Base Year}} \times 100\%$$

Let's calculate: $850 / (200 \times 100) = 4.25\%$

USES

Economic Indicator
Determine Purchasing power to make decisions about monetary and fiscal policies

Used to calculate cost-of-living adjustments for Social Security & other Govt benefits, as well as wage & salary adjustments for employees

Used to track changes in consumer spending patterns and to develop pricing strategies for business & market researcher's products & services

LIMITATIONS

- Limited basket of goods and services due to which it may not accurately reflect the spending patterns of all consumers.
- It is limited by its geographic scope may not accurately reflect the prices of goods and services in rural or suburban areas.
- CPI measures changes in prices but does not always account for changes in quality.

