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Is India's inflation targeting sufficiently capturing the digital economy?

As digital payments reshape consumption patterns, questions arise over whether India's CPI-based inflation targeting adequately reflects real transaction prices in a rapidly evolving economy

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Representative Image

India’s flexible inflation targeting (FIT) regime, adopted in 2016 with a 4 per cent consumer price index (CPI) anchor and a ±2 per cent tolerance band, was designed for an economy dominated by kirana stores, cash payments, and periodic price surveys. A decade later, with rising prosperity, rapid decline in poverty, and increasing global integration, the structure of Indian consumption has probably evolved faster than the statistical system that measures it.

In August 2025, the Reserve Bank of India (RBI), during its review of the inflation-targeting framework, explicitly flagged innovations in payment systems, alongside climate shocks and geo-economic fragmentation, as emerging challenges for monetary policy calibration. The concern is fundamental. If inflation indices do not reflect the price consumers actually pay, the signal guiding interest rates becomes distorted. Illustratively, if body temperature is not correctly measured, a dosage of Crocin cannot be determined.

The question confronting policymakers is simple: does the CPI still capture the implication of India's digital consumer reality?

A payments revolution CPI was never built for

Inflation, at its simplest, reflects the relationship between money and transactions in the economy. In classical monetary theory, this relationship is captured by the quantity equation of money, $MV = PT$, where M denotes money supply, V the velocity of circulation, P the price level, and T the number of transactions. Traditionally, monetary policy has focused primarily on managing M, assuming that V is constant in short run and changes gradually, and that T evolves with underlying economic activity.

Digitisation, however, is beginning to alter this relationship. When transactions become frictionless through digital payments, the velocity of money can increase, and the number of transactions (T) can expand rapidly because the cost and effort of making small, frequent purchases falls sharply. This is particularly relevant in an economy where retail consumption increasingly takes place through instantaneous digital payments rather than cash exchanges. Illustratively, compare the situation of monthly visit to kirana stop vs purchasing through Blinkit.

By mid-2025, India had become one of the world's most digitised retail payments ecosystems. The RBI's Payment Systems Report records 12,549 crore transactions worth ₹1,572 trillion in the first half of 2025, with digital payments accounting for 99.8 per cent of total transaction volume.

At the centre of this transformation is the Unified Payments Interface (UPI). In December 2025 alone, UPI processed 21.63 billion transactions worth ₹27.97 trillion. During first half of 2025, UPI accounted for roughly 85 per cent of retail transaction volume but only about 9 per cent of value, making it the backbone of small-ticket, high-frequency consumption, precisely the categories carrying large CPI weights.

India's payment architecture now reflects a clear dual structure: UPI dominates daily retail flows, while RTGS and other rails handle large-value transfers. Yet for a growing share of consumption, the effective price is no longer the printed MRP. It is shaped by cashbacks, platform promo codes, subscription discounts, buy-now-pay-later incentives, and algorithmic repricing.

Traditional CPI compilation, based largely on periodic store surveys and posted prices, was never designed to capture these layers of digital pricing.

Where CPI underestimates digital price dynamics

First, posted price does not equal the transaction-cleared price. UPI transactions often reflect net-of-discount costs shaped by promotional offers or bundled subscriptions. If CPI records listed prices while households pay less, measurement bias emerges.

Second, digital pricing is high-frequency. E-commerce platforms reprice goods several times daily, while CPI updates are monthly. In sectors like electronics or travel, turning points may occur within days.
Third, services inflation is increasingly digital. Ride-hailing fares, delivery charges, telecom subscriptions and streaming platforms follow pricing mechanisms, surge multipliers and algorithmic yield management, are rarely captured fully in traditional CPI baskets.

Fourth, payments data far outpaces survey frequency. UPI processed 10,636.96 crore transactions worth ₹143.35 trillion in H12025, with daily volumes approaching 700 million transactions by late 2025. Yet inflation measurement remains largely survey-driven.

Why this matters for policy

Measurement error can translate into policy error. If CPI misses digital discounts, inflation may be overstated; if online price spikes are averaged out, volatility may be understated. Either way, the inflation households experience may diverge from the inflation guiding the Monetary Policy Committee (MPC).

A reform agenda

India needs to modernise inflation measurement. Four steps are feasible: Introduce an experimental high-frequency Digital CPI, shift toward transaction-cleared price data, use payments aggregates to refine CPI weights, and establish a secure CPI Data Trust, enabling privacy-protected data sharing between MoSPI, the RBI and digital platforms.

The strategic stakes

Inflation targeting ultimately rests on measurement credibility. As India's payments architecture becomes among the world's most sophisticated, its inflation statistics cannot remain analogue in spirit. Thus, ensuring that CPI reflects what households actually pay is now essential for credible monetary policy in a digital economy.

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