

**Highlights:**

- ✓ ***A novel international survey conducted in early 2025 reveals that post pandemic, household inflation expectations remain elevated despite inflation rates approaching target levels.***
- ✓ ***Households with greater knowledge of central banks and their price stability mandates report lower inflation expectations***
- ✓ ***An RBI study on inflation expectations indicates that improved domestic economic conditions, coupled with policy actions, have helped household inflation expectations ebb from the highs witnessed around the pandemic.***

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What to expect from expectations?

Inflation expectations of households, corporates and professional forecasters hold significant importance for the central bank while formulating monetary policy decisions. Of the three groups, household inflation expectations constitute the largest group and are composed of the most divergent opinions. Hence, for any central bank, especially for an inflation targeting central bank like RBI, the alignment between household inflation expectations and the central bank inflation targets remain an evolving challenge.

The two studies^{1&2} that are discussed here are interesting from the viewpoint of a policymaker as one is based on the global experience covering a group of 29 countries both emerging and advanced economies conducted by the Bank of International Settlements (BIS), while the other study is based on the Inflation expectations survey of households (IESH) conducted bi-monthly by RBI. The two studies indicate some divergent and some overlapping evidence on the formation of inflation expectations, though it must be noted that the reference frames for both are different. Generic viewpoints remain the same.

The Global Experience: The international survey across 29 advanced and emerging markets covering the period from 24th March 2025 to 28th April 2025. points to the fact that household inflation expectations remain elevated even though many jurisdictions have actual inflation close to target levels. The findings of the survey also reveal that perceptions of the surge in inflation experienced during the post-pandemic era still linger and feed into household inflation expectations keeping them elevated. This indicates a certain asymmetry that has been pointed out by Indian policy makers too from time to time that temporary shocks to inflation tend to have a long-lasting impact on inflation expectations, as is confirmed by the evidence provided in the BIS survey.



The Upside Bias: Inflation expectations generated through household surveys tend to have a significant upside bias across the globe as well as in India. Post-pandemic price changes are perceived as larger by the households as per the BIS survey, as compared to the pre-pandemic period. The BIS Bulletin finds that across countries inflation over the next 12 months, i.e. the 1 year ahead forecasts for households were 8 per cent, significantly higher than the current 2.4 per cent average inflation level. Responses remain symmetric around the most likely outcome and vary within 4-11 per cent. This upside bias can be seen in India, as indicated in chart 1.

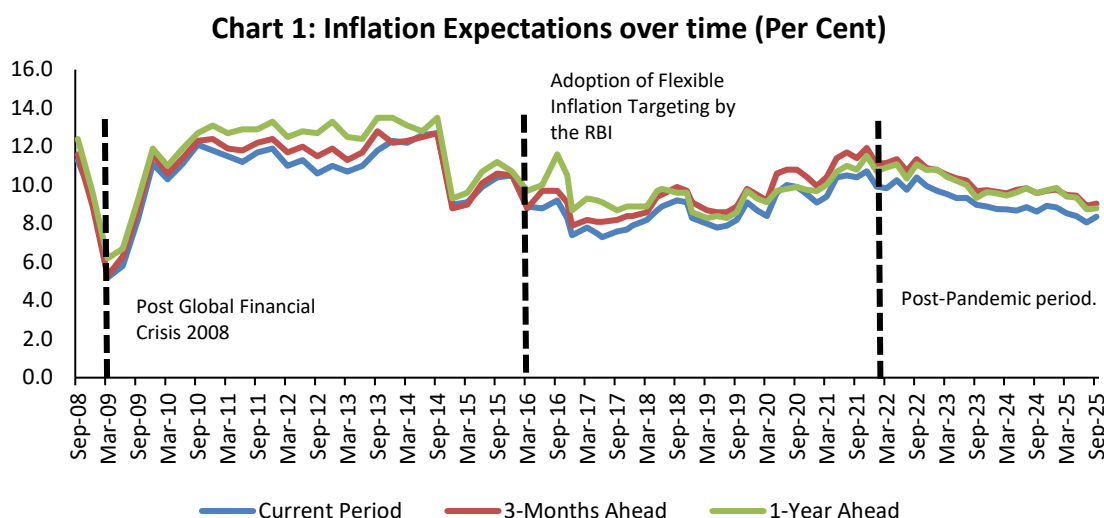
On average across economies a median household believes that prices increased by 9 per cent between 2015-19 and 18 per cent between 2020-24, broadly in line with actual inflation dynamics. A fifth of the respondents surveyed perceive a much stronger 30 per cent or above increase in prices than observed. Households attribute higher inflation to pandemic related shortages and rising commodity prices and central banks are generally not blamed for inflation. Overall central banks enjoy better trust than governments across countries. The BIS survey observes that household sentiment remains subdued, and inflation expectations remain elevated despite central banks being successful in aligning actual inflation levels to their respective targets. Household sentiment about economic conditions appears to be closely tied to the evolution of prices over long stretches of time.

The consumption, savings and investment decision of households depends heavily on the formation of their inflation expectations. The relationship between inflation expectations of the households and the central bank is not a simple one. A natural corollary of households being aware of the central bank's mandate of price stability leads to a lower level of expectations, but this is tricky since the survey also indicates that a significant percentage of the population lack even a basic understanding of the functions of the central bank. As per the survey, around 60 per cent recognize the institution as the central bank of the country and an even lower 49 per cent believe that price stability is the central bank's main goal.

Post Pandemic Shaping of Inflation Expectations: Memories of the recent inflation surge are likely to continue to shape inflation expectations for an extended period and the quantitative effects are significant. A 1 per cent increase in perceived price levels over 2020-24 lifts inflation expectations by 0.12 percentage points. The impact of the perceived increase in prices in the pre-pandemic period 2015-19 is also positive but about half as large i.e. 0.6 percentage points.



The Indian Dynamics: Similar to the international experience, the RBI study reveals that India too experienced a surge in inflation owing to the supply chain disruptions post pandemic and later continuing due to geo-political tensions. Findings of the study conducted on the Inflation Expectations Survey of Households (IESH) which covers 6000 households across India indicated that the post pandemic inflation surge has kept inflation sticky. The study uses unit level data on 1 year forward median inflation expectations from the RBI's IESH to understand the dynamics post pandemic.



Source: RBI Inflation Expectations Survey of Households (IESH), October 2025

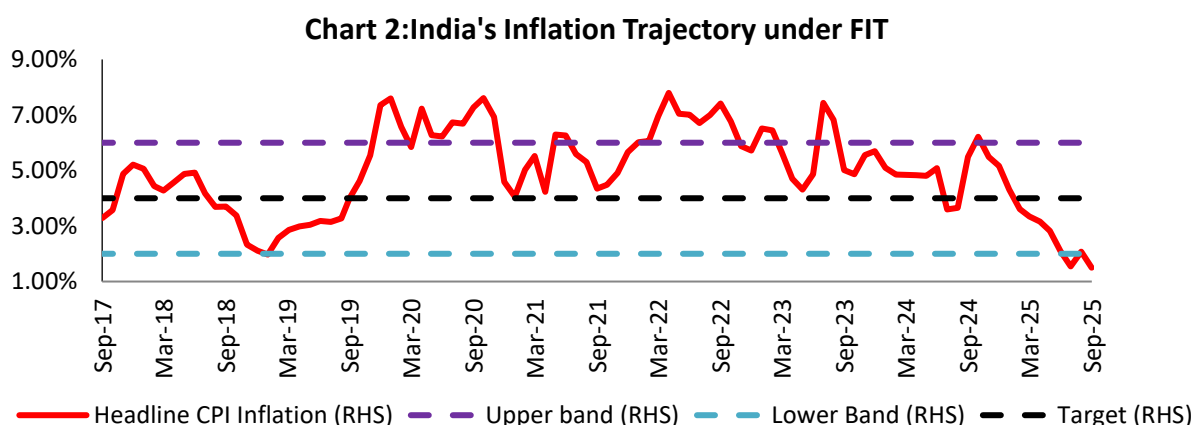
The common thread among the two studies is that household inflation remains elevated owing to past perceptions of prices. The more important observation of the RBI study is that improved domestic economic conditions coupled with prudent monetary policy actions have helped household inflation expectation ebb from the highs that were witnessed post pandemic. This appears to be diverging with overall international experience, as the BIS International survey indicates that inflation expectations have been higher despite actual inflation readings being closer to targets in many jurisdictions where the survey was conducted.

Key Determinants of Inflation Expectations in India: Various theories have explored the role of inflation expectations in shaping the actual inflation dynamics in the overall macroeconomy ranging from adaptive to rational expectations model that fail to account for heterogeneity in agents i.e. households' expectation formation and revisions. The key determinants of inflation expectations in India as per the RBI study are as follows:



- A. Behavioral Factors: Lifetime of experiences may lead to rational inattention and cognitive biases.
- B. Observed Price Change: Households perceive price increases as more lasting than declines.
- C. Social Influences: Herd behavior, media exposure and professional forecasts can influence expectations. Households often trust family and personal networks over media channels.
- D. Individual Characteristics: Older people with more experience of inflation and higher economic literacy and income levels tend to have more informed inflation expectations.
- E. Monetary Policy Actions and Central Bank Communication: can shape inflation expectations by reducing the persistence of inflation shocks. Effective communication like forward guidance can help in managing public expectations, and,
- F. Domestic and global influences: Domestic geographic location can shape inflation expectations. Domestic factors like growth in GDP, unemployment rates, supply shocks and monetary policy credibility as well as global factors like commodity price inflation, volatility in exchange rate markets and financial markets also affect expectations.

These factors have a greater impact on emerging markets as compared to advanced economies. Nevertheless, short-term inflation expectations do vary with business cycles and macroeconomic shocks, while long-term expectations remain anchored as long as they are not significantly influenced by fluctuations in short-term expectations.



Source: RBI, MoSPI



Concluding Observations: Inflation expectations in India are influenced by both domestic factors like GDP growth, actual inflation (headline and core), food and oil prices, monetary policy and fiscal policy and global factors like international oil prices and exchange rate fluctuations, policy uncertainty and financial market volatility. Food price shocks, aggregate demand conditions, monetary policy actions and global shocks significantly shape household expectations, while the impact of oil prices shocks is mixed.

RBI's communication and adoption of the flexible inflation targeting (FIT) regime have helped manage inflation expectations, however only a few studies have explored issues related to bias adjustment in survey-based expectations. There have been episodes where inflation has breached the upper and lower tolerances but has been within the prescribed limits for most of the time. The large disruptions to the inflation trajectory have come from food prices and more specifically volatile runs in vegetable prices, which have also dented public expectations of inflation in the near and medium term. Managing inflation expectations to keep inflation anchored remains an ever-evolving challenge for central banks across the world and for RBI.

1. Household perceptions and expectations in the wake of the inflation surge: survey evidence, Fiorella De Fiore, Damiano Sandri, James Yetman, BIS Bulletin, June 2025
2. Household Inflation Expectations in India: Emerging Trends, Determinants and Impact of Monetary Policy, Ankit Ruhi, Kanupriya Sharma and Subhadra Sankaran, RBI Bulletin, July 2025.

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