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WHAT IS INFLATION?

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Summary: Explanation of inflation and how it is calculated using the consumer price index.

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What is inflation?

In terms of economics, inflation is the average increase in prices of goods and services purchased by consumers. Inflation leads to currency devaluation, which means that fewer goods or services can be purchased with the same amount of money.

How is inflation measured?

In the Netherlands, as in most countries, the consumer price index (CPI) is used to calculate official inflation. The CPI reflects changes in prices of an established average package of consumer goods and services. Inflation in a certain month is calculated as the percentage change of the CPI for that month compared to CPI for the same month in the previous year. For example: in April 2012 the CPI was 2.4 percent higher than in April 2011, therefore inflation calculated for April 2012 was also 2.4 percent.

Consumer price index (CPI) and inflation

	2011	2012	Inflation
	<i>CPI, 2006=100</i>		<i>%</i>
Jan	106.87	109.52	2.5
Feb	107.68	110.35	2.5
Mar	108.90	111.61	2.5
Apr	109.48	112.06	2.4
May	109.57	111.90	2.1
Jun	109.03	111.36	2.1
Jul	109.58	112.10	2.3
Aug	109.76	112.24	2.3
Sep	110.15	112.70	2.3
Oct	110.20	113.36	2.9
Nov	109.86	112.90	2.8
Dec	109.58	112.74	2.9
Year ¹⁾	109.22	111.90	2.5

1) Twelve-month average

Source: CBS

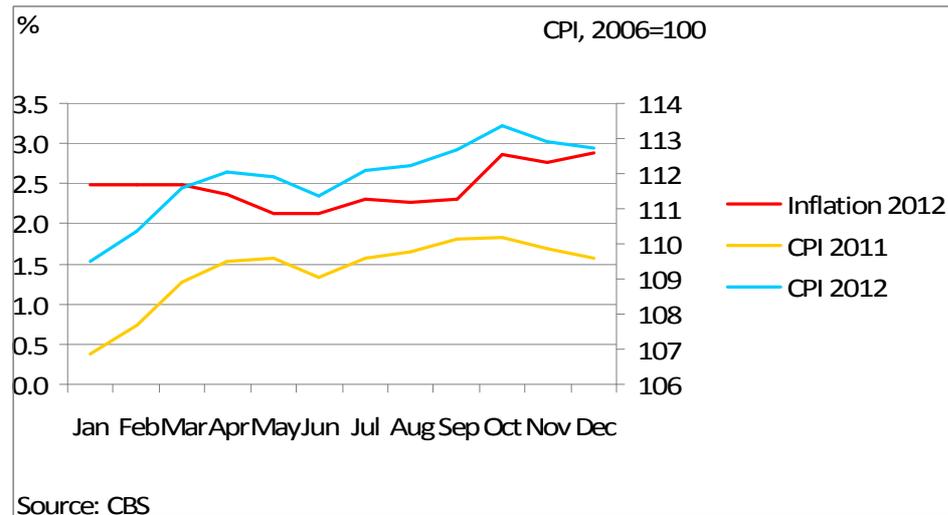
Can prices rise while inflation falls?

If the inflation of a certain month is lower than that of the previous month, this does not automatically mean that prices in general have decreased. For example: in April 2012 inflation was 0.1 of a percent point lower than in March 2012. But prices in April were higher than in March: the CPI in April was 0.4 percent higher. The inflation is measured as the *year-on-year* change, and the CPI increase in April 2012 from April 2011 was smaller than the increase in March 2012 from March 2011. So prices can indeed go up while inflation goes down.

Development of CPI and inflation

The graph below illustrates developments in inflation compared to CPI. The yellow and blue lines show the development of the CPI in 2011 and 2012. The red line shows the level of inflation in 2012: the percentage difference between the CPI in 2012 and the same month in 2011. If the distance between the 2012 and 2011 CPI lines narrows, the inflation rate decreases. If the difference widens, inflation goes up. The distance between the CPI lines in the graph grows in December and, correspondingly, inflation rises from 2.8 to 2.9 percent.

Consumer price index (CPI) 2011 and 2012 and inflation in 2012



More information:

- [Consumer price index](#)