

# 50 Important Concepts

## Indian Economy



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# 50 Important Topics

1. Monetary Policy Transmission
2. Inflation, Deflation, Disinflation, Reflation
3. Inflationary Gap vs Deflationary Gap
4. Bracket Creep and Fiscal Drag
5. Structural Inflation (Bottleneck Inflation)
6. Consumer Price Index
7. Impact of inflation
8. Pro Cyclical and Counter Cyclical Fiscal Policy
9. Types of Deficits in Budget
10. Government Borrowing
11. Bond Yield
12. Financialisation of Economy
13. Indian Economy in “Goldilock Phase”
14. Stablecoins



# Topic 1 – Monetary Policy Transmission

# Monetary Policy Transmission

- Meaning → process through which changes in monetary policy affects real economic activity such as output and inflation
- Repo rate ↑ → Cost of funds ↑ → Lending rates ↑ → Investment ↓  
→ Demand ↓ → Inflation ↓
- Monetary Policy Transmission
  - Slow
  - Asymmetric

# Monetary Policy Transmission

- Factors leading to Poor Monetary Policy Transmission in India
  - Higher NPA's → Banks are reluctant to lend, Risk Aversion.
  - High interest rates for Small Saving Scheme which is administered by GoI
  - Less dependency of banks on repo rate facility of RBI for funds.
  - Double Financial Repression
    - Asset Side - a) High SLR requirement, b) Priority Sector Lending requirement
    - Liability Side - a) sluggish public deposit growth
  - Issue in MCLR system

# Topic 2 - Inflation, Deflation, Disinflation & Reflation

# Inflation, Deflation, Disinflation & Reflation

## Inflation →

- Sustained/persistent/continuous rise in the general price level of goods and services in an economy over a period of time.

## Deflation →

- opposite of Inflation
- decrease in the general price levels of goods and services.
- Inflation rate is negative (below 0%).
- considered bad for the economy as it may lead to recession.

## Disinflation →

- It is decrease in inflation rate.
- Prices are rising, but at a slower speed.
- Inflation is positive. However, rate of inflation slows down (for example from 3% to 2% to 1%)

## Reflation →

- Deliberate action [fiscal or monetary policy] to increase the rate of inflation to stimulate the economy.

# Topic 3 – Inflationary Gap vs Deflationary Gap

# Inflationary Gap vs Deflationary Gap

| Basis                                      | Inflationary Gap                          | Deflationary Gap   |
|--|---|--|
| <b>Meaning</b>                             | Excess demand over full employment output | Deficient demand below full employment output                      |
|  | $AD > AS$ at full employment              | $AD < AS$ at full employment                                       |
| <b>Economic Condition and Output Level</b> | Economy overheating                       | Economy underperforming  |
|  | Actual GDP > Potential GDP                | Actual GDP < Potential GDP   |
| <b>Reasons</b>                             | Excess government spending during boom    | Demand collapse during recession<br>Contractionary Monetary Policy |
| <b>Price Level</b>                         | Prices rise continuously                  | Prices fall or inflation slows                                     |
| <b>Inflation Rate</b>                      | High inflation                            | Low inflation / deflation  |
| <b>Business Cycle Phase</b>                | Boom phase                                | Recession phase  |
| <b>Policy Needed</b>                       | Contractionary policy, Increase repo rate | Expansionary policy, Decrease repo rate                            |
| <b>Risk If Persistent</b>                  | Hyperinflation                            | Depression   |

# Topic 4 – Bracket Creep and Fiscal Drag

# Bracket Creep and Fiscal Drag

- Bracket Creep → inflation pushes people's nominal incomes into higher tax brackets, even though their real purchasing power hasn't actually increased.
  - Economic Growth → Inflation (Increase in prices) → Demand for increase in wages → Income rises → People move into higher tax bracket due to progressive taxation → Larger share of income goes to taxes → Real income falls
- Fiscal Drag (it is economic consequence)
  - Bracket creep → Government taxes increases and Aggregate Demand declines → may lowers economic growth

#Higher effective tax burden

#Reduced Purchasing Power

#Increased Government Revenue

#Economic Growth may decline

# Topic 5 – Structural Inflation (Bottleneck Inflation)

# Structural Inflation (Bottleneck Inflation)

- Inflation built into the economic system due to structural features of economy or government policies.
- Examples
  - Infrastructure Deficiency such as poor roads etc → increases logistic cost → increase in prices
  - Agricultural Supply Chain Bottlenecks due to fragmented landholdings, monsoon dependence, lack of institutional agri credit, poor marketing infrastructure etc → increase in prices

# Topic 6 – Consumer Price Index (CPI)

# Consumer Price Index (CPI)

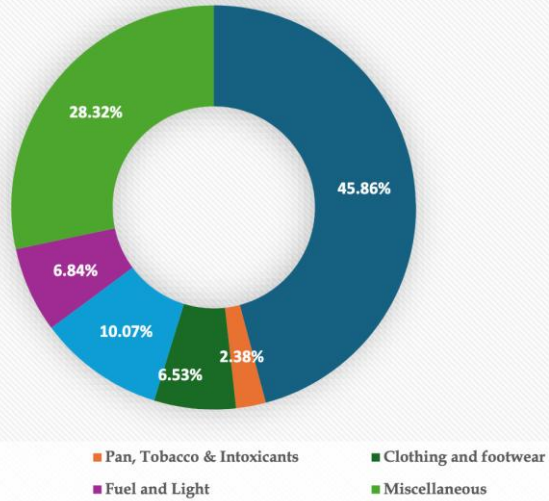
- to measure the changes over time in general level of retail prices of selected goods and services that end consumers purchase for the purpose of consumption.
- In India, following CPI's are compiled regularly, catering to the need of specific population group
  - CPI (IW) → Industrial Worker (Base Year - 2016)
  - CPI (AL) → Agricultural Labour (Base Year - (2019)
  - CPI (RL) → Rural Labour -(Base Year - 2019)
  - CPI (Rural), (Urban), (Combined) → All India Level (being released since Jan, 2011) (Base Year - 2024)
  - Note → CPI (UNME) [discontinued w.e.f. December, 2010] → Urban Non Manual Employee

# Consumer Price Index (CPI)

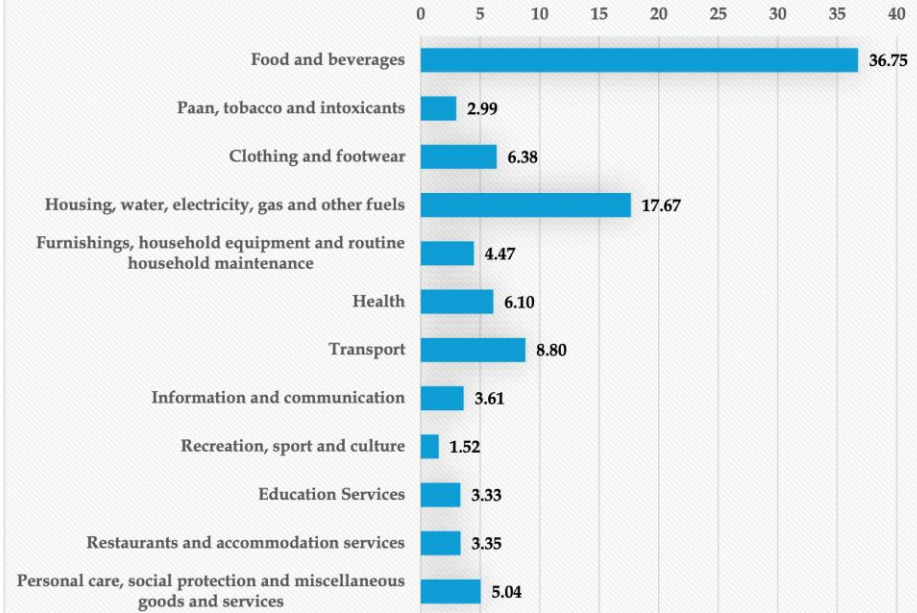
- Key Changes in the CPI
- Base Year Shift: The base year for CPI calculation is updated to 2024=100 from the previous 2012=100
- Basis of assignment of weights → based on Consumer Expenditure Survey (CES), 2023-24
- Updated Basket: The number of items in the CPI basket increased from 299 to 358 to reflect current consumer trends.
  - Goods items are increased from 259 to 308
  - Services items are increased from 40 to 50
- Reduced Food Weightage: The weight of Food & Beverages has been reduced from 45.86% to 36.75%, which is expected to reduce volatility in headline inflation.
- Structural Changes: The classification now follows the international COICOP 2018 framework (12 divisions, 43 groups, 92 classes).
- Expanded Coverage: Price data is collected from 1,465 rural and 1,395 urban markets, plus 12 online marketplaces.
- New Additions: Rural housing, Online media service provider/Streaming services, value added dairy products, Barley & its product, Pen-drive & External Hard disk, Attendant, Babysitter and Exercise equipment
- Items Removed: VCR/VCD/DVD player and hiring charges, Radio, Tape recorder, Clothing second-hand, CD/DVD audio/video cassettes and Coir/rope

# Consumer Price Index (CPI)

Group-wise weights of CPI 2012



Weights of CPI 2024(%)



# Topic 7 – Impact of Inflation

# Impact of Inflation

- Fixed Income Group - Salaried & Pensioners, → Negative Impact as reduction in purchasing power of currency
- Businessman & Entrepreneurs → Profits may increase due to price rise
- Purchasing Power → Negative Impact. Purchasing power of currency reduces
- Standard of Living → Negative Impact. Inflation negatively impact poor more than rich
- Savings → Negative Impact. As people have to spend more on consumption of same amount of goods and services
- Domestic Investment → Decline in domestic investment as domestic savings reduces and interest rate increases
- FDI → Reduces. Inflation increases uncertainty and FI avoids unstable markets
- Creditors → Negatively Impacted
- Debtors → Positively Impacted. Inflation redistributes wealth from creditors to debtors
- Economic Growth → Moderate inflation stimulates economic growth. High Inflation increases uncertainty and negatively impact GDP
- Exports → Price rise make exports uncompetitive
- Imports → Higher price of domestic goods encourages cheaper imports
- Employment → Moderate Inflation leads to decrease in unemployment. Higher Inflation leads to increase in unemployment
- Bond Holders → Bonds provides fixed interest rate. Bond holders tend to lose due to higher inflation.
- Government Tax collection → Increases due to bracket creep. Also, govt is the major debtor, inflation benefits government.
- Real Interest Rate →  $(\text{Real Interest Rate} = \text{Nominal Interest rate} - \text{Inflation rate})$ . Negatively Impacted.
- Balance of Payment (BoP) → Negatively Impacted. (Exports falls, imports increases)
- Informal Sector → Negatively Impacted. Informal sector do cash based transactions.



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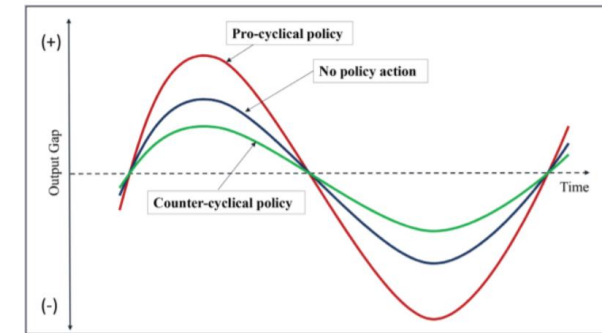
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# Topic 8 – Pro Cyclical and Counter Cyclical Fiscal Policy

# Pro Cyclical and Counter Cyclical Fiscal Policy

- Pro - cyclical → fiscal policy reinforces the business cycle
- Counter cyclical → fiscal policy against the direction of business cycle



**Figure: Business Cycle under Various Fiscal Policy Stance**

| Fiscal Policy (FP) Stance | Recession  | Expansion  | Outcome  |
|---------------------------|--|--|--|
| Pro-cyclical              | Contractionary FP<br>Decrease in Govt. Expenditure<br>Increase in Govt. Tax rate | Expansionary FP<br>Increase in Govt. Expenditure<br>Decrease in Govt. Tax rate   | Deepens recession and amplifies expansions, thereby increasing fluctuation in business cycles              |
| Counter-cyclical          | Expansionary FP<br>Increase in Govt. Expenditure<br>Decrease in Govt. Tax rate   | Contractionary FP<br>Decrease in Govt. Expenditure<br>Increase in Govt. Tax rate | Softens the recession and moderates the expansions, thereby decreasing fluctuations in the business cycle. |

# Topic 9 – Types of Deficits in Budget

# Types of Deficits in Budget

## बजट का सार Budget at a Glance

(₹ करोड़) (In ₹ crore)

|  |  | 2024-2025<br>वास्तविक<br>Actuals | 2025-2026<br>बजट<br>अनुमान<br>Budget<br>Estimates | 2025-2026<br>संशोधित<br>अनुमान<br>Revised<br>Estimates | 2026-2027<br>बजट<br>अनुमान<br>Budget<br>Estimates |
|--|--|----------------------------------|---|--|---|
| 1. राजस्व प्राप्तियां                              | 1. Revenue Receipts                                    | 3036619                          | 3420409   | 3342323  | 3533150   |
| 2. कर राजस्व<br>(केंद्र को निवल) <sup>1</sup>      | 2. Tax Revenue (Net to<br>Centre) <sup>1</sup>         | 2500039                          | 2837409   | 2674661  | 2866922   |
| 3. कर भिन्न राजस्व                                 | 3. Non Tax Revenue                                     | 536580                           | 583000  | 667662   | 666228  |
| 4. पूंजीगत प्राप्तियां                             | 4. Capital Receipts                                    | 1616249                          | 1644936   | 1622519  | 1814165   |
| 5. ऋणों की वसूली                                   | 5. Recovery of Loans                                   | 24617                            | 29000   | 30190  | 38397   |
| 6. अन्य प्राप्तियां                                | 6. Other Receipts                                      | 17202                            | 47000   | 33837  | 80000   |
| 7. उधार और अन्य देयताएं <sup>2</sup>               | 7. Borrowings and Other<br>Liabilities <sup>2</sup>    | 1574431                          | 1568936   | 1558492  | 1695768   |
| 8. कुल प्राप्तियां (1+4)                           | 8. Total Receipts (1+4)                                | 4652867                          | 5065345   | 4964842  | 5347315   |
| 9. कुल व्यय (10+13)                                | 9. Total Expenditure<br>(10+13)                        | 4652867                          | 5065345   | 4964842  | 5347315   |
| 10. राजस्व लेखा<br>पर<br>जिसमें से                 | 10. On Revenue Account<br><br>of which                 | 3600914                          | 3944255   | 3869087  | 4125494   |
| 11. ब्याज भुगतान                                   | 11. Interest Payments                                  | 1115575                          | 1276338   | 1274338  | 1403972   |
| 12. पूंजीगत आस्तियों के सृजन<br>हेतु सहायता अनुदान | 12. Grants in Aid for<br>creation of Capital<br>Assets | 272656                           | 427192  | 308151   | 492702  |
| 13. पूंजीगत लेखा पर                                | 13. On Capital Account                                 | 1051953                          | 1121090   | 1095755  | 1221821   |
| 14. प्रभावी पूंजीगत व्यय<br>(12+13)                | 14. Effective Capital<br>Expenditure (12+13)           | 1324609                          | 1548282   | 1403906  | 1714523   |
| 15. राजस्व घाटा (10-1)                             | 15. Revenue Deficit (10-1)                             | 564296<br>(1.7)                  | 523846<br>(1.5)                                   | 526764<br>(1.5)  | 592344<br>(1.5)                                   |
| 16. प्रभावी राजस्व घाटा<br>(15-12)                 | 16. Effective Revenue<br>Deficit (15-12)               | 291640<br>(0.9)                  | 96654<br>(0.3)                                    | 218613<br>(0.6)  | 99642<br>(0.3)                                    |
| 17. राजकोषीय घाटा<br>[9-(1+5+6)]                   | 17. Fiscal Deficit<br>[9-(1+5+6)]                      | 1574431<br>(4.8)                 | 1568936<br>(4.4)                                  | 1558492<br>(4.4)                                       | 1695768<br>(4.3)                                  |
| 18. प्राथमिक घाटा (17-11)                          | 18. Primary Deficit<br>(17-11)                         | 458856<br>(1.4)                  | 292598<br>(0.8)                                   | 284154<br>(0.8)  | 291796<br>(0.7)                                   |

**Deficit = imbalances in revenue and expenditure**

## घाटे का सार Deficit Statistics

(₹ करोड़) (In ₹ crore)

|                        |                              | 2024-2025<br>वास्तविक<br>Actuals | 2025-2026<br>बजट<br>अनुमान<br>Budget<br>Estimates | 2025-2026<br>संशोधित<br>अनुमान<br>Revised<br>Estimates | 2026-2027<br>बजट<br>अनुमान<br>Budget<br>Estimates |
|------------------------|------------------------------|----------------------------------|---|--|---|
| 1. राजकोषीय घाटा       | 1. Fiscal Deficit            | 1574431<br>(4.8)                 | 1568936<br>(4.4)                                  | 1558492<br>(4.4)                                       | 1695768<br>(4.3)                                  |
| 2. राजस्व घाटा         | 2. Revenue Deficit           | 564296<br>(1.7)                  | 523846<br>(1.5)                                   | 526764<br>(1.5)  | 592344<br>(1.5)                                   |
| 3. प्रभावी राजस्व घाटा | 3. Effective Revenue Deficit | 291640<br>(0.9)                  | 96654<br>(0.3)                                    | 218613<br>(0.6)  | 99642<br>(0.3)                                    |
| 4. प्राथमिक घाटा       | 4. Primary Deficit           | 458856<br>(1.4)                  | 292598<br>(0.8)                                   | 284154<br>(0.8)  | 291796<br>(0.7)                                   |

कोष्ठक में दिये गए आंकड़ें जीडीपी के प्रतिशत के रूप में हैं।  
 Figures in parentheses are as a percentage of GDP

# REVENUE DEFICIT

## Revenue Deficit = Revenue Expenditure - Revenue Receipt

- It shows the shortfall of the government's current receipts over current expenditure.
- It represents net dis-savings of the government for the sake of present consumption
- It indicates increase in liabilities of the Central Government without increase in the assets of that Government
- Revenue Deficit Impact
  - It indicates that the government does not have sufficient revenue to fund its routine operations across departments.
  - To cover this shortfall, it may need to rely on disinvestment or borrowing to bridge the gap.
- Remedial Measure
  - governments typically look to either reduce expenditure or increase their tax and non-tax revenues
  - This may include introducing new taxes or raising existing ones

# EFFECTIVE REVENUE DEFICIT

**Effective Revenue Deficit = Revenue Deficit - Grants to states for creation of capital assets**

- Introduced in Budget 2011-12
- It is used to distinguish grants-in-aid (GIA) for creation of capital assets from GIA used to finance current expenditure

# FISCAL DEFICIT

**Fiscal Deficit = Total Expenditure - (Revenue Receipts + Non Debt Capital Receipt)**

**Fiscal Deficit = total borrowings by the government in a single financial year**

- Fiscal Deficit Impact
  - A high fiscal deficit often forces the government to borrow more, which can push up interest rates and limit the availability of credit for the private sector.
- Remedial Measure
  - reducing public expenditures—such as subsidies, bonuses, LTC, and leave encashment
  - increasing revenue by broadening the tax base, restructuring taxes, or divesting government holdings in public sector units.

# PRIMARY DEFICIT

**Primary Deficit = Fiscal Deficit - Interest Payments on Previous Borrowings**

- Primary Deficit Impact
  - PD = 0 (shows entire borrowing is utilised for interest payment. Shows high public debt)
  - Low PD (more borrowings used for interest payments)
  - High PD (less borrowings are used for interest payments)
- Remedial Measure
  - To address a primary deficit, the government must tackle the excessive borrowing undertaken during the current year.
  - This can involve lowering non-essential spending, improving revenue mobilisation, and enhancing the efficiency of existing programmes.



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# Topic 10 – Government Borrowing

# Government Borrowing

- Government Expenditure > Government Revenue. Government Borrows
- Govt Borrows to a) fund fiscal deficit, b) Manage cash flow mismatches
- Govt can borrow from internal sources and External Sources
- Govt borrowing can be Short term and Long term

# Government Borrowing

# Topic 11 – Bond Yield

# Bond Yield

- Return an investor earns on a Bond
- Factors affecting Bond Yield
  - Inflation
  - Government Borrowing
  - Central Bank Policies of Foreign Countries

# Bond Yield

# Topic 12 – Financialisation of Economy

# Financialisation of Economy

- The financialization of an economy refers to the growing dominance of financial markets over the real economy.
- It refers to the increasing dominance of financial markets, financial institutions, and financial motives in the overall economy.
- Financialisation of saving - refers to the shift of household or corporate savings from traditional, physical assets (like gold, real estate, or cash) to financial assets (like stocks, mutual funds, bonds, and insurance).

# Financialisation of Economy

- Increasing Financialisation of Indian Economy
  - Expansion of Financial Market such as stock market, bond market, derivatives etc.
  - Increase in retail investor participating in stock market
  - Rise in Number of IPO
- Some Potential Risks
  - Speculative behaviour in the market
  - more youth indulging in risky F&O trading
- Economic Survey warns that rapid financial market growth without corresponding economic growth has led to crises in both developed and developing countries

# Topic 13 – Indian Economy in “Goldilock Phase”

## Goldilocks Moment in Economy

1. Meaning - Goldilocks scenario for an economy refers to a point where it is running just perfectly - neither too hot (high inflation) nor too cold (faltering GDP growth).
2. No major imbalances in major economic aggregates
  - Low Inflation --> Subdued / moderate inflation. CPI inflation was 0.25% in October. WPI is in negative.
  - High GDP --> Economic growth remains stable and strong. Real GDP for Q2 FY 2025-26 was 8.2%
  - Monetary space to cut Interest rates --> Low interest rates. MPC recently cut repo rate by 0.25%.

# Topic 14 - Stablecoins

# STABLECOINS

## Points to know about Stable Coins

- Stablecoins are category of cryptocurrencies designed to maintain a stable value by having their market value pegged to an external reference, typically fiat currency such as US dollar
- The most widely used stablecoins are backed by the US dollar.
- Some stablecoins are also backed by commodities, such as gold and oil.
- Example – Tether, USD Coin, TrueUSD, PayPal USD etc.
- Advantage of stable coins
  - They maintain stable value when compares to other cryptocurrencies which see extreme price volatility
  - They are based on block chain technology
  - They are easy to hold directly, settle transactions quickly, and are particularly efficient for cross-border transfers, which can be faster and cheaper than

conventional banking channels



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# STABLECOINS

## Points to know about Stable Coins

- Concerns regarding stable coins
  - Stable coin is private money, it is not backed by any sovereign guarantee
  - It may not have universal acceptability
  - In the domestic space, systems such as UPI, RTGS, and NEFT already provide fast, low-cost, and secure payment capabilities to millions of users, and stablecoins hardly offer any additional advantages.

## Points to know about Stable Coins

- Systemic Risk arising from stablecoins
  - One major risk is currency substitution. Because stablecoins are designed to function like money, they risk displacing domestic currencies
  - There are also implications for monetary policy. If households and businesses increasingly transact or save in stablecoins, central banks may find it more challenging to influence economic activity through interest rate adjustments or changes in the money supply.
  - Prices could become more volatile if official currency and crypto-based instruments coexist in everyday transactions.
  - large-scale adoption could disrupt banking and credit intermediation. If stablecoins replace bank deposits, banks may lose access to low-cost funds, pushing up credit costs or increasing dependence on central bank liquidity.

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