

ABSTRACT

In this study, we construct a variety of core inflation measures using exclusion based, reweighted, and weighted exponential smoothing by Cogley (2002), weighted trimmed and median based methods proposed by Bryan and Cecchetti (1993) and Bryan, Cecchetti and Wiggins (1997) and wavelet methods to estimate Indian core inflation. The study also contrasts and compares wavelet based methods with the traditional measures and suggests that they are better suited to measure core inflation for the Indian data.

Estimates of core inflation based on these methods are then constructed for 1995 to 2010 using monthly data. Finally, the estimated core inflation measures are put to empirical evaluation of how well they satisfy certain desirable properties of core inflation. While choosing criteria for empirical evaluation, the following were considered: tracking trend inflation and predicting future inflation. The empirical findings show that wavelet-based measures of core inflation perform better compared to all other traditional measures of core inflation in terms of similarity in means, lower volatility, lower turning point ratios and an ability to predict future transient movement in headline inflation at both 18 month and 24 month horizon. The evidences suggest that wavelet methods could be a promising alternative for future research on core inflation.