### Because items and quantities in the basket are fixed, the CPI does not account for substitutions consumers do in response to higher prices

## CPI uses old quantity with new price



## \$0.30/each



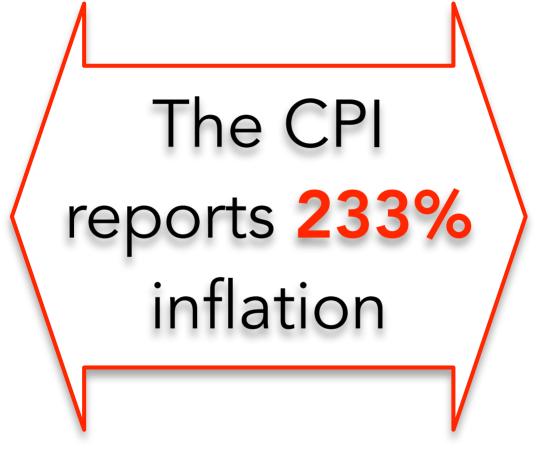
## \$1/each

#### Cost of the basket = 10x0.3 = \$3

```
Cost of the
basket =
```

10x1 = \$10

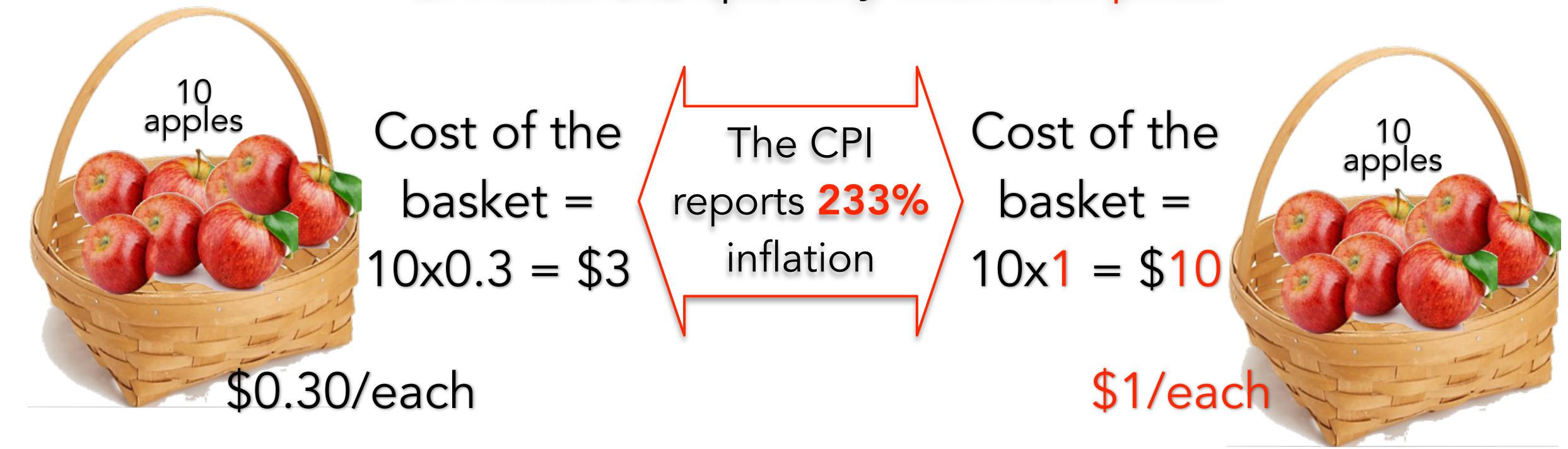
## We do not calculate the CPI correctly: Substitution Bias



#### We do not calculate the CPI correctly: Substitution Bias

Because items and quantities in the basket are fixed, the CPI does not account for substitutions consumers do in response to higher prices

CPI uses old quantity with new price



# To avoid a drop in real salary, the nominal salary must increase by inflation