⑥ "Inflation targeting is monetary policy framework wherein the central bank focuses only on maintaining the rate of inflation within a targeted range." Discuss India's experience with it. Expected Question for 2022

definition of inflation targeting

Inflation is general increase in prices and fall in purchasing power of money. It adversely affects price stability, financial stability & exchange rate.

1 highest inflation in last 200 years was 53% during Bengal famine of 1943.

1 also acts as tax on poor

Inflation targeting was introduced through mip framework agreement b/w RBI & govt in 2015. A/c to it RBI's primary objective is to maintain price stability while keeping in mind the objective of growth.

In accordance to it Flexible Inflation Target (FIT) of CPI inflation at 4 ± 2 % was adopted and given statutory status under RBI Act, 1934. The same band is retained for next 5 years in 2021.

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Benefits of Inflation targeting

① Promotes growth → by preventing loss in purchasing power of currency and thereby leading to high saving and investment → capital creation → growth ↑

② Investor confidence → due to transparency regarding inflation rate and assurance of policy response in case of breach.

③ Autonomy & Accountability of RBI

FIT given statutory status
- RBI gets autonomy in maintaining inflation within range
- but also required to submit in writing the reason if inflation breaches range.

④ Stability in ancilliary variables → exchange rate, equity market

Problem and challenges

① Disregards RBI's multifaceted role → only focus price stability

② Able to maintain inflation within range but
- Economic growth is on the slide from last 5 years
- unemployment → 45 year high of 6.1% in 2019-20 (PLFS)

③ Poor monetary policy transmission → reduces the effectiveness of inflation targeting.

④ Does not address supply side inflation → such as increase in crude oil prices, poor monsoon etc.

IT was successful in prevented any sharp rise in inflation even during the crisis periods of pandemic and crude oil price rise. At the same time it may be tweaked to assist in fostering growth.

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