Subject: GE – Introductory Macroeconomics **Paper Code: 12275201**

Topic: The Perils of RBIs fixation on Inflation **Unit III–Reading 5 by Pulapre Balakrishnan**

Retail inflation climbed to a six-year high of 7.35 per cent breaching the Reserve Bank of India's upper band of 6 per cent for the first time since the Monetary Policy Committee was created.

RBI's Mandate

In India, the RBI had earlier pursued a 'multiple indicators approach', implying concern for outcomes other than inflation, including even the balance of payments.
However, the Indian government instituted inflation targeting as the sole objective of monetary policy since 2016-17. This was hailed by the government as the adoption of the 'modern monetary policy framework' by India.
Till now inflation remained within the range envisaged, however with the recent data showing the retail inflation breaching the 6% range, doubts have been raised over narrow objective of Inflation targeting as the main objective of RBI.

Criticism of RBI's fixation on Inflation

1. RBI's **responsibility to regulate the financial sector may have taken a back seat** after adoption of inflation targeting as the main objective. Some of the crisis in financial sector which is partly attributed to short comings in regulations are:

- Within three years of adoption of inflation targeting as goal, a **crisis engulfed IL&FS**– It defaulted on several of its obligations, including repayment of bank loans and the redemption of commercial paper.
- **Punjab and Maharashtra Co-operative Bank-** fictitious accounts created and deposits were siphoned off as loans to the promoters.

2. **Inefficiency of Monetary Policy tools**:

- Recent spike in inflation is primarily due to rise in food prices which is temporary and seasonal phenomenon. Inflation led by rising prices of food stuff cannot quickly or easily be contained by the mode of control which RBI uses.
- Thus, the inflation rate was within the intended range so far, may have been due to both declining food prices and, for a phase, oil prices.

3. **Bad management of Currency**

- Ordinary Indian considers the RBI's principal mandate as the management of the currency so that trade is facilitated.
- There is shortage of small denomination notes in the bazaars of India

Way Ahead

The establishment of some of the world's oldest central banks was inspired by the goal of maintaining financial stability. Central Banks emerged as lender of last resort accompanied by tough regulatory oversight powers over banking system. However, with the rise of neoliberalism whereby markets should be given free play, the regulatory role of central banks took a back seat. They came to be primarily mandated with inflation control. Central Banks need to revisit their mandate in the spate of financial crisis.

Do you know?

Monetary Policy Framework

- The Government of India and Reserve Bank of India signed a Monetary Policy Framework Agreement in 2015.
- The objective of monetary policy framework is to primarily maintain price stability, while keeping in mind the objective of growth.
- As per the agreement, RBI would set the policy interest rates and would aim to bring inflation below 6 per cent by January 2016 and within 4 per cent with a band of (+/-) 2 per cent for 2016-17 and all subsequent years.

Monetary Policy Committee (MPC):

- Monetary Policy is announced by MPC which has been setup based on recommendations of Urjit Patel committee.
- MPC consist of six members, 3 from RBI and 3 appointed by the Government.
- Members from RBI are governor of RBI, a deputy governor and one officer of RBI.
- Members from government are appointed on the recommendations of a search cum selection committee headed by cabinet secretary.