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Flexible inflation targeting a good balance

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The present Flexible Inflation Targeting (FIT) framework in India as a mandate for monetary policy to manage inflation at 4% (+/-) 2% is ending in March 2026 and is under review. Here, this article addresses three questions: **headline versus core (excluding food), acceptable level of inflation, and inflation band.**

Inflation

Inflation isthe rate at which prices for goods and services rise over time, which reduces the purchasing power of money. This means that over time, a given amount of money will buy fewer goods and services than it did before. It is a broad economic concept measured by tracking the prices of a "basket" of selected goods and services, such as food, housing, and energy, often using theConsumer Price Index (CPI)

Key aspects of inflation

Decreased purchasing power: As the price level increases, the value of each unit of currency declines.

Measured over time: It is not about the price of a single good, but a continuous increase in the general price level across the economy over a period, usually calculated as an annual percentage change.

Calculated using a "basket of goods": A representative sample of goods and services is tracked to determine the overall inflation rate.

Causes: Inflation can be caused by factors like increased demand, higher production costs, expansionary monetary and fiscal policies, and changes in the money supply.

Opposite is deflation: The opposite of inflation is deflation, a decrease in the general price level of goods and services

Controlling inflation

Before responding to these questions, it is pertinent to highlight that inflation control by itself is an important objective of monetary policy. High inflation, above a tolerable level, is a regressive consumption tax that affects poorer households more disproportionately than the rich and households whose incomes are hedged.

Chakravarty Committee which was of the opinion that "…the acceptable rise in prices is 4 per cent (reflecting changes in relative prices necessary to attract resources to growth sectors)…." The reasoning given is somewhat opaque.

The RBI has been focusing on inflation management all along, and more explicitly since the dismantling of automatic monetisation in 1994 that gave functional autonomy to the RBI in conducting monetary policy.

Phillips Curve, have argued that there is a trade-off between **growth and inflation**. Empirically, the Phillips Curve argument did not stand the test of time.