1. Flexible Inflation Targeting – Economy

In light of the recent extension of India's monetary policy mandate, here is an elaborated breakdown of the Flexible Inflation Targeting (FIT) framework, its legal foundations, and its operational mechanics.

1. Background

The shift toward inflation targeting represented a paradigm shift in Indian monetary policy. Historically, the RBI managed multiple indicators (the "multiple indicator approach"), which often led to lack of clarity in policy objectives.

Global Origin - New Zealand pioneered this approach in 1990. Its success in stabilizing prices led to its adoption by numerous developed and emerging economies.

The Urjit Patel Committee - In 2014, a committee headed by Dr. Urjit Patel recommended that inflation should be the "nominal anchor" of India's monetary policy.

Formal Agreement (2015) - The Government of India (GoI) and the RBI signed the Monetary Policy Framework Agreement to prioritize price stability.

Legal Institutionalization (2016) - The RBI Act, 1934 was amended to provide a statutory basis for the FIT framework and the establishment of the Monetary Policy Committee (MPC).

2. Defining Flexible Inflation Targeting (FIT)

Flexible Inflation Targeting is a monetary policy regime where the central bank is mandated to maintain a specific inflation rate, but with the "flexibility" to consider other macroeconomic factors.

Primary Objective - Maintain price stability to ensure the purchasing power of the currency remains steady.

Secondary Objective - Support economic growth and employment, provided the inflation target is not compromised.

The "Flexible" Element - Unlike "strict" inflation targeting, FIT allows the central bank to deviate from the target temporarily to cushion the economy against shocks (like a pandemic or recession).

3. The Current Target and Timeline

The government, in consultation with the RBI, reviews and sets the inflation target every five years.

The Benchmark - Headline Consumer Price Index (CPI) is used to measure inflation. As per the latest updates, the base year is 2024.

The Target - A central point of 4%.

The Tolerance Band - A margin of ±2%, creating a range between 2% (lower limit) and 6% (upper limit).

Extended Mandate - The government has recently extended this 4% (±2%) target for another five-year period, ending March 2031.

4. Key Features of the FIT Framework

Clear Nominal Anchor

The 4% target serves as a "nominal anchor," helping businesses and consumers predict future prices. This stability helps in long-term financial planning and investment.

The Monetary Policy Committee (MPC)

The framework moved decision-making from a single individual (the Governor) to a collective body.

Composition - 6 members (3 from RBI, including the Governor, and 3 external members appointed by the Government).

Meetings - The committee must meet at least four times a year.

Voting - Each member has one vote; the Governor has a casting vote in case of a tie.

Accountability and Transparency

If the RBI fails to meet the target (i.e., inflation stays outside the 2%–6% range for three consecutive quarters), it must submit a report to the government explaining -

1. Reasons for failure.
2. Remedial actions proposed.

3. An estimated time frame to return to the target.

Medium-Term Orientation

The RBI does not react to every "blip" in the data. It focuses on the medium-term trend, allowing it to "look through" temporary shocks such as seasonal spikes in vegetable prices.

5. Comparison - Flexible vs. Strict Targeting

Feature	Strict Inflation Targeting	Flexible Inflation Targeting (FIT)
Primary Goal	Inflation only.	Price stability + Economic growth.
Response to Shocks	Aggressive interest rate hikes regardless of growth.	Gradual adjustment to avoid harming employment.
Growth Consideration	Not a formal part of the mandate.	Explicitly stated in Section 45-ZA of the RBI Act.
Policy Stance	Rigid and predictable.	Adaptive and pragmatic.

6. Implementation and Tools

To keep inflation within the 2%–6% band, the RBI utilizes several liquidity management instruments -

Repo Rate - The primary tool. Increasing the Repo Rate (as seen in 2022–23 when it rose from 4% to 6.5%) makes borrowing expensive, cooling down the economy to curb inflation.

Reverse Repo Rate - Used to absorb excess liquidity from the banking system.

Open Market Operations (OMO) - Buying or selling government securities to regulate the money supply.

7. Real-World Examples of FIT in Action

The Pandemic Exception - During the COVID-19 crisis, the RBI prioritized growth. It kept the Repo Rate at a historic low of 4% and tolerated higher inflation to prevent an economic collapse.

Post-Pandemic Tightening - In 2022–23, when global supply chains and the Russia-Ukraine war pushed inflation above 6%, the MPC pivoted back to its primary mandate, aggressively raising rates to protect price stability.

Food Price Volatility - The RBI often ignores sudden surges in onion or tomato prices if they are deemed "transitory," opting not to raise interest rates which might hurt the broader manufacturing or service sectors unnecessarily.

Source - https -//www.thehindu.com/business/Economy/govt-asks-rbi-to-maintain-retail-inflation-at-4-till-mar-2031/article70785251.ece