Sticking to Inflation Targeting Regime

Why in news?

Recently, Centre confirmed that RBI will continue to target the retail inflation within the band of 2% to 6%.

What is the major role of RBI?

- RBI is the main monetary policy authority for the country, regulator of the banking system and functions as lender of last resort.
- It sets the benchmark for interest rates and credit growth which can be done in two diametrically opposite ways.
- If the RBI wants to boost economic growth, it will keep the interest rates lower, relax the regulations for banks to give cheaper new loans.
- On the other hand, if the RBI wants to maintain financial stability and the control prices, then it would keep a tight control on the interest rates and provisioning of new loans.

What is the odd thing with inflation targeting?

- Some argue that RBI should focus on the retail core inflation than the retail inflation rate.
- This is because retail core inflation has fuel and food items whose prices often shoot up in the short-term due to temporary factors —excessive rains or supply side disruption.
- Thus core inflation is the most robust indicator of the rate of rise in prices.
- Others can argue that the RBI should look at wholesale inflation.
- This is because RBI's move to tweak interest rate affects the credit available to businesses –making loans costlier- which in turn affects the wholesale inflation not retail inflation.
- Proponents of this view argue that there is a vast gap between the retail and wholesale inflation rates in recent years.
- Still others say RBI should neither use the above rates as targets but create a Producer Price Index — a more focussed inflation rate index to best suit RBI's need.

Why RBI should not focus only on Inflation targeting?

- RBI has the degrees of freedom in setting the credit policy in the economy.
- But singular focus on maintaining price stability will be counter-productive for a developing economy such as India.
- So instead of being overly focusing about the inflation rate, RBI should be work with the government to ensure fast economic growth.
- These statements have emerged because of India's decelerating economic growth rate since the start of 2017.

What are the takeaways from this?

- Earlier RBI Governor stated that there is a clear shift in the RBI's stance to boost economic growth which is coincided with the economic disruption due to the Covid-19 pandemic.
- Over the past 12 months, RBI has either relaxed or suspended several regulatory norms for economic growth but the inflation rate has consistently stayed above RBI's comfort zone.
- High inflation rate is the most regressive kind of tax as the poor are hit the hardest.
- And another wave of Covid-induced lockdowns can lead to spike in inflation rates again.
- Under the circumstances, it is a wise decision by the government to not ask the RBI to give up targeting retail inflation.

Source: The Indian Express

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