4% Inflation Target Retained by Government

Why in News

The Government of India has decided to retain the **inflation target of 4%,** with a **tolerance band of +/- 2 percentage points** for the **Monetary Policy Committee** of the **Reserve Bank of India** (RBI) for the coming five years.

- Earlier, the RBI in its **Currency and Finance (RCF) report** for the year 2020-21 also recommended the inflation target to be kept same as 4% +/-2% for next 5 years.

Key Points

- **About:**
    - To control the price rise, **the Centre in 2016 gave a mandate to the RBI to keep the retail inflation at 4% with a margin of 2% on either side** for a five-year period **ending 31st March, 2021.**
        - The **Consumer Price Index (CPI)** tracks the change in retail prices of goods and services which households purchase for their daily consumption.
    - The **inflation target for the period 1st April, 2021 to 31st March, 2026** under the Reserve Bank of India Act 1934 has been **kept at the same level** as was for previous 5 years.

- **Background:** //
  - The **central bank and the government agreed in 2015 on a policy framework** that stipulated a primary objective of ensuring price stability while keeping in mind the objective of growth.
  - The **Flexible Inflation Target (FIT) was adopted in 2016.** The **Reserve Bank of India Act, 1934 was amended** to provide a statutory basis for a FTI framework.
  - The amended Act **provides for the inflation target to be set by the Government, in consultation with the RBI, once every five years.**
- **Inflation Targeting:**
  - It is **a central banking policy** that revolves around adjusting monetary policy to achieve a specified annual rate of inflation.
  - Inflation targeting is known to **bring more stability, predictability, and transparency** in deciding monetary policy.
  - **Strict Inflation Targeting:**
    - It is adopted when the central bank is only concerned about **keeping inflation as close to a given inflation target as possible,** and nothing else.
  - **Flexible Inflation Targeting:**
    - It is adopted **when the central bank is to some extent also concerned about other things,** for instance, the stability of interest rates, exchange rates, output and employment.

Monetary Policy

- It is the macroeconomic policy laid down by the central bank. It **involves management of money supply and interest rate and is the demand side economic policy** used by the government of a country to achieve macroeconomic objectives like inflation, consumption, growth and liquidity.
- In India, monetary policy of the Reserve Bank of India is **aimed at managing the quantity of money in order to meet the requirements of different sectors** of the economy and to increase the pace of economic growth.
- The RBI implements the monetary policy through **open market operations, bank rate policy, reserve system, credit control policy, moral persuasion** and through many other instruments.

Monetary Policy Committee

- It is a **statutory and institutionalized framework** under the **Reserve Bank of India Act, 1934,** for maintaining price stability, while keeping in mind the objective of growth.
    - The **Governor of RBI is ex-officio Chairman** of the committee.
- The MPC **determines the policy interest rate (**repo rate**)** required to achieve the inflation target (4%).
- An RBI-appointed committee led by the then deputy governor Urjit Patel in 2014 recommended the establishment of the Monetary Policy Committee.

Source: TH