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EDITORIAL ANALYSIS

Beyond Rate Cuts — Why Monetary Policy Alone Cannot Fix India's Inflation

 **ECONOMIC TIMES**

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SUBJECTS COVERED**ECONOMY****GS PAPERS****GS3****CURATED & WRITTEN BY****Bharat Choudhary**

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Beyond Rate Cuts — Why Monetary Policy Alone Cannot Fix India's Inflation

The Economic Times 20 March 2026

GS3

ET The Economic Times

MAINS RELEVANCE:

GS Paper 3



INTERVIEW ANGLE

"The RBI's inflation targeting framework is due for a five-year review. Should India retain the 4% CPI target with $\pm 2\%$ band? Can interest rate policy alone address supply-side inflation driven by food prices, logistics bottlenecks, and global commodity shocks?"

WHY IN NEWS

RBI Governor Sanjay Malhotra signalled that India's policy repo rate (at **5.25%**) may trend lower as retail inflation (CPI) moderates to 5.1% in February 2026, with Q4 FY26 inflation projected at 3%. Simultaneously, the RBI's **inflation targeting framework** — operative since August 2016 — is due for its mandatory 5-year review, reigniting debate about whether rate-based monetary policy is the right tool for India's structurally supply-driven inflation.

INDIA'S MONETARY POLICY FRAMEWORK — KEY MECHANICS

The Monetary Policy Committee (MPC) sets India's repo rate under the **inflation targeting framework**:

Mandate: Maintain CPI inflation at **4%** with a tolerance band of **$\pm 2\%$** (i.e., 2%–6%)

Legal basis: Reserve Bank of India Act, 1934 (Section 45ZA–ZL, inserted by Finance Act 2016)

MPC composition: 6 members — 3 from RBI (Governor, Dy. Governor, one nominee) + 3 external members appointed by Government (4-year terms)

Current Governor: Sanjay Malhotra (appointed December 2024; succeeded Shaktikanta Das)

Decisions: Simple majority; Governor has casting vote in case of tie

Review frequency: Bi-monthly (6 times/year); minutes published 14 days after

Current rates (as of March 2026):

Rate	Level
Repo rate	5.25%
SDF (Standing Deposit Facility)	5.00%
MSF (Marginal Standing Facility)	5.50%
CRR (Cash Reserve Ratio)	4.0%
SLR (Statutory Liquidity Ratio)	18.0%

Recent trajectory: MPC cut rates from 6.5% to 5.25% in a series of cuts beginning February 2025, as inflation moderated after the food price spike of 2024.

THE INFLATION PICTURE — FEBRUARY 2026

Indicator	Data
CPI inflation (Feb 2026)	5.1%
CPI inflation (Jan 2026)	5.3%
Q4 FY26 projected CPI	~3.0% (RBI projection)
Core inflation (ex-food, fuel)	~3.8%
Food inflation	~6.2% (vegetables still elevated)
WPI (wholesale) inflation	~2.4%

Key driver of recent moderation: A bumper kharif and rabi harvest (2025-26 season) has cooled vegetable prices significantly after the tomato-onion-potato (TOP) commodity price spike of 2024.

THE EDITORIAL'S CENTRAL ARGUMENT — THE LIMITS OF MONETARY POLICY

The Economic Times editorial argues that **interest rate policy is a blunt instrument** for India's inflation problem:

WHY INDIA'S INFLATION IS STRUCTURAL, NOT DEMAND-DRIVEN

In standard macroeconomic theory, raising interest rates reduces inflation by:

Reducing borrowing → less investment → lower demand

Increasing savings → less consumption spending

Strengthening currency → cheaper imports

But India's inflation has historically been driven by **supply-side factors** that rate hikes cannot address:

Food price volatility: Monsoonal dependence, fragmented cold chain, MSP distortions, vegetables' 5-year price cycles (tomato, onion, potato)

Fuel/energy costs: Global crude price pass-through to CPI via petrol, diesel, LPG; the West Asia conflict is a live risk

Logistics and supply chains: Poor rural road connectivity, multi-intermediary agricultural value chains inflate food prices at retail

Structural wage-price dynamics: Wage growth in construction and services is pushing up service sector inflation independently of monetary policy

Mark-up pricing: Concentrated corporate sectors (FMCG, telecom) exhibit oligopolistic pricing power immune to rate signals

The evidence: During the 2022–23 global inflation episode, RBI raised rates by 250 basis points (from 4.0% to 6.5%). Yet food inflation remained elevated because the driver was global commodity prices and domestic supply disruption — not demand excess.

THE FIVE-YEAR FRAMEWORK REVIEW

The RBI's inflation targeting framework was first established for a 5-year period (2016–2021) and renewed for 2021–2026. With the renewal deadline in **March 2026**, three key questions are under debate:

1. SHOULD THE 4% TARGET BE REVISED?

Arguments for raising to 5–5.5%:

India's structural inflation floor (driven by food and fuel) is higher than in advanced economies

A 4% target requires aggressive rate hikes that damage growth unnecessarily

Emerging economies (Brazil, South Africa) operate with higher targets

Arguments for retaining 4%:

Higher target may un-anchor inflation expectations, pushing actual inflation higher

Credibility of the framework depends on maintaining the target

RBI has successfully brought inflation within the 2–6% band for extended periods

2. SHOULD FOOD BE EXCLUDED FROM THE TARGET?

Some economists argue for “**core inflation targeting**” (excluding food and fuel):

Food prices are supply-driven and rate-insensitive

Including food makes the MPC raise rates even when the inflation is in food (not services/manufactured goods)

Japan, Canada, UK target “core” or “trimmed mean” measures

Counter-argument: Food inflation is what the poor feel most acutely — excluding it would disconnect monetary policy from real household welfare.

3. SHOULD THE MPC'S EXTERNAL MEMBERS BE GIVEN MORE INDEPENDENCE?

Current concern: Government-appointed external MPC members may vote in sync with the government's preference for lower rates. The RBI Governor's casting vote further concentrates power. **Reform proposal:** Allow MPC external members to serve renewable terms with explicit provisions for independence from executive pressure.

FISCAL-MONETARY COORDINATION — THE MISSING LINK

The editorial argues that monetary policy must be **complemented by fiscal and supply-side measures**:

Problem	Fiscal/Structural Response
Food price volatility	Expand PM-AASHA (price stabilisation), buffer stock operations, Nafed procurement
Cold chain gaps	PM Kisan Sampada Yojana — food processing infrastructure
High fertiliser costs → food cost	Fertiliser subsidy rationalisation; promote nano-urea
Fuel pass-through	Excise duty calibration; strategic petroleum reserve expansion
Logistics inflation	PM Gati Shakti — NIP (National Infrastructure Pipeline) execution

India's fiscal deficit trajectory (FY26): 4.9% of GDP (down from 5.6% in FY23) — fiscal consolidation reduces excess demand, complementing monetary tightening when needed.

UPSC RELEVANCE

MPC composition (3 RBI + 3 external), RBI Act Section 45ZA–ZL, inflation target (4% \pm 2%, CPI), repo rate (5.25%), SDF, MSF, CRR (4%), SLR (18%), RBI Governor Sanjay Malhotra (appointed Dec 2024), Q4 FY26 CPI projection (3%).

Mains GS3: *Monetary policy – inflation targeting framework, MPC, limitations of rate policy for supply-driven inflation, fiscal-monetary coordination, food inflation causes, RBI framework review, India's CPI vs WPI distinction, global comparisons (core inflation targeting).*

★ FACTS CORNER — KNOWLEDGEPEDIA

RBI MONETARY POLICY FRAMEWORK:

Legal basis: RBI Act 1934, Sections 45ZA–ZL (inserted by Finance Act 2016)

Inflation target: CPI 4% ± 2% (band: 2%–6%)

Framework first established: August 2016 (for 5 years)

Review due: March 2026 (5-year renewal)

MPC: 6 members — 3 from RBI (Governor chairs, casting vote) + 3 government-appointed external members

Meeting frequency: Bi-monthly (6 per year); minutes released 14 days after

CURRENT RATES (MARCH 2026):

Repo rate: 5.25% (reduced from 6.5% in cycle starting Feb 2025)

SDF (Standing Deposit Facility): 5.00% (floor of LAF corridor)

MSF (Marginal Standing Facility): 5.50% (ceiling of LAF corridor)

CRR: 4.0%

SLR: 18.0%

INFLATION DATA (EARLY 2026):

CPI Feb 2026: 5.1%

CPI Jan 2026: 5.3%

RBI Q4 FY26 projection: ~3.0%

Core CPI (ex food, fuel): ~3.8%

Food inflation: ~6.2%

WPI: ~2.4%

RBI GOVERNORS — RECENT:

Sanjay Malhotra: Appointed December 2024 (current; succeeded Shaktikanta Das)

Shaktikanta Das: Dec 2018–Dec 2024 (managed COVID-era and tightening cycle)

FOOD INFLATION STRUCTURAL DRIVERS:

Monsoonal dependence; TOP (tomato, onion, potato) price cycles; MSP distortions; fragmented cold chain

PM-AASHA: Price Support and Stabilisation Scheme for farmers and consumers

Nafed: National Cooperative Exports Ltd — buffer stock operations for pulses, oilseeds

KEY PRICE STABILITY CONCEPTS:

Inflation targeting vs. exchange rate targeting vs. monetary targeting

Core inflation: CPI excluding food and fuel (rate-sensitive component only)

WPI vs CPI: WPI measures factory-gate prices; CPI measures household retail prices; India targets CPI

Output gap: Difference between actual and potential GDP — positive gap = demand-pull inflation

OTHER RELEVANT FACTS:

India fiscal deficit FY26: 4.9% of GDP (FRBM target: 4.5% by FY26)

PM Gati Shakti: National Master Plan for infrastructure — NIP (₹111 lakh crore pipeline)

PM Kisan Sampada Yojana: Food processing infrastructure scheme (MoFPI)

Basis points: 1% = 100 basis points; rate cut cycle = -325 bps (from 6.5% to 5.25%)

Sources: Economic Times, RBI, MOSPI

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