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EDITORIAL ANALYSIS

Inflation Targeting at 10 — Has the 4% Framework Delivered?



27 March 2026

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The Hindu 27 March 2026

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INTERVIEW ANGLE

"Has flexible inflation targeting served India well? Should the RBI target core inflation instead of headline CPI?"

Inflation Targeting at 10 — Has the 4% Framework Delivered?

The Central Government, on March 25, 2026, notified the retention of the 4% Consumer Price Index (CPI) inflation target with a tolerance band of 2-6% for the five-year period from April 1, 2026 to March 31, 2031, exercising powers under Section 45ZA of the Reserve Bank of India Act, 1934. This marks the second consecutive review in which the existing target has been retained under the Flexible Inflation Targeting (FIT) framework.

Background — The Journey from Multiple Indicators to FIT

India formally adopted Flexible Inflation Targeting in 2016, marking a **paradigm** shift in monetary policy. The journey began with the **Urjit Patel Committee** (January 2014), which recommended abandoning the Reserve Bank of India (RBI) traditional multiple-indicators approach in favour of anchoring **monetary policy** on a single nominal target — headline CPI inflation at 4%, with a tolerance band of plus or minus 2 percentage points.

The key milestones in this transition were:

YEAR	EVENT
January 2014	Urjit Patel Committee submits report recommending FIT
February 2015	Monetary Policy Framework Agreement (MPFA) signed between Government and RBI
May 2016	RBI Act, 1934 amended; Sections 45ZA, 45ZB, 45ZC inserted to provide statutory basis for FIT and the Monetary Policy Committee (MPC)
October 2016	First MPC meeting held; repo rate set at 6.25%
March 2021	First five-year review: Government retains 4% target for 2021-2026
August 2025	RBI releases Discussion Paper on Review of Monetary Policy Framework seeking stakeholder feedback
March 25, 2026	Government notifies retention of 4% target for 2026-2031

Before FIT, the RBI relied on a multiple-indicators approach where several macroeconomic variables — money supply (M3), credit growth, exchange rate, output gap, and inflation — guided monetary policy decisions. This lack of a single anchor often led to ambiguity in policy signalling. The shift to FIT was designed to anchor inflation expectations, improve monetary transmission, and enhance RBI accountability.

The Decision to Retain 4%

The Department of Economic Affairs, Ministry of Finance, issued the official notification under Section 45ZA of the RBI Act, 1934, retaining the inflation target at 4% with the upper tolerance level at 6% and the lower tolerance level at 2%. The notification states that the target applies for the period beginning April 1, 2026 and ending March 31, 2031.

This decision followed a comprehensive review process. In August 2025, the RBI released a Discussion Paper seeking feedback from economists, market participants, and the public on four critical questions:

- ❶ **Headline vs. Core Inflation** — Should headline inflation or core inflation guide monetary policy, given the high weight of food in the CPI basket?
- ❷ **Optimality of 4%** — Does the 4% target remain optimal for a fast-growing, large emerging economy like India?
- ❸ **Width of the Band** — Is the 2-6% tolerance band appropriate, or should it be narrowed or widened?
- ❹ **Target vs. Range** — Should the point target be removed in favour of a range-only approach to enhance flexibility?

The consensus from stakeholders largely favoured continuity. The decision was also informed by the fact that CPI inflation had moderated significantly – the February 2026 reading stood at 3.21%, well within the target band.

Performance Review — A Decade of Data

The FIT framework has produced a mixed but broadly positive record. Average CPI inflation declined from approximately 6.8% during the four-year pre-FIT period (2012-2016) to around 4.9% since the adoption of the framework.

FISCAL YEAR	AVERAGE CPI INFLATION (%)	WITHIN TARGET BAND?	REPO RATE (END OF YEAR, %)
2016-17	4.5	Yes	6.25
2017-18	3.6	Yes	6.00
2018-19	3.4	Yes	6.25
2019-20	4.8	Yes	4.40
2020-21	6.2	Borderline (breached upper limit in some months)	4.00
2021-22	5.5	Yes (annual average)	4.00
2022-23	6.7	Breached for 3 consecutive quarters	6.50
2023-24	5.4	Yes	6.50
2024-25	4.6	Yes	6.50
2025-26 (est.)	~3.7	Yes	5.25

The most significant stress test came in 2022-23, when average inflation breached the 6% upper tolerance level for three consecutive quarters (January-September 2022). This triggered the **failure clause** under Section 45ZB for the first time since FIT was adopted. The RBI was required to submit a report to the Central Government explaining the reasons for failure, proposed remedial actions, and an estimated timeline for returning inflation to target. The Government chose not to make this report public.

Arguments For Continuity

Anchored expectations: Inflation expectations of households and businesses have become more anchored around the 4% mark. The RBI Household Survey shows that median inflation expectations have moderated from over 10% in 2015-16 to around 8-9% in recent years – still high but trending downward.

Improved credibility: A clear, legislated target has enhanced RBI credibility. Markets and businesses can plan with greater certainty about the monetary policy trajectory. Forward guidance has become more effective because the anchor is transparent.

Post-pandemic success: Despite the unprecedented supply shocks of COVID-19, the Russia-Ukraine conflict, and global commodity price surges, the framework proved resilient. After the 2022-23 breach, inflation returned to the target band within two quarters following aggressive rate hikes (250 basis points between May 2022 and February 2023).

Global alignment: Over 45 countries now practice inflation targeting. India retaining its framework signals macroeconomic maturity to global investors and rating agencies. It also disciplines fiscal policy by creating an implicit constraint on government borrowing that might fuel inflation.

Growth-inflation balance: The repo rate has moved from 6.50% in early 2024 to 5.25% by December 2025, reflecting the MPC ability to pivot toward growth support once inflation durably moderated. This demonstrates the “flexible” in Flexible Inflation Targeting.

Criticisms and Challenges

Supply-side dominance: A fundamental critique of FIT in India is that CPI inflation is frequently driven by supply-side shocks — erratic monsoons, global crude oil prices, disrupted logistics — rather than excess demand. Monetary policy (interest rate adjustments) is a demand-side tool and has limited efficacy against supply-driven price pressures. Raising the repo rate during a vegetable price spike, for instance, does not increase tomato supply.

Food inflation weight: Under the CPI series with base year 2011-12, food and beverages carried a weight of approximately 45.86% in the CPI basket. This meant that a drought or unseasonal rainfall could push headline CPI above 6% even when core inflation remained benign — forcing the MPC into tightening that hurt growth without addressing the root cause.

Growth sacrifice: Critics argue that the singular focus on inflation has come at the cost of growth. The RBI has had to maintain elevated real interest rates even during periods when industrial output and private investment were subdued. Small and medium enterprises (SMEs) and agriculture-dependent rural households bear a disproportionate burden of tight monetary conditions.

Blunt instrument: Interest rate changes affect the economy with a lag of 2-4 quarters. By the time a rate hike takes full effect, the supply shock may have already dissipated. This creates a risk of over-tightening that drags growth unnecessarily.

Accountability gaps: While the failure clause was triggered in 2022, the Government did not make the RBI report public. This undermined the transparency and accountability that the framework was designed to ensure.

Core vs. Headline Inflation Debate

This remains the most contentious technical question in Indian monetary policy. The RBI August 2025 Discussion Paper explicitly solicited views on whether core inflation (which excludes food and fuel) should replace headline CPI as the policy anchor.

Arguments for headline CPI (current approach):

- Food and fuel account for over 50% of the consumption basket; excluding them makes the target unrepresentative of lived reality, especially for the poor
- Persistent food inflation can spill over into core prices through second-round effects — higher wages, rents, and input costs (the “wage-price spiral”)
- Almost all inflation-targeting countries globally use headline inflation; only Uganda targets core inflation
- Headline CPI converges with core inflation over the medium term
- Clear communication — households understand “price of goods” better than an abstract “core” measure

Arguments for core inflation:

- Core inflation better reflects demand-side pressures that monetary policy can actually influence
- Food and energy prices are volatile and driven by supply shocks largely beyond central bank control
- Targeting headline CPI forces the MPC to react to temporary supply disruptions, leading to unnecessary growth volatility
- Core inflation provides a more stable signal for forward-looking policy decisions

The RBI Discussion Paper ultimately noted that while the arguments for core inflation have merit, the risks of excluding more than half the consumption basket from the policy anchor outweigh the benefits — particularly in a country where food price inflation directly affects the welfare of hundreds of millions of low-income households.

New CPI series as a partial resolution: The introduction of the new CPI series with base year 2024, released on February 12, 2026, has reduced the weight of food and beverages from 45.86% to 36.75%. This structural change partially addresses the criticism by making headline CPI less sensitive to food price volatility while still reflecting overall consumption patterns. The new series comprises 358 weighted items across 12 divisions, aligned with the Classification of Individual Consumption According to Purpose (COICOP) 2018 international standard.

Global Comparison

India FIT framework broadly aligns with international practice, though with notable differences in target levels reflecting its stage of economic development.

COUNTRY / REGION	CENTRAL BANK	INFLATION TARGET	TOLERANCE BAND	CURRENT INFLATION (EARLY 2026)
India	RBI	4%	2-6%	3.21%
United States	Federal Reserve	2%	No formal band	~2.8%
Eurozone	ECB	2%	Symmetric around 2%	~2.1%
United Kingdom	Bank of England	2%	+/- 1%	~2.5%
Canada	Bank of Canada	2%	1-3%	~2.0%
Brazil	BCB	3%	+/- 1.5%	~4.5%
South Africa	SARB	4.5%	3-6%	~3.2%

Key observations: India 4% target is higher than the 2% standard in advanced economies, reflecting the reality that developing economies with structural supply bottlenecks, administered price adjustments, and productivity catch-up tend to experience moderately higher inflation. The 2-6% band is wider than most peers, providing the MPC greater room for accommodation.

The MPC — Composition and Functioning

The Monetary Policy Committee, constituted under Section 45ZB of the RBI Act, is the institutional centrepiece of the FIT framework. It comprises six members:

Ex-officio members (RBI):

- ❶ RBI Governor (Chairperson) — currently Sanjay Malhotra
- ❷ Deputy Governor in charge of Monetary Policy — currently Poonam Gupta
- ❸ One officer nominated by the Central Board — currently Executive Director in charge of monetary policy

External members (Government-nominated, 4-year term): 4. Dr. Nagesh Kumar, Director and Chief Executive, Institute for Studies in Industrial Development (ISID) 5. Shri Saugata Bhattacharya, Economist 6. Prof. Ram Singh, Director, Delhi School of Economics, University of Delhi

Decisions are taken by majority vote. The Governor holds the casting vote in case of a tie. The MPC meets at least four times a year (currently six bi-monthly meetings). The minutes of each meeting, including individual member votes and rationale, are published — a significant transparency improvement over the pre-FIT era.

Former Deputy Governor **Michael Debabrata Patra** (January 2020 - January 2025), who oversaw monetary policy during some of the most turbulent years including the pandemic and post-pandemic inflation surge, noted that India experience with inflation targeting is “distinctive” due to recurring shocks to food and fuel prices. In an October 2024 address at the “Central Banking at Crossroads” conference commemorating RBI 90th year, Patra projected that headline retail inflation would align with the 4% target on a durable basis by FY2025-26 — a projection that appears to have been borne out, with current inflation at 3.21%.

Way Forward

The retention of the 4% target provides policy continuity, but several reforms could strengthen the framework going forward:

- ❶ **Leveraging the new CPI series:** The reduced food weight (36.75% vs. 45.86%) in the new 2024-base CPI series will structurally moderate the impact of food price volatility on headline inflation. The MPC should recalibrate its reaction function to account for this methodological shift.
- ❷ **Complementary supply-side measures:** Monetary policy alone cannot tame food inflation. The Government must invest in cold chain infrastructure, warehouse capacity, agricultural market reforms, and buffer stock management to reduce supply-side volatility. A standing coordination mechanism between the Finance Ministry and RBI on supply-side interventions would be valuable.
- ❸ **Publishing the failure report:** If the accountability clause is triggered again, the Government should make the RBI report public. Transparency is the foundation of inflation targeting credibility.
- ❹ **Monitoring core inflation as a supplementary indicator:** While retaining headline CPI as the formal target, the MPC should give greater weight to core inflation trends in its forward guidance and policy deliberations. This provides better signal extraction without abandoning the comprehensive measure.
- ❺ **Climate-proofing monetary policy:** As Michael Debabrata Patra warned, climate change will pose increasing challenges to inflation targeting through more frequent and severe supply shocks — droughts, floods, heat waves affecting crop output. The framework needs to develop protocols for treating climate-driven inflation spikes differently from demand-pull inflation.
- ❻ **Narrowing the band over time:** As India economy matures and supply-side volatility reduces, the Government should consider narrowing the tolerance band from 4 percentage points (2-6%) to 3 percentage points (2.5-5.5%), signalling greater commitment to price stability.

UPSC Angle

Prelims: Section 45ZA of RBI Act 1934, MPC composition (6 members — 3 RBI + 3 external), inflation target (4% with 2-6% band), Urjit Patel Committee (2014), failure clause (3 consecutive quarters above 6% or below 2%), new CPI series (base year 2024, food weight 36.75%), COICOP 2018 classification

Mains GS-3: Monetary policy framework, inflation targeting vs. growth, core vs. headline inflation debate, supply-side constraints on monetary policy effectiveness, global comparison of inflation targeting regimes, new CPI methodology, role of MPC in policy credibility

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FLEXIBLE INFLATION TARGETING (FIT) FRAMEWORK:

Adopted: 2016 (RBI Act amended May 2016; first MPC meeting October 2016)

Legal basis: Sections 45ZA, 45ZB, 45ZC of RBI Act, 1934

Target: 4% CPI inflation with tolerance band of 2-6%

Review cycle: Every five years by Central Government in consultation with RBI

First review (2021): Target retained at 4% for 2021-2026

Second review (2026): Target retained at 4% for April 2026 - March 2031

Notification date: March 25, 2026 by Department of Economic Affairs, Ministry of Finance

URJIT PATEL COMMITTEE (2014):

Appointed by: RBI Governor Raghuram Rajan

Report submitted: January 2014

Key recommendation: Shift from multiple-indicators approach to headline CPI-based inflation targeting at 4% (+/- 2%)

Recommended MPC composition: Governor + Deputy Governor + Executive Director + 2 external members (5 members); Government amended this to 6 members (3 RBI + 3 external)

MONETARY POLICY COMMITTEE (MPC):

Total members: 6 (3 ex-officio from RBI + 3 external nominated by Government)

Chairperson: RBI Governor (currently Sanjay Malhotra)

Casting vote: Governor, in case of tie

Meeting frequency: At least 4 times a year (currently 6 bi-monthly meetings)

External members term: 4 years, not eligible for reappointment

Current external members: Dr. Nagesh Kumar, Saugata Bhattacharya, Prof. Ram Singh (appointed October 2024)

FAILURE CLAUSE (SECTION 45ZB):

Triggered when: Average inflation exceeds 6% (upper limit) or falls below 2% (lower limit) for 3 consecutive quarters

RBI must submit report to Government explaining: (a) reasons for failure, (b) remedial actions, (c) estimated timeline for return to target

First and only trigger: January-September 2022 (CPI above 6% for 3 consecutive quarters)

Government did not make the RBI report public

CPI INFLATION TRACK RECORD UNDER FIT:

Pre-FIT average (2012-2016): ~6.8%

Post-FIT average (2016-2026): ~4.9%

Lowest fiscal year average under FIT: ~3.4% (FY2018-19)

Highest fiscal year average under FIT: ~6.7% (FY2022-23)

February 2026 CPI inflation: 3.21% (provisional, new CPI series base 2024)

RBI projected FY2025-26 average: ~3.7%

NEW CPI SERIES (BASE YEAR 2024):

Released: February 12, 2026

Food and beverages weight: 36.75% (reduced from 45.86% in 2011-12 series)

Total weighted items: 358 (across 12 divisions, 43 groups, 62 classes, 192 sub-classes)

Classification: COICOP 2018 (Classification of Individual Consumption According to Purpose)

January 2026 CPI inflation under new series: 2.75%

REPO RATE MOVEMENT UNDER FIT:

October 2016 (first MPC meeting): 6.25%

Lowest under FIT: 4.00% (May 2020 - May 2022, pandemic accommodation)

Highest under FIT: 6.50% (February 2023 - June 2025, post-pandemic tightening)

Current (as of early 2026): 5.25% (after 25 bps cut in December 2025)

Total tightening cycle 2022-23: 250 bps (4.00% to 6.50%)

RBI AUGUST 2025 DISCUSSION PAPER:

Released: August 21, 2025

Public comments deadline: September 18, 2025

Four key questions: (1) headline vs. core inflation, (2) optimality of 4%, (3) width of band, (4) target vs. range-only approach

Conclusion: Consensus favoured retaining headline CPI at 4% with existing band

GLOBAL INFLATION TARGETING:

Total countries practising inflation targeting: Over 45 (plus the Euro Area)

Most advanced economies target: 2%

Only country targeting core inflation: Uganda

India target (4%) is higher than advanced economies but appropriate for a large emerging economy with structural supply constraints

OTHER RELEVANT FACTS:

Michael Debabrata Patra served as RBI Deputy Governor (January 2020 - January 2025), overseeing monetary policy during pandemic and post-pandemic inflation

Monetary Policy Framework Agreement (MPFA) signed: February 2015

Section 45ZA empowers Central Government to set inflation target in consultation with RBI

Section 45ZB provides for MPC constitution and functioning

Section 45ZC mandates publication of MPC decisions and minutes

RBI Household Inflation Expectations Survey: Median expectations moderated from over 10% (2015-16) to around 8-9% in recent years

Engel Law: As incomes rise, the share of food in total expenditure declines — basis for reducing food weight in new CPI series

Sources: [The Hindu](#), [Business Standard](#), [RBI](#), [PRS India](#), [PIB](#)



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