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# RBI Inflation Target Review 2026 — Could India Lower the 4% CPI Target and Narrow the Band?

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# RBI Inflation Target Review 2026 — Could India Lower the 4% CPI Target and Narrow the Band?

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## WHY IN NEWS

RBI Deputy Governor Poonam Gupta stated on May 5, 2026 that India could consider **lowering the inflation target** and **trimming the  $\pm 2\%$  tolerance band** in the 2026 five-year review of the Flexible Inflation Targeting (FIT) framework, if GDP growth remains robust and inflation remains more stable. The current target is **4% CPI with a  $\pm 2\%$  band (2%–6%)**. The 2026 review is the framework’s second since adoption in 2016.

## INDIA’S FLEXIBLE INFLATION TARGETING (FIT) FRAMEWORK

### Legal Basis

FEATURE	DETAIL
<b>Legal authority</b>	<b>Section 45ZA</b> of the Reserve Bank of India Act, 1934 (inserted by Finance Act 2016)
<b>Inflation target set by</b>	<b>Central Government</b> (in consultation with RBI) — not by MPC or RBI alone
<b>Review frequency</b>	<b>Every 5 years</b> (or when target is missed for 3 consecutive quarters)
<b>Current target</b>	<b>4% CPI with <math>\pm 2\%</math> tolerance band</b> (2%–6%)
<b>Previous target period</b>	2016–2021; 2021–2026
<b>Current period</b>	2021–2026 (being reviewed now)
<b>Inflation metric</b>	<b>Consumer Price Index (CPI) — Combined</b> (headline inflation)

## Monetary Policy Committee (MPC) — Composition

MEMBER	CATEGORY
RBI Governor	Member + Chair (casting vote if tied)
RBI Deputy Governor (in charge of monetary policy)	Member
One RBI official nominated by Central Board	Member
Three external members nominated by Central Government	Members (4-year term, non-renewable)

**Total: 6 members** — 3 from RBI, 3 external. Decisions by **majority vote**.

## WHAT ARE THE PROPOSALS?

### Option 1: Lower the Target (from 4% to ~3.5% or 3%)

- **Rationale:** India's CPI inflation has averaged closer to 5%+ historically; but recent moderation (FY26 average: ~4.3%) and strong growth suggest a lower target is achievable
- **Risk:** Tighter monetary policy required to hit lower target → higher interest rates → slower growth
- **International comparison:** US Fed target: 2%; EU: 2%; UK: 2%; India's 4% was always a higher-than-advanced-economy target reflecting structural food inflation

### Option 2: Narrow the Band (from ±2% to ±1.5% or ±1%)

- **Rationale:** A tighter band signals more policy precision and commitment
- **Risk:** MPC loses flexibility to tolerate supply shocks (e.g., food price spikes from monsoon failure); more frequent policy rate changes needed
- **Consequence:** If inflation touches 5.5%, it would be a "failure" under a ±1.5% band (vs current 6% threshold)

## HISTORICAL PERFORMANCE UNDER FIT

YEAR	AVERAGE CPI	STATUS
2016–17	4.5%	Within band
2019–20	4.8%	Within band
2020–21	6.2%	<b>Breached upper band</b>
2022–23	6.7%	<b>Breached upper band — declared failure</b>
2023–24	5.4%	Within band
2024–25	4.8%	Within band
FY26 projection	4.6%	Within band

**MPC “Failure” Rule:** If inflation remains above 6% or below 2% for **three consecutive quarters**, RBI must report to Parliament explaining why and what it will do.

In 2022–23, RBI sent a report to Parliament — the only time the failure clause was triggered.

## WHY THIS MATTERS FOR UPSC

### Monetary Policy Transmission

- RBI’s repo rate decisions are the primary tool to keep inflation within the target
- A lower target → higher real interest rates → less credit, slower investment
- A narrower band → more frequent repo rate changes → greater **volatility** in borrowing costs

### Growth-Inflation Trade-off

- India needs ~7–8% GDP growth for employment absorption
- Excessively tight inflation targets can suppress growth
- The 2026 review must balance India’s development stage with monetary credibility

## UPSC RELEVANCE

PAPER	ANGLE
GS3 — Economy	Monetary policy, inflation targeting, MPC, RBI Act, CPI vs WPI
GS3 — Economy	Repo rate, reverse repo, LAF corridor, monetary transmission
GS2 — Governance	RBI autonomy vs government, MPC composition, parliamentary accountability

**Mains Keywords:** Flexible Inflation Targeting, Section 45ZA RBI Act, MPC, CPI inflation target, 4% target,  $\pm 2\%$  tolerance band, Poonam Gupta RBI, five-year review 2026, monetary policy credibility, growth-inflation trade-off, repo rate

### Prelims Facts Corner

ITEM	FACT
FIT legal basis	<b>Section 45ZA</b> , RBI Act 1934 (Finance Act 2016)
Inflation target set by	<b>Central Government</b> (in consultation with RBI)
Current target	<b>4% CPI <math>\pm</math> 2%</b> (band: 2%–6%)
Review frequency	<b>Every 5 years</b>
MPC members	<b>6 total:</b> 3 RBI + 3 government nominees; RBI Governor chairs
MPC “failure” trigger	Inflation above 6% or below 2% for <b>3 consecutive quarters</b>
Inflation metric	<b>CPI-Combined (Headline CPI)</b>
2022–23	MPC sent failure report to Parliament (CPI avg: 6.7%)
RBI DG who raised revision	<b>Poonam Gupta</b>
FY27 RBI CPI projection	<b>4.6%</b>

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