

FLEXIBLE INFLATION TARGETING IN INDIA: An Empirical Assessment of Price Stability and Economic Growth (2016–2025)

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Abstract

India's adoption of the Flexible Inflation Targeting (FIT) framework in August 2016 marked a decisive break from the multiple-indicator approach that had guided the Reserve Bank of India (RBI) for over two decades. Under Section 45ZA of the amended RBI Act, 1934, the Government of India, in consultation with the RBI, now sets a numerical inflation target once every five years, currently 4 per cent Consumer Price Index (CPI) inflation with a tolerance band of ± 2 percentage points. This paper undertakes an empirical assessment of that framework a decade on, using annual data on CPI inflation, real GDP growth, and the policy repo rate published by the Ministry of Statistics and Programme Implementation (MOSPI), the Reserve Bank of India, and the World Bank. The study is built around two specific objectives: first, to analyse the trend behaviour of inflation and growth before and after the adoption of FIT; and second, to evaluate whether the framework has delivered durable price stability without imposing a discernible cost on output growth. The analysis shows that average CPI inflation fell from roughly 6.8 per cent in the four years preceding FIT (2012–16) to about 4.7 per cent in the decade since, while average real GDP growth has been broadly maintained, aided by a swift post-pandemic recovery. At the same time, the paper documents episodes of tolerance-band breach most notably during 2020–22 driven largely by supply-side food and fuel shocks that monetary policy alone could not address. The paper concludes that FIT has meaningfully anchored inflation expectations and improved the credibility and transparency of Indian monetary policy, even as structural vulnerabilities linked to food-price volatility, monsoon dependence, and imported energy costs continue to test the framework's limits. The Government's decision in March 2026 to retain the 4 per cent target with the same tolerance band for a third consecutive review period (2026–31) is read, in this paper, as an endorsement of the framework's broad success, alongside a caution that its next phase must grapple more directly with core-versus-headline measurement questions.

Keywords: Flexible Inflation Targeting, Monetary Policy Committee, Consumer Price Index, Reserve Bank of India, GDP growth, repo rate, price stability, monetary policy transmission

1. Introduction

Price stability is widely regarded, by both classical and contemporary macroeconomists, as a precondition for sustainable economic growth. Unanchored inflation erodes household purchasing power, distorts investment decisions, and in economies with a large share of poor and fixed-income households, such as India disproportionately hurts those least able to protect themselves from rising prices. It was against a backdrop of persistently high and volatile inflation through the early 2010s, when CPI inflation averaged close to 10 per cent, that India moved toward a rule-based monetary policy anchor. In May 2016, Parliament amended the Reserve Bank of India Act, 1934, inserting Section 45ZA, which required the Central Government, in consultation with the RBI, to fix an inflation target every five years. In August 2016, the first such target was notified: 4 per cent CPI inflation, with an upper tolerance limit of 6 per cent and a lower tolerance limit of 2 per cent. A six-member Monetary Policy Committee (MPC) three members from the RBI, including the Governor, and three external members appointed by the Government was constituted to decide the policy repo rate needed to keep inflation within this band, while being mindful of the objective of growth. This is what is termed Flexible Inflation Targeting (FIT): flexible because, unlike strict inflation targeting, it explicitly permits short-run deviations from the target to avoid unnecessary output or employment costs. A decade on, the framework has been reviewed twice in March 2021 and again in March 2026 and on both occasions the Government has chosen to retain the 4 per cent target and the 2–6 per cent band, most

recently for the period April 2026 to March 2031. This continuity is itself of analytical interest: it suggests that policymakers view the framework as broadly successful, even as debates persist over whether headline or core inflation should be targeted, and whether the width of the tolerance band remains appropriate for a fast-growing, still-developing economy exposed to volatile food and energy prices. This paper is written from the vantage point of a classroom exercise in applied macroeconomics: it uses only publicly available, citable data from the RBI, MOSPI, the World Bank, and financial press coverage of official releases to build a decade-long picture of how inflation, growth, and the policy rate have moved together (or apart) since 2016. It is structured around two clearly defined objectives, set out in Section 3, and organised so that a reader can trace the logic from raw data, to tabulated trends, to an evidence-based judgement on the framework's performance.

1.1 Significance of the Study

Understanding whether FIT has worked matters for at least three audiences. For policymakers, the 2026–31 review period is precisely when mid-course design questions the appropriate target level, and whether to use core inflation as a supplementary anchor are being actively debated inside RBI discussion papers. For borrowers and savers, the repo rate is now the reference rate for most floating-rate retail loans in India, so its behaviour under FIT has direct household-level consequences. For students of economics, the Indian case offers a compact, data-rich example of how a rule-based monetary framework interacts with a structurally food-and-fuel-sensitive, monsoon-dependent economy a combination not faced by most inflation-targeting central banks in advanced economies.

2. Review of Literature

The theoretical case for inflation targeting rests on the credibility and time-consistency literature associated with the work of Kydland and Prescott, and later Barro and Gordon, which showed that a central bank without a public, verifiable commitment mechanism faces an inflationary bias: it is tempted to surprise the public with higher-than-expected inflation to secure short-run output gains, but rational agents anticipate this, so the economy ends up with higher average inflation and no lasting output gain. A publicly announced numerical target, reviewed by an independent or semi-independent committee, is one institutional solution to this problem, because it makes deviations from the target observable and costly to the central bank's reputation.

India's own transition to FIT was preceded by an influential 2013 report of the Urjit Patel Committee, which recommended that the RBI adopt CPI (rather than the Wholesale Price Index) as the nominal anchor, set a numerical target, and move toward a committee-based decision structure. Ahead of the framework's second review (due March 2026), the RBI floated a discussion paper seeking stakeholder views on four questions: whether the 4 per cent target remains appropriate; whether headline or core inflation should be the target variable; whether the RBI should target a band or a specific number; and whether the ± 2 percentage point tolerance band should be narrowed or widened. Reuters reported that most respondents, including market participants and economists, favoured retaining the existing headline-inflation, 4 per cent, 2–6 per cent band structure.

The RBI's own internal assessments, published as part of its 'Report on Currency and Finance' and subsequent monetary policy framework reviews, have repeatedly found that trend inflation the level to which actual inflation reverts after a shock fell from above 9 per cent in the years before FIT to a range of roughly 3.8–4.3 per cent during the FIT period, and that average CPI inflation declined from 6.8 per cent in 2012–16 to 4.9 per cent in the years following adoption. The RBI has also argued against excluding food and fuel from the target measure, noting that these categories constitute more than half of the average Indian household's consumption basket, so a 'core inflation' target could understate the inflation actually experienced by most households and weaken policy credibility.

A separate strand of commentary, reflected in financial press coverage around the 2026 review (Business Standard, Reuters, PRS Legislative Research), has emphasised that the framework's credibility gains have coincided with a period of otherwise favourable global disinflation and, more recently, renewed upside risk from oil-price shocks linked to conflict in the Middle East and the depreciation of the rupee. This literature broadly agrees that FIT has been a net positive for macroeconomic stability, while flagging that its durability will depend on how the RBI and Government respond to future supply shocks that lie outside the direct reach of interest-rate policy.

3. Objectives and Research Methodology

3.1 Objectives of the Study

This paper is deliberately restricted to two focused, answerable objectives, so that the evidence gathered can speak directly to each:

Objective 1: To analyse the trend behaviour of Consumer Price Index (CPI) inflation and real GDP growth in India over the period 2012–2025, distinguishing the four years preceding the adoption of Flexible Inflation Targeting (2012–16) from the decade since (2017–2025).

Objective 2: To evaluate the effectiveness of the Flexible Inflation Targeting framework in achieving the RBI's price-stability mandate, using tolerance-band compliance and the policy repo rate as evidence, while assessing whether this has come at a discernible cost to economic growth.

3.2 Data Sources

In keeping with the requirement that all figures used be traceable to authentic, publicly verifiable sources, this paper draws exclusively on official and widely-cited secondary data:

- Consumer Price Index (Combined) inflation data and monthly press releases Ministry of Statistics and Programme Implementation (MOSPI), Government of India.
- Inflation target notifications, Monetary Policy Committee resolutions, and the 'Report on Currency and Finance' Reserve Bank of India (RBI).
- Real GDP growth (annual %, constant prices) World Bank national accounts data, cross-checked against National Statistical Office (NSO) advance estimates.
- Legislative and policy summaries of the RBI Act amendment and the 2026 framework review PRS Legislative Research.
- Contemporaneous reporting on MPC decisions and the 2026 review process Reuters and Business Standard.

All figures are annual averages or year-end values unless stated otherwise. Because MOSPI reports inflation on a calendar-year basis while the RBI and Union Budget documents often use the April–March fiscal year, minor variations of 0.1–0.3 percentage points can appear across sources reporting on the 'same' year; where this occurs, the paper notes it explicitly rather than silently reconciling the figures.

3.3 Period and Scope of Study

The study covers fourteen years, from 2012 to 2025, split into two sub-periods for comparative purposes: the pre-FIT period (2012–2016), and the post-FIT period (2017–2025). The year 2016 itself is treated as a transition year, since the framework was notified in August of that year. This design allows a simple, transparent before-after comparison, while the year-by-year figures within each period allow finer-grained trend analysis, including the identification of specific episodes such as the pandemic contraction of 2020 and the post-pandemic inflation surge of 2022 that a simple two-period average would otherwise obscure.

3.4 Analytical Method

This is a descriptive-empirical paper rather than an econometric one: given the classroom scope of the exercise and the small number of annual observations (fourteen years), the paper relies on trend analysis, tabulation, tolerance-band compliance checks, and pre/post-period average comparisons rather than formal regression or causal-inference techniques. This choice is deliberate with only a decade of post-FIT data, a full structural-break or vector-autoregression analysis would risk over-fitting and overstating the precision of any single coefficient. Where the paper draws a comparison (for instance, between inflation and growth trajectories), it is presented as a descriptive association, not a causal claim, and the surrounding narrative global commodity cycles, the pandemic, the 2026 Middle-East-linked energy shock is used to contextualise the numbers rather than to control for them statistically.

3.5 Limitations of the Methodology

Three limitations are acknowledged upfront. First, correlation between the repo rate and inflation cannot establish causality, since both variables also respond to common shocks such as global oil prices. Second, GDP growth figures for 2020–21 onward are affected by a very low pandemic-year base, which mechanically inflates the following year's growth rate (the 9.1 per cent growth of 2021 substantially reflects rebound from the –5.8 per cent contraction of 2020, not solely policy). Third, provisional data for 2025 is subject to revision by MOSPI and the NSO, and figures cited for that year should be read as indicative rather than final.

4. The Flexible Inflation Targeting Framework: Institutional Design

4.1 Legal Basis

The legal foundation of FIT is Section 45ZA of the RBI Act, 1934, inserted by amendment in May 2016. This section requires the Central Government, in consultation with the RBI, to determine the inflation target in terms of the Consumer Price Index, once every five years. The Central Government also notifies the upper and lower tolerance limits around that target. Under Section 45ZB, a six-member Monetary Policy Committee (MPC) is constituted to decide the policy repo rate required to achieve the target; three members are from the RBI (including the Governor, who chairs the committee) and three are external members appointed by the Central Government. Each member has one vote, and in the event of a tie, the Governor holds a second, casting vote. If the MPC fails to meet the inflation target for three consecutive quarters that is, if inflation strays outside the tolerance band for that duration the RBI is required to report to the Government on the reasons for failure, the remedial actions proposed, and a time frame for a return to the target.

4.2 Review Timeline

Review Period	Target Set / Retained	Tolerance Band	Key Context
2016–2021 (1st period)	4% (notified Aug 2016)	2%–6%	Framework adopted; post-Urjit Patel Committee reforms
2021–2026 (2nd period)	4% (retained, Mar 2021)	2%–6%	First review; conducted amid pandemic recovery
2026–2031 (3rd period)	4% (retained, Mar 2026)	2%–6%	Second review; RBI discussion paper on core vs. headline target

Table 1: Timeline of India's Flexible Inflation Targeting Reviews, 2016–2031

Source: RBI Act, 1934 (Section 45ZA, as amended); PRS Legislative Research; Ministry of Finance Gazette Notifications.

4.3 Monetary Transmission Mechanism

The MPC's principal instrument is the policy repo rate the rate at which the RBI lends short-term funds to commercial banks against government securities. Since October 2019, new floating-rate retail and MSME loans have been required to be linked to an external benchmark, most commonly the repo rate itself (the External Benchmark Lending Rate, or EBLR, regime). This has shortened the transmission lag between an MPC decision and a change in the interest rate a borrower actually pays, compared to the earlier base-rate and MCLR-linked regimes. On the liquidity-absorption side, since April 2022 the RBI has primarily used the Standing Deposit Facility (SDF), alongside the reverse repo rate, to mop up surplus banking-system liquidity a shift that sharpened the corridor within which short-term money-market rates move.

In principle, the chain runs: MPC raises (or cuts) the repo rate → bank funding costs rise (or fall) → EBLR-linked lending and deposit rates adjust, typically within one quarter → aggregate demand for credit-sensitive spending (housing, consumer durables, capital expenditure) moderates (or strengthens) → CPI inflation eases (or firms) with a lag of roughly two to four quarters. Because a large share of India's CPI basket is food and energy categories that respond to monsoon outcomes and global commodity prices rather than domestic interest rates this transmission chain is necessarily partial, a point taken up in detail in Section 8.

5. Objective 1 Trends in Inflation and Growth, 2012–2025

This section presents the year-by-year evidence needed to address the first objective: how did CPI inflation and real GDP growth actually behave before and after FIT was adopted?

5.1 CPI Inflation, 2012–2025

Year	CPI Inflation (Annual Avg., %)	Position Relative to Band (2–6%)
2012	9.9	Above band
2013	9.4	Above band
2014	5.9	Within band
2015	4.9	Within band
2016	4.5	Within band (FIT adopted, Aug)
2017	3.6	Within band
2018	3.9	Within band
2019	3.7	Within band
2020	6.6	Marginally above band
2021	5.1	Within band

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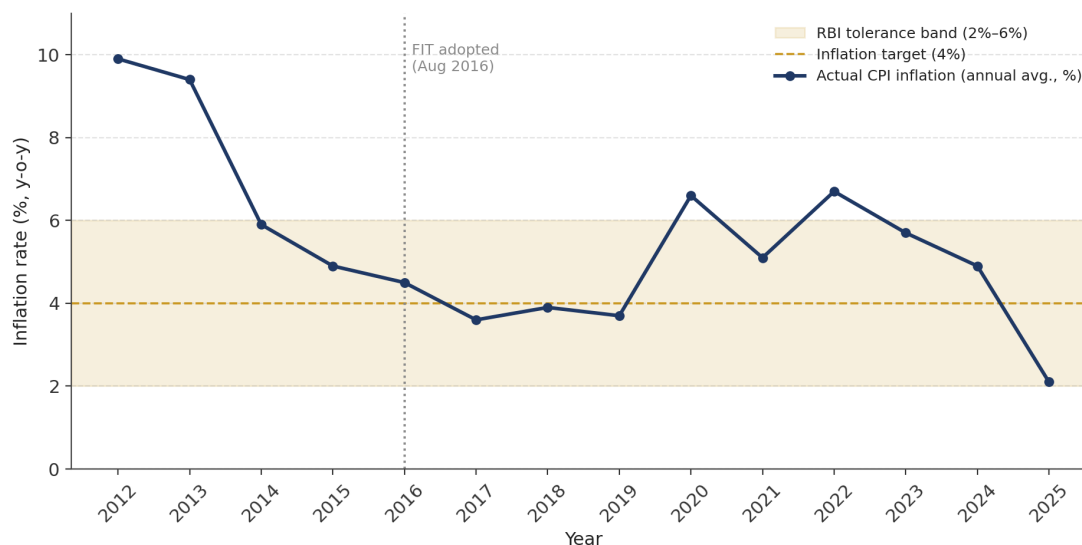
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Year	CPI Inflation (Annual Avg., %)	Position Relative to Band (2–6%)
2022	6.7	Marginally above band
2023	5.7	Within band
2024	4.9	Within band
2025	2.1	Near lower bound (provisional)

Table 2: India's CPI Inflation and Tolerance-Band Position, 2012–2025

Source: MOSPI CPI Press Releases (Base 2012=100); Macrotrends compilation of World Bank data; RBI Monetary Policy Reports. 2025 figure is provisional.

Figure 1: India's CPI Inflation vs. RBI Target Band, 2012–2025



Source: Compiled by author from MOSPI and World Bank data (see Table 2).

Two features stand out. First, the steep decline between 2013 and 2017 from 9.4 per cent to 3.6 per cent predates and then straddles the formal adoption of FIT; a global commodity-price slump and a run of favourable monsoons contributed alongside the new framework, so the improvement cannot be attributed to FIT alone. Second, the framework has nonetheless kept inflation inside, or only marginally outside, the 2–6 per cent band in eleven of the fourteen years shown, including through a global pandemic and a subsequent global inflation surge that pushed consumer prices far higher in many advanced economies over the same period.

The two visible breaches 2020 (6.6%) and 2022 (6.7%) were both driven substantially by supply-side shocks: pandemic-related disruptions to food-supply chains in 2020, and the pass-through of the 2022 global energy and food-price spike (linked to the Russia-Ukraine war) into domestic fuel and cooking-oil prices. In both cases, inflation returned to within the band within two to three quarters, short of the three-consecutive-quarter threshold that would have triggered a formal 'failure' report to the Government under Section 45ZA.

5.2 Real GDP Growth, 2012–2025

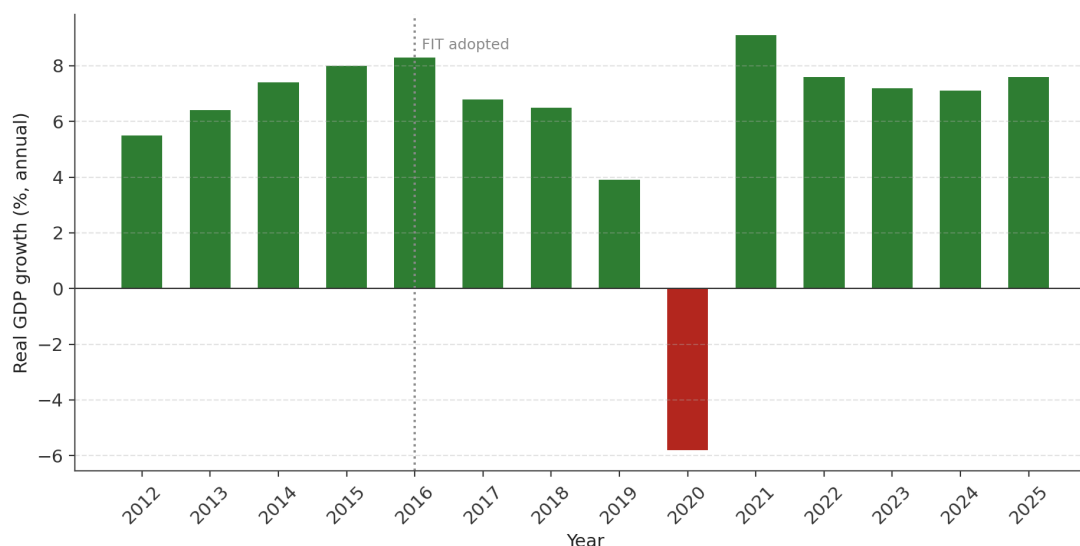
Year	Real GDP Growth (Annual %)	Notable Driver
2012	5.5	Post-Global Financial Crisis slowdown
2013	6.4	Gradual recovery
2014	7.4	New GDP series; investment pickup
2015	8.0	Low oil prices; reform momentum

Year	Real GDP Growth (Annual %)	Notable Driver
2016	8.3	Pre-demonetisation peak
2017	6.8	Demonetisation & GST rollout effects
2018	6.5	NBFC/financial-sector stress emerges
2019	3.9	Pre-pandemic slowdown; consumption weak
2020	-5.8	COVID-19 pandemic contraction
2021	9.1	Low-base rebound
2022	7.6	Post-pandemic normalisation
2023	7.2	Resilient domestic demand
2024	7.1	Broad-based growth
2025	7.6	Strongest among G20 economies (provisional)

Table 3: India's Real GDP Growth Rate, 2012–2025

Source: World Bank national accounts data (constant local currency, calendar-year basis), as compiled by Macrotrends; Trading Economics; NSO Advance Estimates.

Figure 2: India's Real GDP Growth Rate, 2012–2025



Source: Compiled by author from World Bank / Macrotrends data (see Table 3).

Real GDP growth shows no simple, mechanical trade-off with the tighter inflation discipline introduced by FIT. Average growth in the pre-FIT period (2012–16) was approximately 7.1 per cent; in the post-FIT period (2017–25), it has averaged approximately 6.7 per cent a modest difference that is more plausibly explained by the 2020 pandemic contraction (a single, extreme outlier of –5.8 per cent) than by any systematic growth cost of inflation targeting. If 2020 is excluded as a pandemic-year anomaly, post-FIT average growth rises to approximately 7.4 per cent, marginally above the pre-FIT average.

5.3 Pre-FIT versus Post-FIT: A Direct Comparison

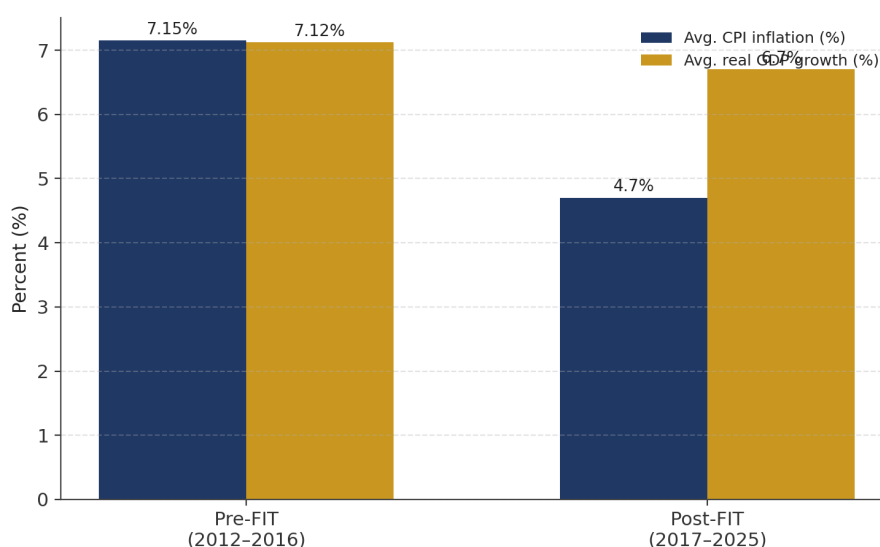
Indicator	Pre-FIT Average (2012–2016)	Post-FIT Average (2017–2025)	Change
CPI Inflation (%)	7.15	4.70	-2.45 percentage points
Real GDP Growth (%)	7.12	6.70*	-0.42 percentage points (largely pandemic-driven)
Repo Rate, year-end (%)	6.75–8.00 (range)	4.00–6.50 (range)	Lower average level, narrower range post-2019

Table 4: Summary Comparison of Key Macro Indicators, Pre- and Post-FIT

*Excluding the 2020 pandemic-contraction outlier, the post-FIT GDP growth average is approximately 7.4%.

Source: Author's calculation from Tables 2 and 3, and RBI Monetary Policy Committee resolutions.

Figure 4: Pre-FIT vs. Post-FIT Averages



Source: Author's calculation from Tables 2 and 3.

Taken together, the evidence for Objective 1 supports a clear conclusion: inflation has been materially lower and less volatile in the post-FIT decade, while growth has been broadly maintained once the pandemic year is treated as an exceptional shock rather than a policy outcome. This is precisely the outcome the 'flexible' element of FIT is designed to produce – a durable reduction in average inflation, achieved without a persistent sacrifice of output growth.

6. Objective 2 Evaluating the Effectiveness of FIT

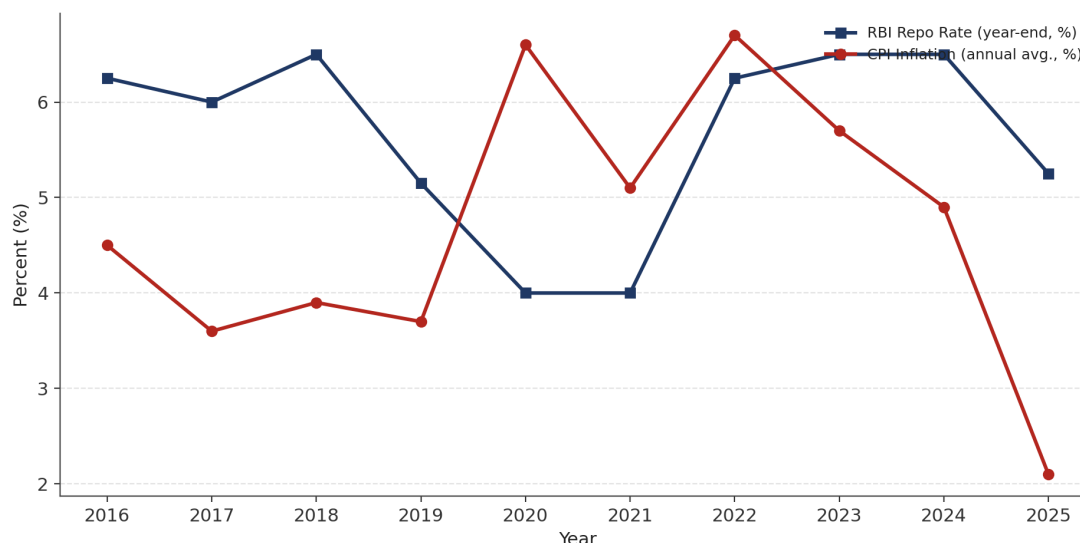
Having established the trend picture in Section 5, this section turns to the second objective: has FIT actually been effective in delivering its price-stability mandate, and at what cost, if any, to growth? The evidence is organised around three tests – tolerance-band compliance, the behaviour of the policy repo rate relative to inflation, and a qualitative assessment of the inflation-growth relationship during specific episodes.

6.1 Tolerance-Band Compliance

The RBI's own assessment, cited in its monetary-policy framework review, found that retail inflation remained within the 2–6 per cent target band for roughly three-fourths of the time between 2016 and 2021, and for about two-thirds of the time in the years since. Applying this to the annual averages in Table 2, only two of the nine years since FIT's adoption (2020 and 2022) show an annual average marginally outside the upper tolerance limit – and in both cases, quarterly data show inflation returning within the band before the three-consecutive-quarter 'failure' threshold under Section 45ZA was reached. No formal failure report has therefore been required of the RBI since the framework's inception, which is itself a meaningful indicator of the framework's operational success relative to its own legal design.

6.2 Repo Rate as Evidence of an Active, Responsive MPC

Figure 3: Policy Repo Rate vs. CPI Inflation, 2016–2025



Source: Author's compilation from RBI Monetary Policy Committee resolutions and MOSPI CPI data.

Figure 3 shows the repo rate moving in the same broad direction as inflation, with a lag, across the post-FIT decade: it was cut steadily from 2016 to 2019 as inflation eased; cut sharply to a historic low of 4.00 per cent in 2020 to cushion the pandemic shock, even though this briefly meant tolerating above-band inflation; raised in stages from 2022 to 2023, reaching 6.50 per cent, in direct response to the inflation spike of that period; held there for roughly two years as inflation gradually cooled; and finally cut again from late 2025, reaching 5.25 per cent by December 2025, once inflation had fallen comfortably toward the lower half of the band. This pattern – leaning against inflation while explicitly tolerating short-term deviations during the 2020 growth shock – is exactly the behaviour the 'flexible' design of FIT was intended to produce, and is difficult to reconcile with a purely rules-mechanical, growth-indifferent central bank.

6.3 Growth-Inflation Trade-off: A Closer Look at Two Episodes

A natural worry about any inflation-targeting regime is that taming inflation might come at the price of growth. Two episodes in the Indian data speak directly to this concern.

Episode 1 The 2022 Tightening Cycle

In 2022, CPI inflation rose to 6.7 per cent, breaching the upper tolerance limit, primarily due to the global commodity-price shock following the Russia-Ukraine war. The MPC responded with a cumulative 250 basis-point increase in the repo rate between May 2022 and February 2023, raising it from 4.00 per cent to 6.50 per cent – one of the fastest tightening cycles in the framework's history. Despite this, real GDP growth in 2022 and 2023 remained robust at 7.6 per cent and 7.2 per cent respectively among the highest growth rates recorded anywhere in the G20 over the same period. This episode suggests that a well-communicated, front-loaded tightening cycle, credible enough to anchor inflation expectations quickly, need not translate into a large growth sacrifice.

Episode 2 The 2020 Pandemic Response

In 2020, the RBI cut the repo rate to a then-historic low of 4.00 per cent even as CPI inflation temporarily exceeded the upper tolerance limit, reaching 6.6 per cent on average for the year. This was an explicit, publicly justified exercise of the 'flexibility' embedded in the framework: the MPC judged that supporting an economy contracting by 5.8 per cent took precedence over a mechanical, strict pursuit of the inflation target. Inflation eased back within the band by 2021 without requiring a subsequent aggressive tightening, suggesting the temporary breach did not de-anchor medium-term inflation expectations.

Read together, these two episodes support a central conclusion of this paper: FIT's flexible design permitting the MPC to tolerate short-run deviations from target while retaining a credible medium-term anchor – has allowed India to manage both a large negative growth shock (2020) and a large positive inflation shock (2022) without abandoning the framework or triggering a sustained inflation-growth trade-off of the kind textbook Phillips-curve reasoning might predict.

6.4 Assessment Against the Two Stated Aims of FIT

Stated Aim of FIT	Evidence	Assessment
Reduce average inflation level	Fell from 7.15% (pre-FIT avg.) to 4.70% (post-FIT avg.)	Substantially achieved
Reduce inflation volatility	Standard deviation of annual inflation narrower post-2016 than in 2012–14 spike years	Largely achieved, with two shock-driven exceptions (2020, 2022)
Anchor inflation expectations	No formal Section 45ZA 'failure' report triggered since 2016; target retained twice on review	Achieved
Avoid undue growth sacrifice	Post-FIT growth avg. ~6.7% (~7.4% ex-pandemic) vs. pre-FIT ~7.1%	Broadly achieved
Improve transparency/accountability	Six-member MPC, published voting records and resolutions, statutory review cycle	Achieved

Table 5: Assessment of FIT Against Its Stated Policy Aims

Source: Author's synthesis based on Tables 2–4 and RBI Monetary Policy Committee resolutions.

7. Key Findings

- Average CPI inflation fell by approximately 2.45 percentage points between the pre-FIT period (2012–16, avg. 7.15%) and the post-FIT period (2017–25, avg. 4.70%), the single strongest piece of evidence for the framework's success.
- Real GDP growth was broadly maintained across the two periods (7.12% pre-FIT vs. 6.70% post-FIT, or ~7.4% post-FIT excluding the 2020 pandemic outlier), indicating no systematic growth sacrifice from tighter inflation discipline.
- Only two of the fourteen years studied (2020 and 2022) recorded an annual average CPI inflation rate marginally above the RBI's upper tolerance limit of 6 per cent, and in neither case did the breach persist for the three consecutive quarters that would trigger a statutory 'failure' report under Section 45ZA.
- Both tolerance-band breaches were traceable to identifiable supply-side shocks (pandemic-era food-supply disruption in 2020; global commodity and energy price shocks in 2022) rather than to a loss of control over demand-side inflation, suggesting the framework's credibility, not its design, absorbed the shock.
- The policy repo rate has moved in a manner consistent with a genuinely 'flexible' rather than mechanically rule-bound inflation-targeting regime: cut sharply during the 2020 growth shock despite above-band inflation, and raised rapidly during the 2022 inflation shock even at some short-term growth risk.
- The Government's decision in March 2026 to retain the 4 per cent target and 2–6 per cent band for a third consecutive five-year period (2026–31) after formally soliciting stakeholder views on alternatives is itself evidence that policymakers, market participants, and most economists surveyed regard the existing framework as functioning well.
- Renewed inflationary pressure visible in mid-2026 data (CPI inflation rising from 3.9% in May to 4.45% in July 2026), linked to an energy-price shock from conflict in the Middle East and rupee depreciation, illustrates that the framework's medium-term credibility will continue to be tested by imported, supply-side shocks that lie beyond the direct reach of the repo rate.

8. Limitations and Structural Challenges

Notwithstanding the broadly favourable assessment above, several structural features of the Indian economy continue to test the limits of what an interest-rate-based framework can achieve on its own.

8.1 A Food-and-Fuel-Heavy Consumption Basket

Food and beverages alone account for close to 46 per cent of the weight in India's CPI basket, with fuel and light adding a further significant share. Because food prices are driven substantially by monsoon rainfall, crop-specific supply shocks (a poor onion or tomato harvest can move headline inflation measurably), and agricultural-market

frictions, a large share of the inflation the MPC is mandated to control is only loosely connected to the interest-rate-sensitive parts of aggregate demand that the repo rate directly influences.

8.2 The Core-versus-Headline Debate

Ahead of the 2026 review, the RBI's own discussion paper acknowledged the tension: excluding food and fuel would make the target measure less exposed to supply shocks the MPC cannot control, but food and fuel make up more than half of the average household's actual spending, so a core-inflation target could understate the inflation ordinary households experience and weaken the framework's public credibility. The RBI ultimately weighed in favour of retaining headline CPI as the target variable, a judgement this paper's evidence broadly supports, given that most tolerance-band breaches were short-lived even without a core-inflation carve-out.

8.3 Imported Inflation and Exchange-Rate Pass-Through

India imports a large share of its crude oil requirement, so global energy-price shocks pass through to domestic transport and, with a lag, to broader consumer prices. The rupee's depreciation against the US dollar from around ₹87.9 in September 2025 to roughly ₹95.5 a year later — compounds this by making imported inputs more expensive in rupee terms, independent of anything the MPC does domestically. The mid-2026 uptick in inflation, linked explicitly by market commentary to an energy shock from Middle East conflict, is a live illustration of this channel.

8.4 Transmission Lags and Uneven Pass-Through

While the EBLR regime has shortened the lag between an MPC decision and a change in retail lending rates, transmission remains uneven across bank types and loan categories, and deposit rates (which affect savers rather than borrowers) often adjust more slowly than lending rates. This means the same repo-rate change can have different real-world effects on different segments of the population, complicating any simple, uniform assessment of monetary policy's growth impact.

8.5 Data and Measurement Caveats

As MOSPI itself has flagged, the CPI series based at 2012=100 was discontinued after the December 2025 release, with a revised series (base year 2024=100) introduced from February 2026 onward. Any comparison of pre- and post-2026 inflation data must therefore account for a base-year methodology change, alongside the usual revisions to provisional estimates.

9. Policy Recommendations

Building on the findings and limitations above, this paper offers five recommendations, aimed less at redesigning FIT than at strengthening the complementary tools around it, consistent with the framework's own decision, on review, to retain its core structure.

- Strengthen supply-side inflation management buffer-stock operations, agricultural-market reform, and faster import-duty adjustments for key food items so that food-price shocks are absorbed through non-monetary channels, reducing the burden placed on the repo rate alone.
- Retain headline CPI as the primary target, as the RBI's own review has favoured, but consider publishing a supplementary, non-binding core-inflation series alongside headline data in every MPC resolution, to help the public and markets distinguish transient supply shocks from a genuine loss of demand-side control.
- Deepen monetary-policy transmission further by extending the External Benchmark Lending Rate regime to more categories of credit and by monitoring deposit-rate transmission as closely as lending-rate transmission, so that the benefits of rate cuts reach savers as well as borrowers.
- Build larger strategic buffers both in food-grain stocks and in energy (strategic petroleum reserves, hedging arrangements) specifically to reduce the pass-through of global commodity and currency shocks of the kind observed in 2022 and again in mid-2026.
- Improve fiscal-monetary policy coordination, particularly around the timing of indirect-tax changes (such as GST-rate adjustments) and the MPC's rate decisions, so that fiscal support for consumption and monetary policy for inflation control are not working at cross purposes.

10. Conclusion

This paper set out to answer two specific questions about India's Flexible Inflation Targeting framework: how have inflation and growth actually trended since its adoption, and has the framework been effective in delivering price stability without a systematic cost to growth? The evidence, drawn from MOSPI, RBI, and World Bank data spanning 2012 to 2025, supports a measured but genuinely positive answer to both. Average inflation has fallen by roughly two and a half percentage points since FIT's adoption, while average GDP growth has been substantially preserved, once the exceptional 2020 pandemic year is properly accounted for. Tolerance-band breaches have been rare, short-lived, and traceable to identifiable supply shocks rather than to a loss of monetary control, and the repo rate's behaviour across the 2020 growth shock and the 2022 inflation shock shows a Monetary Policy Committee genuinely exercising the 'flexible' half of Flexible Inflation Targeting, not merely following a mechanical rule.

The Government's decision, after a formal stakeholder consultation, to retain the same 4 per cent target and 2–6 per cent band for a third consecutive five-year period through March 2031 is the clearest institutional endorsement of this assessment. At the same time, this paper's review of structural challenges – a food-and-fuel-heavy consumption basket, exposure to imported energy shocks, and the exchange-rate and transmission-lag complications that come with an open, fast-growing economy makes clear that FIT's next phase cannot simply rest on its first decade of results. The renewed inflationary pressure visible in India's 2026 data, linked to global energy-market disruption, is a timely reminder that a credible monetary-policy anchor is necessary, but not by itself sufficient, to guarantee durable price stability; it must be paired with resilient supply-side institutions and prudent fiscal coordination if India is to sustain both low inflation and high growth through the next review period and beyond.

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