

Inflation Targeting in India: A Decadal Study

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Rising prices have been prime focus of money management since 2016 in India. Central bank's target: keep consumer inflation close to 4 percent +/- 2 points. Initial numbers were good - quiet markets, stable numbers. But then there was 2020 and the year shook things up – pandemic waves, broken supply chains, and oil cost fluctuations. As it all happened, doubts arose as to whether the system could live up to the expectations. In this study, the success of this price goal is examined from 2016 to 2025. Sources of information include official records, previous reports and published information - not new surveys. The first was to establish confidence, the second to withstand storms beyond borders and the third to uncover deep-rooted flaws. Rain-fed farms don't have a one size fits all formula, factories are not scaled up and wages are insufficient. Rules are important - but also the realities, such as the informal sector, the weight of the food in baskets, and unexpected crop failures. The model had logic. Life outside models? Less predictable. Surprisingly, setting clear inflation goals seems to have boosted trust in central bank actions while taming wild price swings. Still, rising food costs keep causing trouble, on top of delayed effects across markets and repeated disruptions from production issues. Oddly enough, one way forward might be adjusting policies to better fit local economic realities instead of sticking strictly to standard models.

Keywords: Inflation Targeting, Monetary Policy, RBI, Monetary Policy Committee, India, Post-Pandemic Economy.

1. Introduction

Every now and then, prices across stores and services creep upward - this slow climb has a name: inflation. Year by year, it's tracked as a percent shift. As those numbers grow, your money doesn't stretch as far - it simply covers less. What you once bought without thinking now costs more just to keep up. Food on shelves, gas at pumps, school fees - all feel heavier on budgets even when pay stays flat. Higher prices change how companies handle supplies, pay talks, worker salaries, yet shape long-term spending choices too. When numbers rise, officials face tighter budgets, weaker income from taxes, pressure on aid programs instead. Such broad consequences make keeping price growth in check a top priority for economic leaders across nations now. Handling this task usually falls to money policy tools guided by a country's main financial authority always.

That role belongs to the Reserve Bank of India within its borders today. Getting control over prices means changing how expensive loans are plus how much money banks can lend. A common way nations do this is aiming for steady inflation numbers. When using that method, the main bank picks a clear number for rising costs across shops then tweaks tools to hit it. Back in 2016, India made it official law after updating rules tied to its central bank setup. Officials there agreed - alongside the RBI - that staying near four percent was best, allowing small shifts up or down by two points if needed. Inflation should stay within 2 to 6 percent. Measured through the Consumer Price Index. Households feel price shifts in everyday items like food, rent, clothes, travel, schooling - CPI follows those changes. Instead of tracking factory prices, RBI chooses CPI since it shows real-life spending better. A group called the Monetary Policy Committee runs this system now. Six people make up the

MPC - three come from the RBI, while others are outside specialists picked by India's government. Meetings happen no fewer than half a dozen times every twelve months, where they look closely at how the economy is doing before setting the repo rate. That rate decides what cost banks must pay when getting brief loans from the RBI. Shifts upward or downward ripple through loan prices, shaping how much households spend along with broader market appetite. After gathering, full notes appear, laying out reasoning behind choices to keep things open and clear.

Stability held through the early stretch of inflation targeting - those opening years between 2016 and 2019. Around 4.1 percent: that's where inflation settled, give or take. Households and businesses started seeing it more clearly, their outlooks steadier. Then came 2020, a pivot, stress creeping into the system. Pandemic shocks rattled how goods moved, who worked where. Oil plus cooking oil costs jumped fast during 2021 and 2022. Bad weather pushed up food expenses in many three-month periods. Because of that, consumer price increases went above six percent more than once before 2023 ended. That made people wonder if aiming for low inflation really works when supply problems happen often. What shapes India's economy isn't quite like what drives richer nations. Nearly half the items tracked in its price index relate to food - way more than in countries like the U.S. or Britain, where it's below one-seventh. Rainfall during monsoon season heavily influences how much farms produce, yet those rains come without warning most years. When central banks adjust rates,

changes take time reaching borrowers because financial tools like bonds aren't widely used, and many rely on unofficial lending instead. Because of such traits, rising prices often stem from shortages or harvests - not something interest shifts can fix fast.

This paper looks at inflation targeting in India between 2016 and 2025. How the system works is laid out piece by piece. Performance gets reviewed through three separate periods, each with its own traits. Structural flaws stand in the way of keeping prices stable. Some changes are proposed so the approach fits better with local realities.

2. Objectives of the Study

Looking into how India's system operates when aiming to control rising prices. The structure behind these efforts reveals much about its daily workings. Performance of inflation targeting in India between 2016 and 2025 - how well it worked, where it fell short. Not every goal was met, though some results stood out. Through shifting economic pressures, the approach faced real tests. Despite careful plans, outcomes did not always match expectations. By looking closely at each phase, patterns start to show.

3. Literature Review

Starting in the early 1990s, countries began using inflation targets to guide money policy - New Zealand led the way. Because of work by Bernanke and Mishkin, many saw this approach as a clear reference point, one that helped shape public forecasts about prices. Over time, evidence from wealthy nations

suggested steady gains: price swings narrowed while trust in central banks grew stronger. Though not perfect, the method reshaped how policymakers communicated goals.

The 2014 Urjit Patel Committee Report in India pushed for inflation targeting as a way to handle ongoing price rises. Once changes were made to the RBI Act by 2016, Patra along with Kapur pointed out clearer policies and less guesswork. Years after the shift, Ghate plus Prasad saw people expecting prices to stay steadier.

Still, experts highlight built-in constraints when looking at India's setup. Food price swings and fuel disruptions tend to push up inflation there, Rajan observed - forces beyond what central bank tools can touch. When it comes to passing rate changes to borrowers, the system drags its feet, Virmani and Mohan showed, shaped by how finance works locally. During the pandemic stretch, Das and Goyal saw the Reserve Bank bending rules quietly, letting prices run high a while so the economy could keep moving.

Now things look different after the pandemic ended. Sticky core inflation stuck around while headline numbers cooled down, noticed Kumar plus Singh. Watching just CPI might not be enough now - other signs could matter more for the MPC. Inflation targeting earned trust over time, yet India's economy makes rigid rules hard to follow.

4. Methodology

Looking at how things have been done before shapes the way this work moves forward. From writings by the Reserve Bank

of India, clues emerge about past choices. Notes from meetings where money rules were debated add another layer. Government summaries on economic health feed into the picture too. Ideas take form after going through articles checked by experts in their fields. Papers released by the central bank offer quiet insights behind closed doors. Global assessments help ground local patterns in wider trends. There is no gathering of fresh numbers here. Calculations built on surveys do not shape what follows. Instead, meaning comes from reading between the lines of earlier conclusions. What shows up rests on careful thought, not number crunching. Results grow out of stepping back, then looking again.

5. Inflation Targeting Framework in India

What keeps India's inflation in check comes down to a clear goal, an organizing body, one tool after another. A job defined by purpose shapes how numbers are held steady through structure backed by means. Now comes the part where India's government sets the rules, working alongside the RBI. Sitting at 4 percent, that's where CPI inflation aims to stay - no less than 2, never above 6. Should numbers stray beyond this range across three straight quarters, a written explanation follows - from the RBI - with details on why it happened and what will be done.

Who makes the call? That job belongs to the Monetary Policy Committee. Six people fill its seats - half come from the RBI, the rest bring outside insight. When they decide, most votes win the day. Published notes later show each person's take, opening windows into their

thinking. Transparency grows when voices stay visible.

Overnight borrowing shifts when the repo rate moves. Lending numbers follow those changes, nudging how people spend and where money flows into projects. What backs this up? Tools like the Cash Reserve Ratio plus the Statutory Liquidity Ratio, both steered by the RBI. Banks stash part of their deposits at the central bank - that share is the CRR. Another slice has to sit in safe, tradable forms such as government bonds - call that the SLR. Nowhere near like richer nations, India leans on broad financial safeguards when certain industries face trouble. Built to bend, not break, its system permits short detours from goals when prices jump due to broken supplies.

6. Inflation Targeting Performance 2016–2025

Looking back at how inflation targeting worked in India means splitting the years from 2016 to 2025 into three chunks. One follows another, yet each behaves unlike the rest. Economic climates shift. So do reactions from policymakers. Results change, too.

Phase 1: 2016 to 2019 building stability and credibility

Back then, the system had just rolled out. About four-point one percent - that's where inflation settled, staying between two and six most of the time. Thanks to solid rains in 2016 and again in 2017, food prices didn't spike. Oil on world markets held steady, so moving goods and powering homes cost less than feared.

Right then, the group in charge of money matters leaned on the repo rate to give growth a nudge while keeping prices steady. Take 2019 - they dropped that rate by 135 basis points across five straight gatherings. Folks' inflation outlooks, tracked through the RBI's survey at home level, started easing little by little. That shift hinted people were slowly believing the central bank really meant to stick near 4 percent.

That phase worked well enough to earn trust within institutions. Thanks to clearer policy messages, market players could finally grasp why rates moved the way they did after each MPC meeting. People now point to those years when arguing India's inflation targeting makes sense - so long as crop failures or fuel spikes stay out of the picture.

Phase 2: 2020-2022 – COVID-19 and Global Shocks

Out of nowhere, the coronavirus crisis twisted how money rules worked. When cities shut down during 2020, factories stalled, deliveries slowed, yet people stopped buying things they could live without. Getting food to markets got harder, pushing costs up - even though most prices stayed flat overall. Instead of waiting, India's central bank dropped its main lending level fast: first step was lowering it from 5.15 percent early that March, then again until reaching 4.00 percent by May; held steady like that close to twenty-four months just to keep spending alive.

Come 2021 into 2022, outside forces started calling the shots. When war broke out between Russia and Ukraine, oil climbed past \$100 a barrel; meanwhile, cooking oils jumped

because supplies got shaky. On top of that, odd rains back home messed with crops, nudging up costs for veggies and grains. Because of these layers stacking up, overall price growth stayed above 6 percent - crossing the danger mark - for two full years without pause.

Hard choices landed on the MPC's desk. Move fast on rates and risk dragging down expansion, yet hold back too long might let price pressures slip loose. A measured path won out. Rate increases began in May 2022, adding up to 250 basis points before February 2023 closed. Alongside those moves, the RBI shaped its messaging carefully - making clear through public notes that taming inflation stood first.

Now came a time that tested how well inflation targeting could bend without breaking. When outside forces pushed prices up, the system gave some room to let things settle. Yet trouble stayed visible in what people eat and burn every day across India. That part did not fade fast, even if other numbers calmed down.

Phase 3: 2023-2025 – Gradual Disinflation and Policy Normalization

By summer 2023, outside forces started letting up. Prices for raw materials worldwide settled down; at the same time, shipping routes returned to steady patterns. Officials stepped in with controls - bans on exporting certain grains kicked in, while emergency reserves of lentils and onions were let into markets. With that, swings in grocery costs grew smaller.

Holding steady through much of 2023 into 2024, the RBI kept the repo rate fixed at 6.50 percent so people wouldn't expect prices

to spiral. By 2025, overall consumer price inflation settled within the desired range, ending the year near a 4.3 percent average. Yet underneath, core measures - stripping out volatile food and energy items - hovered close to 4.5 percent, slowed only slightly by rising pay in services and rent burdens.

Later on, the MPC turned away from emergency steps and aimed at steady conditions. Because changes in interest rates take half a year to over a year to fully hit the economy, cutting too soon might undo progress - that was their main point. Slow shifts in policy kept trust growing while avoiding sudden drops in economic activity.

Overall Assessment

Most of the time since shifting to inflation targets, price increases stayed more predictable compared to years before 2016, back when numbers often crossed 6 percent. Clarity grew under this system - RBI now had a defined job. Still, it became obvious over time that tweaking rates can't fix every kind of rising cost. Say crops fail or oil gets pricier overseas; then central bank tools tend to do little. Even so, having a target helped shape expectations. Outside shocks simply need different answers.

Looking back at how things went from 2016 to 2025, keeping prices stable worked fairly well in India. Still, without help from government spending choices, changes to boost production, and clearer messaging, dealing with surprises gets tough.

7. Limitations and Challenges

Supply-side inflation

Almost half the items tracked in consumer prices are food. When rains fail, crops get sick, or world grain costs rise, prices jump fast. Growing more tomatoes isn't something central bankers control. Rate hikes by the RBI during such times hit factories even though farms stay broken. Fixing harvests needs farming fixes, not tighter money.

Transmission lag

Most loans still follow old reference points, so when the reserve bank shifts its main interest level, banks do not fully reflect that move right away. Because unofficial borrowing stays widespread, adjustments trickle through slowly. Changes in official settings need months before they truly affect spending choices. Not every financial route updates at once, meaning delays pop up across the system.

Growth-inflation trade-off

Higher interest rates slow rising prices but hit small businesses harder when loans get costlier. Where many rely on unofficial lenders, effects spread unevenly across regions. Keeping prices steady cannot come at the expense of jobs - that tension shapes every MPC decision.

Expectation anchoring

Fresh memories of food costs keep guiding how people in India think about inflation. Though messaging has gotten clearer, it still drags on longer here to settle those views compared to richer nations where finance systems run wider and deeper.

8. Final Thoughts and Policy Ideas

The transition to an inflation targeting regime has had a greater effect in India than anywhere else. By itself, that action made money management more tightly-controlled; reducing the extreme fluctuations in prices. When the external forces were applied the system bent but did not break. People are better informed as to what the price situation is.

However, given the way India's economy is structured, it is difficult to have interest rates perform their functions correctly. A step toward alleviating this could be more definite inflation goals. One additional measure could be to fine-tune government expenditure and central bank action. There's also the issue of making banking more resilient to allow signals to get through more quickly. Finally, only a slightly increased degree of openness of financial markets would facilitate the flow of money where it is needed.

1. Firstly, make changes to supply management. If the government's spending matches import regulations for such necessities as fuel and crops, price increases are abated. This change should help to alleviate inflation pressure, not only because of higher rates, but because of the cooperation of departments working together.
2. As digital lending expands, there is a faster impact on borrowers' perception of the rate change. Outside reference points are helpful in quickly passing these updates on. As these systems become connected throughout channels, flows become faster.
3. When clarity increases, expectations will change. Reports on food and energy risks

might emanate from the central bank. Such information is information that influences public thinking. Feeling anxious, it might help to calm down by publishing it. It's important to know what pressures there are, and thus, people respond better. The institute has data which should be shared on regular basis. Clear updates help to minimize guesswork. "What is measured, is what is known." It's important to have some understanding of vulnerabilities so people can make a gradual adjustment. The key to a community's balance is forewarning.

4. Monitoring the prices in a steady way - beyond just prices, it can give some insight into the economic patterns. Alongside those trends are household reports which help to put those trends into perspective. They work together to influence the decision making related to future steps.

An effective response to inflation (inflation response) might be ineffective if applied individually. If it doesn't get support in government spending plans, some tweaks in the way things are done behind-the-scenes, or easier transport for goods, then it can fail. But, in India's context, adapting that approach to local realities may be the key to the success of the strategy in maintaining stable prices while ensuring economic growth.

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