



Sciro Publishers

International Journal of Business and Management Sciences

2026; 2(3): 04-13 | ISSN(O): 2693-3500

www.sciro.org/ijbms

DOI: [10.5281/zenodo.20373641](https://doi.org/10.5281/zenodo.20373641)

Flexible Inflation Targeting and the Architecture of Macroeconomic Stability in India: Channels, Constraints, and Cross-Country Perspectives

Dr. M. Krishna Naidu^{1,*}, Dr Dasari Rajesh Babu².

¹Assistant Professor (A) of MBA, School of Management Studies, JNTUA, Anantapur, Andhra Pradesh.

² 2Associate Professor, School of Commerce & Management, Department of Management, Mohan Babu University, Tirupathi, Andhra Pradesh, India

Email address*: India.mellemputikn@gmail.com

Received:12.03.2026 | **Revised:** 20.04.2026 | **Accepted:**22.05.2026

Abstract: India's monetary buildup and structure changed substantially with the official adoption of Flexible Inflation Targeting in 2016, formalised through amendments to the Reserve Bank of India Act and operationalised by a statutory six-member Monetary Policy Committee.

In this paper, we conduct a systematic conceptual analysis of the multifaceted impact of FIT on macroeconomic consistency in India, including price stability, output dynamics, exchange rate behaviour, monetary transmission efficacy, fiscal-monetary coordination, and the formation of inflation expectations. The study uses longitudinal data of macroeconomic parameters over 12 years (2012-2024). The methodology is a mixed-methods conceptual framework that includes descriptive statistical analysis, regime-phase comparisons, six-channel transmission mapping, and international benchmarking with 7 inflation-targeting economies. The analysis shows a large fall in headline Consumer Price Index (CPI) Inflation from an average of 9.85% (2012-2016) before the IT. The paper's conceptual contribution is the development of a cohesive analytical framework that concurrently assesses aims, scope, limitations, transmission channels, and cross-national insights. The findings affirm that India's FIT is a conditionally effective regime—effective in managing expectations and reducing Inflation, but requiring institutional complementary to achieve the full macroeconomic stability benefit.

Keywords: flexible Inflation targeting, Monetary Policy Committee, Reserve Bank of India, macroeconomic stability, monetary transmission, price stability.

1. Introduction

The issue of how central banks in structurally complex, quickly evolving economies should implement monetary policy to attain sustainable price stability without hindering growth has engaged macroeconomic research for numerous decades. The rise of inflation targeting (IT)—officially and mentioned embraced by over 40 nations by 2024—marks the most significant paradigm shift in central banking since the dissolution of the Bretton Woods system.

The evolution of India's monetary policy serves as a par-

ticularly enlightening case study. For much of the post-independence period, the RBI functioned under a formally articulated 'multiple-indicator approach'. This discretionary framework tracked a wide range. The development of monetary policy in India gives us a very illuminating case study. For much of the post-independence period, RBI operated on a formally articulated 'multiple-indicator approach' of quantitative variables (M1, M3, credit aggregates), price indicator information and external sector metrics, without assigning any single nominal anchor lexicographic priority. This approach provided operational flexibility but resulted in chronic Inflation,

diminished central bank credibility, and a structural incapacity to stabilize private-sector inflation expectations—conditions linked to time-inconsistent policymaking in macroeconomic literature (Kydland & 1983).

The impetus for structural reform solidified with the Urjit Patel Expert Committee Report of January 2014, which advocated for the official implementation of CPI-based Inflation targeting, delineated a medium-term objective of $4\% \pm 2\%$, and suggested and represented the creation of a statutory Monetary Policy Committee. These recommendations were given statutory backing in the Reserve Bank of India (Amendment) Act 2016, making India a member of the global club of flexible inflation targeters. The new mandate now describes price stability as the important goal of monetary policy, with growth as a secondary constraint. This ordering is a significant change to the framework.

This article examines the degree to which this institutional reform has fulfilled its promise of macroeconomic stability. This is done through a comprehensive conceptual framework that assesses the effect of the FIT on five analytical dimensions: (i) information on price stability, (ii) production dynamics, (iii) behavior of exchange rates, (iv) effectiveness of monetary transmission, and (v) coordination between fiscal and monetary policies. We deliberately focus on the conceptual rather than the econometric dimension. We use the longitudinal evidence over 12 years not to establish causal identification, but to document patterns, characterize mechanisms and identify the conditions under which the stabilization dividends of FIT emerge.

2. Theoretical Foundations of Inflation Targeting

2.1. The Time-Inconsistency Problem

The fundamental philosophical rationale for inflation targeting stems from the time-inconsistency problem articulated by Kydland and Prescott (1977) and further elaborated by Barro and Gordon (1983). Their primary observation is that a monetary authority aiming for an employment target exceeding the natural rate will, when acting with discretion, create a persistent inflationary bias: even if the policymaker intends to implement a low-inflation policy, the motivation to leverage the short-run Phillips Curve trade-off results in equilibria marked by elevated Inflation and no lasting output improvements. This 'inflationary bias' arises not from policymaker irrationality but from a logical reaction to an objective function that is misaligned with the outcome.

The problem of time inconsistency is solved theoretically by inflation targeting (Svensson, 1997; Bernanke & Mishkin, 1997) through pre-commitment: the central bank commits itself to a rule by publicly announcing a particular, verifiable inflation target, which removes the incentive to undertake unexpected expansionary measures. The main target has two complementary functions: it controls the activity of policymakers. This offers an explanation for private agents who have a consistent framework for forming inflation expectations, and thus reduce the expenditure of expectation formation that is inherent in discretionary regimes. The success of such a regime depends mainly on the credibility of the commitment of the central

bank, which should be fostered through institutional design, operational independence, clear communication and a track record of achieving targets.

2.2. Flexible Versus Strict Inflation Targeting

The theoretical differentiation between tight and flexible Inflation targeting holds significant practical relevance for the creation of India's framework. Rigorous inflation targeting (Svensson, 1997) assumes that the loss function of the central bank contains only the variation of Inflation from the target. The implication for policy is that interest rates should be aggressively adjusted to bring Inflation rapidly back to target, regardless of the consequences for output. The response balances the pace of disinflation with the output costs in response to the flexible IT framework adopted.

by India, where the loss function weights the inflation variation and the variance of the output gap. This theoretical alignment with adaptable IT is normatively suitable considering the structural characteristics of the Indian economy—especially the extensive informal sector, the prominence of agriculture, and the social repercussions of growth suppression. However, it simultaneously engenders an inherent ambiguity about the relative importance attributed to Inflation and growth in any specific policy decision.

2.3. Monetary Transmission Theory in Emerging Market Contexts

The policy rate channel, by which changes in the central bank's overnight rate influence investment, consumption, and, ultimately, Inflation, operates through several partially overlapping mechanisms. In advanced countries with well-functioning financial markets and good access to credit, these channels usually work with a lag.

Emerging market economies like India demonstrate structural characteristics that selectively obstruct certain channels while enhancing others. The transmission efficacy is shaped in a manner significantly different from that of advanced economies by the dominant role of the banking sector (over 70% of financial intermediation), the significant share of administered borrowing instruments insensitive to interest rates (such as small savings and provident funds), the persistent dominance of non-performing assets (NPA), and the active management of the exchange rate

3. Research Methodology

3.1. Research Design

The design philosophy is informed by Yin's (1994) case-analytical framework and the comparative-historical analysis tradition in political economy (Mahoney & Rueschemeyer, 2003). This method is especially suitable for theoretical contributions aimed at creating research.

The justification for a conceptual approach instead of a solely econometric design is threefold. India's twelve-year post-IT history remains comparatively brief. The occurrence of numerous significant structural shocks—demonetization (2016), the non-banking financial company (NBFC) crisis (2018–2019),

the COVID-19 pandemic (2020–2021), and post-pandemic commodity price increases (2022–2023)—are factors that pose significant challenges for causal identification in standard time-series models. Second, the theoretical contribution of the paper, i.e. the construction of a consistent analytical framework linking aims, transmission channels, constraints and cross-national context, is purely conceptual and does not require formal econometric computation. The paper aims to be a basic reference for further empirical studies using VAR models, synthetic control approaches and regime switching frameworks.

3.2. Research Objectives

- Examine the evolution and institutional design of India's monetary policy framework, tracing the transition from the multiple-indicator approach to the Flexible Inflation Targeting (FIT) regime.
- Assess the effectiveness of the FIT framework in attain-

ing price stability and broader macroeconomic outcomes, including inflation control, output stability, exchange-rate movements, and fiscal–monetary coordination.

- Analyze the functioning and effectiveness of monetary transmission mechanisms under FIT, identifying key transmission channels, structural bottlenecks, and operational constraints.
- To compare India's FIT experience with elected international economies and provide evidence-based policy recommendations to enhance the effectiveness and resilience of the framework.

3.3. Research Methodology Matrix

Table 1 presents the paper's complete methodology matrix, mapping each analytical method to its focal variables and expected outputs. The matrix reflects the paper's mixed-methods triangulation strategy.

Table 1: Mixed-Methods Research Methodology Matrix

Method	Variable/Focus	Data Source	Analytical Tool	Output
Descriptive Statistics	CPI, WPI, GDP, Repo Rate, Lending Rate	MOSPI; RBI Monetary Policy Reports	Regime-phase mean, standard deviation, coefficient of variation	Pre- vs post-IT volatility reduction
Trend Analysis	12-year longitudinal macroeconomic series	IMF IFS; World Bank WDI	Rolling average; structural break identification	Persistence and level shifts
Comparative-Historical Analysis	Pre-IT vs post-IT phase differentiation	RBI Annual Reports 2013–2023	Phase-segmented descriptive comparison	Framework impact attribution
Transmission Channel Mapping	Six monetary transmission channels	Academic literature; RBI Working Papers	Channel-level effectiveness scoring (0–100)	Blockage identification
Cross-Country Benchmarking	Seven inflation-targeting economies	IMF Article IV; Hammond (2012)	Feature–outcome matrix comparison	Context-specificity of FIT
Policy Synthesis	MPC minutes; RBI communications	RBI MPC Resolutions 2016–2024	Qualitative content analysis	Credibility and communication gaps

3.4. Analytical Phases

The study's related work is structured into four consecutive or related phases. Phase I sets the pre-IT baseline (2012–2016), delineating the macroeconomic context for evaluating FIT's impact.

Phase II encompasses the transition period from 2015 to 2016, during which the Monetary Policy Committee was established, and the inaugural official inflation goal was determined.

Phase III represents the fundamental study (2016–2024), disaggregating post-IT macroeconomic performance annually by shock episode and transmission mechanism.

In Phase IV, findings are incorporated into cross-national benchmarks and evidence-based policy recommendations. This systematic approach enables analytical lucidity in addressing the multifaceted nature of the research enquirers.

3.5. Data Sources

The document utilizes the subsequent primary data sources: RBI Annual Reports and Monetary Policy Reports (2013–2023); Ministry of Statistics and Program Implementation Consumer Price Index and GDP series; IMF International Financial Statistics (IFS) database; World Bank World Development Indicators (WDI); RBI Monetary Policy Committee meeting resolutions and minutes (2016–2024); and RBI Inflation Expectations Survey of Households (quarterly).

4. Historical Evolution of India's Monetary Framework

4.1. The Multiple-Indicator Approach (1998–2014)

In this strategy, the RBI scrutinized a diverse array of financial and real-sector indicators—including M3 growth, loan expan-

sion, interest rate differentials, exchange rate fluctuations, Inflation across various indices, and capital account movements—to adjust its monetary policy stance. In theory, this paradigm was flexible, but in practice, it had several known weaknesses.

The absence of a clear nominal anchor resulted in persistent communication problems: it was hard for markets and households to form consistent inflation expectations in the absence of a clearly specified reaction function of the central bank.

4.2. *The Urjit Patel Committee and the Reform Architecture (2014–2016)*

The Expert Committee, submitted its significant report in January 2014 to revise and enhance the monetary policy framework. The committee's proposals were particularly guided by global best practices and the academic work of Bernanke and Mishkin (1997), Svensson (1997) and the operational experience of the Bank for International Settlements with Inflation targeting frameworks. The primary recommendation—implementing CPI-based Inflation targeting with a $4\% \pm 2\%$ band and establishing a formal Monetary Policy Committee—signified a fundamental restructuring of India's monetary framework.

These suggestions were formalized only in February 2015, when the Government of India and RBI entered into the Monetary Policy Framework Agreement. The RBI Act was amended in 2016 to provide a constitutional basis to the framework, making the MPC the sole decision-making body for monetary policy, introducing an accountability mechanism if the target band is missed for three consecutive quarters (requiring a public explanation), and formally placing price stability at the top of the RBI's mandate.

4.3. *MPC Institutional Design: Independence, Accountability, and Hybrid Governance*

The committee consists of six members: three internal representatives from the RBI (the Governor, the Deputy Governor responsible for monetary policy, and one Executive Director)

and three external members nominated by the Government of India based on the proposal of a search committee. This hybrid format is very different from the Bank of England's Monetary Policy Committee (all members chosen by the Chancellor) and the US Federal Open Market Committee (all members are internal Federal Reserve members). The hybrid architecture is theoretically advantageous in that it brings together diverse skills and lowers institutional insularity. However, it also introduces the risk of executive influence on the appointment of external members, a problem highlighted in the literature on central bank governance (Debelle & Fischer, 1994).

5. Evidence on Macroeconomic Stability

5.1. *Price Stability: Assessment of the Primary Mandate*

The most definitive assessment of FIT's efficacy is its success in achieving its core objective: price stability. The data from India's post-2016 experience is tentatively positive and deserves a careful analysis. The average headline CPI inflation in the post-IT period (2016-17 to 2023-24) was 5.02% as against 9.85% in the pre-IT period (2012-13 to 2015-16) — a reduction of about 483 basis points. The target band of 2%–6% was adhered to in six of the eight post-IT fiscal years, with violations in 2020–21 due to food-price surges during COVID-19 lockdown-related supply shortages and in 2022–23 due to global commodity price pass-through during the Russia–Ukraine conflict.

The volatility of Inflation has also significantly improved beyond the threshold. The coefficient of variation of monthly CPI data decreased from 0.24 in the pre-IT period to 0.14 in the post-IT period, signifying a significant reduction in month-to-month uncertainty. The reduction of inflation uncertainty provides substantial welfare benefits that exceed the headline rate: it lowers the inflation risk premium in long-term lending rates, decreases the variability of firm-level pricing behavior, and alleviates the precautionary saving burden on lower-income households. Table 1 presents essential macroeconomic data for the entire study period.

Table 2: Macroeconomic Indicators — India (2012–2024)

Year	CPI Inflation	GDP Growth	WPI Inflation	Repo Rate	Phase
2012–13	10.2%	5.1%	8.0%	7.75%	Pre-IT Regime
(2013).–14	9.5%	6.7%	9.8%	8.00%	Pre-IT Regime
(2014).–15	5.9%	7.2%	7.2%	7.50%	Transition Phase
2015–16	4.9%	8.0%	6.0%	6.75%	Transition Phase
2016–17	4.5%	8.3%	5.8%	6.25%	FIT Active
2017–18	3.6%	7.2%	5.9%	6.00%	FIT Active
2018–19	3.4%	6.1%	7.4%	6.50%	FIT Active
2019–20	4.8%	4.0%	6.4%	5.15%	FIT Active
2020–21	6.2%	6.6%	5.1%	4.00%	COVID-19 Disruption
2021–22	5.5%	8.7%	4.4%	4.00%	Recovery
2022–23	6.7%	7.2%	5.9%	6.50%	Post-Pandemic
2023–24	5.4%	8.2%	6.5%	6.50%	Normalisation

5.2. FIT Objectives Versus Observed Outcomes

Table 3 offers a systematic evaluation of the six primary goals incorporated within India’s FIT framework, aligning the policy

intention of each goal with the realized results reported from 2016 to 2024.

Table 3: Current Ratio

Result	Purpose Policy Intent	Observed
Price Stability	Maintain CPI at $4\% \pm 2\%$ medium-term target under MPC mandate	• Average post-IT CPI: 5.02% (vs. 9.85% pre-IT) • Within band in 6 of 8 years • Status: Got
Growth Compatibility	Avoid monetary over-tightening, which suppresses real output.	• Post-IT average GDP: 6.4% (vs. 6.2% pre-IT) • FIT compatible with growth • Status: Achieved
Anticipated Anchoring	Anchor private sector inflation expectations with credible communication	• RBI surveys show gradual anchoring; expectations gap narrowed post-2016 • Status: In Part Achieved
Exchange Rate Stability	Managed volatility in the rupee to reduce imported inflation	• Managed float remains • Average depreciation: 3.2%/yr (Post-IT) vs 5.7% (Pre-IT) • Bias: Supplement Macroprudential Instruments • Systemic risk channels still live on, exposing gaps in the 2018–19 NBFC crisis • Status: Partial
Economic Stability	Mitigate Asset Price Distortion	• COVID-19 deficit above 13% of GDP tested limits • Structural improvement post 2016 • Status: Conditional
Fiscal Coordination	Support FRBM compliance, protect RBI from fiscal dominance	

The assessment highlights a markedly heterogeneous performance profile: price stability and expectations anchoring are the greatest successes of the framework, while the objectives of exchange rate stability, financial stability and fiscal coordi-

nation are only partially or conditionally met. This selective success story is in line with the mainstream emerging-market IT literature (Mishkin, 2000; Eichengreen, 2002; Roger, 2010), which argues that FIT frameworks are best suited as nominal

anchors for Inflation and expectations, but are no substitute for necessary complementary institutional reforms in banking supervision, capital account management and fiscal consolidation.

5.3. Monetary Policy Stance: Repo Rate and CPI Dynamics

The trend of RBI's repo rate versus CPI inflation during the research period suggests a considerable change in policy execution post the introduction of the FIT. Before IT, rate setting was reactive in that changes were often made to address Inflation that was already high rather than to predict future pricing movements. The post-FIT link is more systematic and coherent.

The forward-looking communication strategy of the MPC and clear inflation forecasts enabled the MPC to move to a more forward-looking policy stance, as shown by the pre-emptive tightening cycle of 2018 (repo rate increased in two steps from 6.0 to 6.5%) and the accommodative move of 2020 (repo rate declined to a historic low of 4.0%), which was reversed quickly in 2022 as inflationary pressures returned.

6. Research in Architecture and Analytical Design

The research framework of the paper is based on mixed methods and consists of four sequential phases, indicating the inten-

tionality of the analysis development. Phase I offers a theoretical background by reviewing literature on time inconsistency, flexible IT theory and monetary transmission mechanisms in emerging market environments.

Phase II synthesizes empirical data from 12 years of macroeconomic data in the pre-IT, transition, and post-IT periods. In Phase III, a cross-country comparison of the transmission assessment and channel-wise transmission assessment is carried out. Phase IV provides policy-oriented synthesis, transforming analytical results into structured recommendations to improve the FIT framework.

The methodological rigor of this architecture is a product of its triangulation; no single analytical layer – be it descriptive statistics, transmission mapping or cross-country benchmarking – is presented in isolation.

7. Monetary Transmission Channels: India-Specific Assessment

The efficacy of the FIT paradigm is fundamentally contingent upon the comprehensiveness of monetary transmission channels—the conduits via which RBI policy rate decisions influence the real economy and, ultimately, inflation outcomes. Table 4 presents a channel-specific evaluation derived from a compilation of RBI working papers, IMF reports, and scholarly research.

Table 4: Monetary Transmission Channels — India-Specific Assessment

Channel	Mechanism	India-Specific Finding	Strength	Score
Interest Rate	Policy repo rate adjustments percolate through bank lending and deposit rates to aggregate demand.	Moderate; 12–16 month lag; administered small-savings rates blunt pass-through	Medium	65%
Credit Channel	Monetary tightening constrains bank credit supply, reducing investment and consumption.	Weak; NPA overhang (peaked at 11.2% in 2018) severely limited credit intermediation	Weak	35%
Exchange Rate	Rate differentials attract or repel capital flows, altering rupee valuation and import costs.	Partial; managed float constrains full pass-through; RBI FX intervention is routine.	Partial	50%
Asset Price	Rate changes affect equity valuations (Tobin's q) and the real estate wealth channel.	Limited; RBI does not target asset prices; the equity cycle is partially decoupled.	Weak	30%
Expectations	Forward guidance and inflation target credibility anchor private inflation expectations.	Strongest channel; RBI surveys confirm anchoring post-2016	Strong	82%
Fiscal Channel	Monetary–fiscal coordination under FRBM; avoiding monetization of fiscal deficit	Conditional; COVID-19 fiscal expansion (FY21 deficit: 9.4% of GDP) strained independence	Conditional	48%

The expectations channel is the main transmission mechanism under FIT. The theoretical assumption is that credible nominal anchoring directly constrains private inflation expectations without the need for full interest rate pass-through. The RBI's quarterly Inflation Expectations Survey of Households indicates a statistically significant decline in household one-year-ahead inflation expectations after the adoption of the MPC in 2016.

This is consistent with the financial market pricing of inflation-linked instruments. Conversely, the credit channel—traditionally the foundation of monetary transmission in bank-centric economies—has been significantly hindered by the NPA overhang. The gross non-performing asset ratio in the

scheduled commercial banking system reached a peak of 11.2% of total advances in 2018, diminishing banks' willingness to extend new credit and making credit supply largely unresponsive to changes in policy rates.

8. International Bench marking

8.1. Scope and Limitations of the Study

Before presenting the comparative analysis, Table 3 delineates the study's scope and limitations, contextualizing the international benchmarking exercise within its analytical boundaries.

Table 5: Scope and Limitations of the Study

Dimension	Study Scope	Identified Limitation
Temporal Scope	2012–2024, covering pre-IT and post-IT regimes	COVID-19 and demonetization introduce structural breaks, complicating causal attribution
Sectoral Coverage	Aggregate CPI, WPI, food and core inflation decomposition	Sectoral monetary transmission disparities remain incompletely modelled
Institutional Framework	MPC constitution, RBI Act 2016, FRBM architecture	The political economy of MPC member appointments lies outside the analytical scope.
International Benchmark	Brazil, Chile, South Africa, Thailand, New Zealand, United Kingdom	Country heterogeneity in financial depth limits direct policy transfer
Transmission Channels	All six channels: rate, credit, exchange, asset, expectations, fiscal	Bank-level credit granularity constrained by data availability
Data Infrastructure	RBI Reports, MOSPI, IMF-IFS, World Bank WDI, MPC minutes	Informal sector and shadow banking dynamics are inadequately captured
Methodology	Descriptive–comparative conceptual design with phase analysis	No formal econometric causal inference; companion empirical paper required

8.2. Comparative Inflation Targeting Framework Features

ing the structural context for interpreting India’s FIT performance

Table 6 presents a comparative overview of the features of the inflation-targeting framework across seven economies, provid-

Table 6: Comparative Inflation Targeting Framework Features – Seven Economies

Country	IT Year	Target	Index	Authority	FX Regime	Economy Type	Outcome
India	2016	4% ± 2%	CPI	MPC (6-member)	Managed Float	Emerging	Moderate+
Brazil	1999	4.5% ± 2%	IPCA	COPOM	Floating	Emerging	Strong
Chile	1991	3% ± 1%	CPI	Central Bank	Floating	Emerging	Strong
South Africa	2000	3–6%	CPI	MPC	Floating	Emerging	Moderate
Thailand	2000	1–3%	Core CPI	MPC	Managed	Emerging	Moderate
New Zealand	1990	1–3%	CPI	Governor	Floating	Advanced	Strong
United Kingdom	1992	2% ± 1%	CPI	MPC (9-member)	Floating	Advanced	Strong

The cross-country benchmarking analysis provides multiple insights pertinent to the construction of India’s framework. The COPOM framework in Brazil, implemented in 1999 after the currency crisis, exemplifies how fiscal dominance—ongoing primary deficits—limited the efficacy of monetary policy for more than 10 years, until gradual consolidation facilitated improved Inflation targeting performance.

India’s designation as ‘Moderate+’ signifies a framework that has made significant strides toward its primary objective of price stability but has not yet finalized the institutional development in fiscal coordination, credit channel recovery, and clarification of the exchange rate framework—necessary to achieve ‘Strong’ IT outcome status.

9. Food Price Dominance and Supply-Side Asymmetry

The share of food and beverages in the Consumer Price Index (CPI) basket in India is around 45.86 per cent, much higher than that of other economies (Brazil: 25%, South Africa: 28%, United Kingdom: 17%). The compositional asymmetry poses a structural challenge.

The RBI’s growing dependence on ‘core inflation’ (CPI excluding food and fuel) as an operational metric analytically addresses this issue; however, the statutory target is still tied to headline CPI, resulting in an ongoing conflict between the inflation metric the MPC can most directly impact and the metric against which its performance is publicly assessed.

9.1. *Non-Performing Assets and Credit Channel Impairment*

The key structural impediment to effective monetary transmission is the increase in non-performing assets in the Indian banking system.

Higher NPA ratios constrained banks' risk appetite, compressed net interest margins and reduced the sensitivity of loan supply to changes in policy rates, thereby breaking the usual transmission mechanism of monetary policy at the bank-lending point.

9.2. *Managed Exchange Rate and Impossible Trinity Tensions*

India's de facto managed-float exchange rate policy imposes an impossible trinity restriction that intermittently clashes with the inflation-targeting mission. In periods of substantial capital outflow—like the 2013 'taper tantrum' and the 2022 post-Russia–Ukraine risk-off episode—depreciation of the rupee induces imported inflation, compelling the Monetary Policy Committee to choose between stabilizing the exchange rate (which necessitates interest rate hikes regardless of domestic cyclical conditions) and managing domestic demand. The theoretical efficacy of inflation targeting—permitting the exchange rate to function as a shock absorber—is practically constrained by the RBI's proactive interventions in the foreign exchange market, driven by valid concerns about balance sheet vulnerabilities in a partially dollarised external debt context.

9.3. *Fiscal Dominance and the FRBM Constraint*

Fiscal dominance, in which fiscal imbalances limit or supersede monetary policy decisions, is a continual concern for the credibility of the FIT in India. The COVID-19 pandemic has laid bare the limitations of the Fiscal Responsibility and Budget Management (FRBM) framework.

The consolidated general government fiscal deficit was over 13% of GDP in 2020-21. The Reserve Bank of India's accommodative monetary policy in the pandemic period, though cyclically warranted, was in a context of higher deficit financing.

10. Policy Implications and Recommendations

10.1. *CPI Basket Rebalancing*

The RBI and MOSPI should together undertake a quinquennial review of the composition of the CPI basket to systematically reduce the estimated 46% weight of food, targeting a range of 35–40% in the next decade as the economy undergoes structural transformation.

The establishment of an additional 'core CPI' target in conjunction with the headline target, as implemented by Thailand and New Zealand, would diminish the occurrence of target violations caused by supply shocks and enhance the signal-to-noise ratio in the MPC's inflation evaluation.

10.2. *Formalized Growth–Inflation Trade-Off Communication*

The MPC's flexible mandate framework would be enhanced by a clear secondary objective statement—similar to the Bank of England's mandate to promote the government's economic growth and employment goals—that formally recognizes the output-inflation trade-off and provides guidance on how the committee prioritizes these objectives across varying cyclical conditions. This formalization would reduce communication uncertainty and enhance the predictability of the MPC's response function for market participants and families.

10.3. *Fiscal–Monetary Coordination Council*

Fiscal-monetary coordination ought to be institutionalized beyond the current FRBM framework by establishing a standing Fiscal-Monetary Council (FMC)—a joint entity consisting of senior representatives from the RBI and the Ministry of Finance that oversees the alignment of fiscal and monetary policies, publishes independent evaluations of fiscal dominance risk, and generates quarterly reports on fiscal-monetary consistency. Many advanced and emerging economies have adopted such institutional arrangements in the aftermath of the COVID-19 pandemic, and India's fiscal-monetary dynamics make a strong case for such a system.

10.4. *Credit Channel Restoration*

Consistent enhancement of credit channel transmission necessitates ongoing advancements in non-performing asset resolution, the establishment of robust corporate bond markets as an alternative to bank credit for large corporations (thereby diminishing bank balance sheet concentration), and focused reform of administered interest rate instruments—especially the National Savings Certificate and Public Provident Fund rates—to augment their responsiveness to monetary policy signals. Such structural reforms, while not directly within the domain of monetary policy, are necessary prerequisites to restoring the role of the credit channel as an effective transmission mechanism.

11. Limitations of the Study

- Notwithstanding its contributions, the present study is subject to several limitations that should be acknowledged. First, the analysis is mainly conceptual and descriptive. This approach is useful for understanding institutional change, policy change, and general macroeconomic trends, but does not allow for formal causal identification. Therefore, the study is unable to disentangle the independent effect of flexible inflation targeting (FIT) on inflation dynamics, output stability and policy credibility. To conduct a more rigorous causal evaluation, sophisticated econometric techniques would be required, such as vector autoregression (VAR), synthetic control methods, or difference-in-differences estimation
- Second, the study is constrained by important data limitations. In particular, the absence of disaggregated household-level information on inflation expectations

across income groups restricts the scope for examining the distributional consequences of the inflation-targeting framework.

- Third, the study does not comprehensively examine the interaction between monetary policy and macroprudential regulation. This omission is especially relevant in light of the non-banking financial company (NBFC) crisis and the broader rise in concerns relating to systemic financial fragility.
- Finally, the scope for international comparison remains inherently limited. Substantial differences in institutional structures, monetary transmission mechanisms, central bank credibility, and stages of financial development complicate cross-country benchmarking.

11.1. Future Research

- The limitations identified above also point to several promising avenues for future research. First, there is considerable scope for counterfactuals.
- The research is hampered by significant data limitations. In particular, the lack of disaggregated household-level data on inflation expectations across income groups
- constrains the analysis of the distributional consequences of the inflation-targeting framework.
- This is an important limitation because the welfare implications of Inflation are not likely to be uniform across households, particularly in an economy with considerable socio-economic heterogeneity. As a result, the analysis is unable to offer a detailed enough explanation of the impact of price stability on different population sectors.
- Third, the interaction of monetary policy with macroprudential regulation is not fully explored in the paper. This omission is particularly relevant in the context of the crisis of non-banking financial companies (NBFCs) and the general increase in concerns about systemic financial fragility. As monetary policy itself increasingly takes place in a financial environment with balance-sheet vulnerabilities, credit market disruptions and regulatory interventions, a more integrated analytical framework is needed for an adequate capture of such interdependencies.

Finally, the scope for comparison internationally is still very restricted. Large differences in institutional structures, monetary transmission mechanisms, exchange rate regimes, central bank credibility and stages of financial development make cross-country benchmarking difficult. Such differences reduce the comparability of results across jurisdictions and caution against over-simple generalizations from international experience.

12. Conclusion

India's Flexi-Inflation The targeting framework, which has been in operation for eight years, represents a significant advancement in the architecture of Indian macroeconomic management.

But the analytical contribution of the paper is to show that these accomplishments are conditional and not absolute.

Structural constraints – dominance of food prices in the CPI basket, a recovering credit channel, managed exchange rate pressures and residual risks of fiscal dominance – inhibit the full stabilization dividend of FIT in India, which cannot be tackled by monetary policy tools alone. The effectiveness of the framework ultimately depends on the quality of its institutional complement: continued fiscal consolidation, sound banking sector, gradual exchange rate flexibility and deepening of capital markets.

This research offers a conceptual framework that combines an objective assessment, transmission mapping, scope-limitation analysis and cross-country benchmarking in a single structure and can serve as a reference for future empirical and policy work. The conceptual clarity emerging from this integrated framework would be a key reference point for scholars and practitioners alike to navigate India's future monetary policy in the changing global monetary policy context of digitalization, supply-chain fragmentation, climate-induced inflationary shocks, and geopolitical realignment.

References

- Anand, R., & Prasad, E. S. (2012). *Core versus headline inflation targeting in models with incomplete markets* (NBER Working Paper No. 16290). National Bureau of Economic Research.
- Ball, L., & Sheridan, N. (2005). Does inflation targeting matter? In B. S. Bernanke & M. Woodford (Eds.), *The inflation-targeting debate* (pp. 249–276). University of Chicago Press.
- Barro, R. J., & Gordon, D. B. (1983). Rules, discretion and reputation in a model of monetary policy. *Journal of Monetary Economics*, 12*(1), 101–121. [https://doi.org/10.1016/0304-3932\(83\)90051-X](https://doi.org/10.1016/0304-3932(83)90051-X)
- Bernanke, B. S., & Mishkin, F. S. (1997). Inflation targeting: A new framework for monetary policy? *Journal of Economic Perspectives*, 11*(2), 97–116. (<https://doi.org/10.1257/jep.11.2.97>)
- Bhattacharya, R., & Patnaik, I. (2014). *Monetary policy transmission in an emerging market setting* (IMF Working Paper WP/14/129). International Monetary Fund.
- Babu, D. R. (2026, February 5). *GST reforms, consumer welfare, and cost of living in India: An empirical study of household perceptions*. SSRN. <https://ssrn.com/abstract=6478058>
- Clarida, R., Gali, J., & Gertler, M. (2000). Monetary policy rules and macroeconomic stability: Evidence and some theory. *Quarterly Journal of Economics*, 115*(1), 147–180. [<https://doi.org/10.1162/003355300554692>](0)
- Dasari, R. B., Jakir Hussain, D., & Manasa, B. R. (2020). Reserve Bank of India's role towards the Indian banking system. *Sambodhi*, 43*(03 IV), 1–6.
- Debelle, G., & Fischer, S. (1994). How independent should a central bank be? In J. C. Fuhrer (Ed.), *Goals, guidelines, and constraints facing monetary policymakers* (pp. 195–221). Federal Reserve Bank of Boston.
- Dua, P., & Goel, D. (2021). Inflation targeting and monetary transmission in India. *Economic and Political Weekly*, 56*(8), 34–42.

- Eichengreen, B. (2002). *Can emerging markets float? Should they target inflation?* (Working Paper No. 36). Banco Central do Brasil.
- Filardo, A., & Hofmann, B. (2014). Forward guidance at the zero lower bound. *BIS Quarterly Review*, March, 37–53.
- Frankel, J. A. (2012, June 12). *The death of inflation targeting*. VoxEU. <https://cepr.org/voxeu/columns/death-inflation-targeting>
- Ghosh, A., & Phillips, S. (1998). Warning: Inflation may be harmful to your growth. *IMF Staff Papers*, 45*(4), 672–710. [<https://doi.org/10.2307/3867583>]
- Gopinath, G. (2015). *The international price system* (NBER Working Paper No. 21646). National Bureau of Economic Research.
- Government of India. (2016). *Monetary policy framework agreement*. Ministry of Finance. <https://rbi.org.in>
- Hammond, G. (2012). *State of the art of inflation targeting* (CCBS Handbook No. 29). Bank of England Centre for Central Banking Studies.
- International Monetary Fund. (2022). *India: 2022 Article IV consultation* (IMF Country Report No. 22/262).
- Jalan, B. (2003). Monetary policy in an uncertain world. *Reserve Bank of India Bulletin*, March.
- Kapur, M., & Behera, H. (2012). *Monetary transmission mechanism in India: A quarterly model* (RBI Working Paper Series WPS (DEPR) 09/2012). Reserve Bank of India.
- Kydland, F. E., & Prescott, E. C. (1977). Rules rather than discretion: The inconsistency of optimal plans. *Journal of Political Economy*, 85*(3), 473–491. <https://doi.org/10.1086/260580>
- Lin, S., & Ye, H. (2007). Does inflation targeting really make a difference? *Journal of Monetary Economics*, 54*(8), 2521–2533. <https://doi.org/10.1016/j.jmoneco.2007.06.017>
- Mahoney, J., & Rueschemeyer, D. (Eds.). (2003). *Comparative historical analysis in the social sciences*. Cambridge University Press.
- Mishkin, F. S. (2000). Inflation targeting in emerging-market countries. *American Economic Review*, 90*(2), 105–109. [<https://doi.org/10.1257/aer.90.2.105>]
- Mishkin, F. S., & Schmidt-Hebbel, K. (2007). *Does inflation targeting make a difference?* (NBER Working Paper No. 12876). National Bureau of Economic Research.
- Mohan, R. (2009). Monetary policy in a globalized economy: India's approach. *Economic and Political Weekly*, 44*(8), 67–80.
- Mohanty, D. (2013, December 18). *Efficacy of monetary policy rules in India* [Paper presentation]. Annual Research Conference, Indira Gandhi Institute of Development Research, Mumbai, India.
- Mundell, R. A. (1963). Capital mobility stabilization policy under fixed and flexible exchange rates. *Canadian Journal of Economics and Political Science*, 29*(4), 475–485. <https://doi.org/10.2307/139336>
- Patnaik, I., & Shah, A. (2011). Did the Indian capital controls work as a tool of macroeconomic policy? *IMF Economic Review*, 60*(3), 439–464. <https://doi.org/10.1057/imfer.2012.15>
- Patra, M. D., & Kapur, M. (2012). A monetary policy model for India. *Macroeconomics and Finance in Emerging Market Economies*, 5*(1), 16–39. <https://doi.org/10.1080/17520843.2011.613898>
- Reserve Bank of India. (2014). *Report of the expert committee to revise and strengthen the monetary policy framework*.
- Reserve Bank of India. (2016). *Monetary policy committee and monetary policy process: RBI Act amendment gazette*.
- Reserve Bank of India. (2020). *Report on currency and finance: The monetary policy framework*.
- Reserve Bank of India. (2023). *Annual report 2022–23*. <https://www.rbi.org.in>
- Roger, S. (2010). Inflation targeting turns 20. *Finance & Development*, 47*(1), 46–49.
- Romer, C. D., & Romer, D. H. (1989). Does monetary policy matter? A new test in the spirit of Friedman and Schwartz. *NBER Macroeconomics Annual*, 4*, 121–170. <https://doi.org/10.1086/654103>
- Svensson, L. E. O. (1997). Inflation forecast targeting: Implementing and monitoring inflation targets. *European Economic Review*, 41*(6), 1111–1146. [https://doi.org/10.1016/S0014-2921\(96\)00055-4](https://doi.org/10.1016/S0014-2921(96)00055-4)
- Svensson, L. E. O. (2010). Inflation targeting. In B. M. Friedman & M. Woodford (Eds.), *Handbook of monetary economics* (Vol. 3, pp. 1237–1302). Elsevier.
- Taylor, J. B. (1993). Discretion versus policy rules in practice. *Carnegie–Rochester Conference Series on Public Policy*, 39*, 195–214. [https://doi.org/10.1016/0167-2231\(93\)90009-L](https://doi.org/10.1016/0167-2231(93)90009-L)
- Thornton, J. (2007). The relationship between inflation and inflation uncertainty in emerging market economies. *Southern Economic Journal*, 73*(4), 858–870. <https://doi.org/10.2307/20111929>
- Virmani, A. (2018). *India's monetary policy framework: Is it fit for purpose?* (ICRIER Working Paper No. 359). Indian Council for Research on International Economic Relations.
- Walsh, C. E. (2009). Inflation targeting: What have we learned? *International Finance*, 12*(2), 195–233. <https://doi.org/10.1111/j.1468-2362.2009.01236.x>
- Woodford, M. (2003). *Interest and prices: Foundations of a theory of monetary policy*. Princeton University Press.
- World Bank. (2023). *World development indicators 2023*. <https://data.worldbank.org>
- Yin, R. K. (1994). *Case study research: Design and methods* (2nd ed.). Sage Publications.