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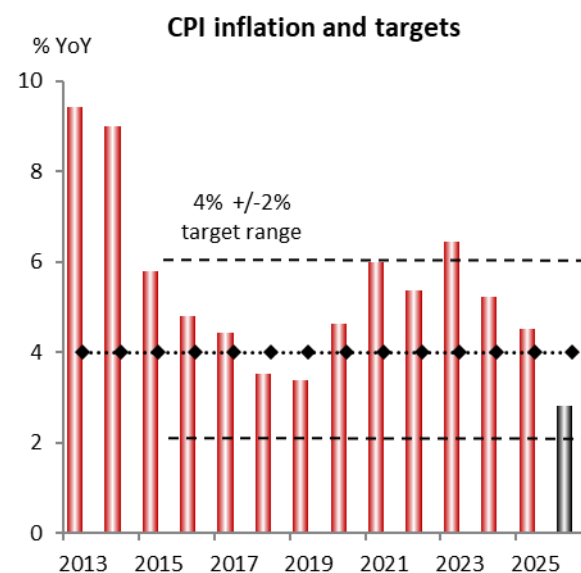


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- The central bank tabled a discussion paper on the current Flexible Inflation Targeting (FIT) framework.
- A periodic review is due by March 2026.
- Since the last review in 2021, inflation has been within the target band for two-thirds of the period.
- A balanced assessment was presented, covering choice of the anchor, mid-point as well as tolerance bands.
- Continuity with current numerical benchmarks is most likely, boding well for credibility of the framework.
- Newly revamped and rebased CPI series is due to be released in early-2026. This might lower volatility in the series.
- **Implications for markets:** FIT continuity is a positive. On policy, the MPC is likely to be guided by growth rather than inflation.

Flexible inflation targeting under review

Ahead of a review of the Flexible Inflation Targeting (FIT) framework by March 2026, the central bank tabled a [discussion paper](#). It is nearly a decade since the FIT framework was introduced and was last reviewed in 2021. Post the second review, the government is likely to approve the framework by 1Q26 (for a validity of another five years). The FIT framework, which came into effect in 2016, marked an institutional change i.e., moving from a Governor centric decision making to a monetary policy committee (MPC). This body was entrusted with the RBI Act preamble, “...the primary objective of monetary policy is to maintain price stability while keeping in mind the objective of growth”. The chosen inflation target band of +/-2% around 4% gave adequate flexibility to the MPC to focus completely on inflation (and its interplay with growth) depending on the evolving situation.

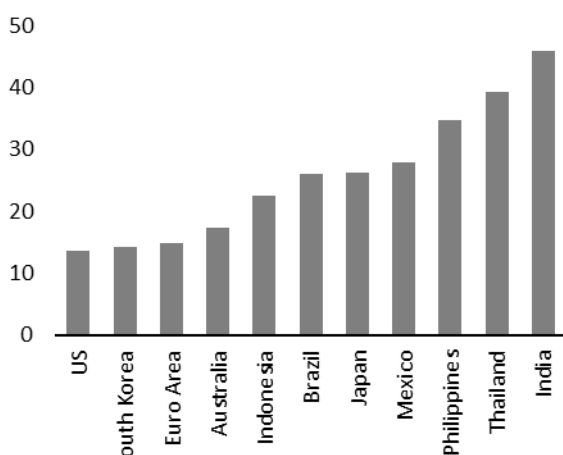


The discussion paper crystallised pertinent questions into four questions:

- *Whether headline inflation or core inflation would be a best guide for monetary policy?*

On the first, the paper argued for and against the headline vs core reading. Arguments in favour of the headline suggests, that ignoring food prices risked undermining policy credibility and de-anchoring inflation expectations. A focus on core readings would also not capture rising incomes and its shift in consumption patterns, which influence broader price dynamics. Moreover, the headline reflects the actual cost of living, with policies based on this likely to be more representative of the price pulse. Focus on core prints would prevent an over tightening of policy, though the paper suggests refocusing core to include non-volatile food items.

Share of food in CPI in selected Inflation-targeting countries (ppt)



Source: RBI, DBS

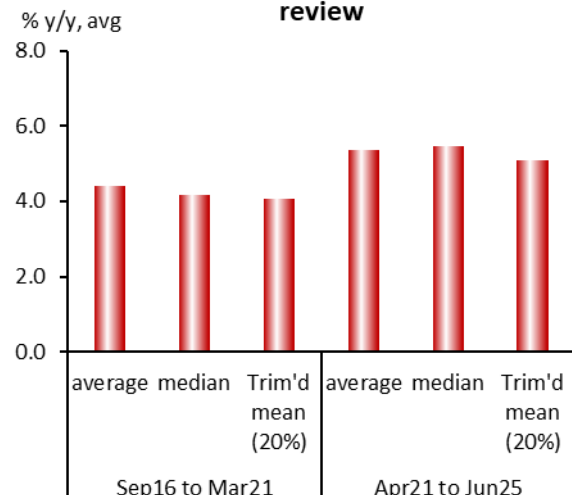
The RBI also cited experiences of other countries, defending the relevance of headline prints. **Overall, headline is viewed as more representative of actual consumer/ price**

experience, increasing the chance that this will remain the anchor target. Notably, the new rebased and reweighted inflation series is due for release in February 2026, which will have a lower share of food products.

- *Whether the 4% inflation target continues to remain optimal for balancing growth with stability for India?*

Taking the performance of inflation vs targets since inception, average inflation was close to 3.9%, near the 4% target. Targets were overshoot in the four succeeding years (2020-2024), due to the pandemic, geopolitical tensions and weather-related shocks. More recently, inflation has moderated, with 1QFY26 at sub-4%. Empirical studies also found 4.0% as optimal, converging with zero output gap and corresponds with trend inflation at ~4%. The Balassa-Samuelson effect was also supportive of a 4% inflation target for fast-growing emerging economies like India, given their higher productivity growth and services inflation.

Inflation trend: during period under review



Source: CEIC, DBS

- *Should the tolerance band around the target be revised in any way?*

The genesis of adopting a range instead of point target stems with the relatively high weightage of volatile food items. Official data showed that between 2016 and 2021, inflation was within the range for 75% of the time, with this decreasing to 66% during 2021–2026 (see table), due to overlapping shocks. Overall, the cyclical trend saw historical deviations (94%) stay within $\pm 2\%$ band, **underscoring the symmetry and appropriateness of the current band.**

Distribution of inflation (no. of months)

Distribution interval (%)	First review (9M16 to 3M21)		Second review (4M21 to 3M25)	
	Headline	Core	Headline	Core
	55 months		48 months	
< 2	2	0	0	0
2-3	8	0	0	0
3-4	16	6	4	14
4-5	12	21	12	7
5-6	6	21	15	15
>6	11	7	17	12

Source: RBI, MOSPI, DBS

- *Should the target inflation level be removed, and only a range be maintained within the overall ambit of maintaining flexibility without undermining credibility?*

The forecast range provides operational flexibility, particularly in responding to domestic as well as external shocks and recognizing forecast uncertainties, while also helping to make room to introduce secondary objectives like growth.

In an assessment of the trend over the past decade (2016–2025), inflation was within the

lower half of the target range i.e. 2–4% for 30% of the time, another 40% within the upper half and the rest exceeded 6%, mostly due to exogenous and domestic price shocks. As this highlights volatility around the 4% target, critics of range targeting argue it may reduce policy clarity and credibility, with a risk of unanchoring inflationary expectations, as MPC members might interpret different implicit targets within the band, weakening the commitment to price stability.

Regarding the choice of the wide tolerance bands, the 2014 committee report had noted that 1% to 3% corresponded to price stability in the advanced economies, providing the lower band for emerging markets, like India. A higher 4-5% for EM/ transition countries provided the higher end of the band. **With the range target viewed as offering flexibility in a volatile domestic and global context, this strengthens the case for retaining the current set-up.**

Volatility in inflation

	Headline	Core	Food	Fuel
Pre-FIT				
Apr12 to Sep16	2.3	2	3.3	2.8
Post-FIT				
First 5Y (Oct16 to Mar21)	1.6	0.8	3.5	2.8
Next 5Y period (Apr21 to May25)	1.2	1.2	2.2	6.1

Source: RBI, DBS

Conclusion

The discussion paper highlighted both sides of the argument, with the government likely to have the final say in March/April 2026. While global practices favour narrower bands, high

weightage for food and structural vulnerabilities make a wider range more suitable for India. Of note, the new revamped and rebased CPI series is due to be released in early-2026. A lower weightage for food is likely to restrain inherent volatility in the series. The paper remarks that, “price stability being a shared responsibility between the government and the central bank”, underscores the need for an effective monetary-fiscal coordination to contain second-round effects and preserve credibility. **We expect the numerical targets as well as the tolerance bands to be maintained for the third successive term of the inflation targeting framework.**

The MPC is likely to be guided by growth rather than inflation in the months ahead. The [neutral guidance](#) in August raised the bar for further rate cuts, with a significant growth shock required to convince policymakers to ease further. One year ahead, factoring in the Apr-Jun26 inflation forecast at 4.9% and repo rate at 5.5%, the real rate buffer will narrow significantly to 60bps vs the preferred 140-190bp. The terminal rate is likely to stay at 5.5% this year.

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