

RBI's policy decisions been in right direction: Goyal



“THE RBI HAS APPROACHED THE INFLATION ORIGINATING FROM FOOD PRICE SHOCKS PRAGMATICALLY”

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SUBRATA PANDA

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The Reserve Bank of India's (RBI's) policy decisions to tame headline inflation have been in the right direction as it has approached the inflation originating from food price shocks pragmatically, said Ashima Goyal, external member of the monetary policy committee (MPC) that decides on the policy rates.

India's retail inflation has been above the RBI's upper tolerance limit of 6 per cent for eight consecutive months. In August, the retail inflation inched up to 7 per cent from 6.71 per

cent in July driven by higher food prices, putting pressure on the central bank to further increase policy rates later this month.

In a working paper on “What drives inflation? Demand or Supply”, authors Goyal and Abhishek Kumar have argued that inflation shock is still a predominantly supply shock — originating and operating through food inflation. Central banks need to respond to such inflation under an inflation targeting regime, which leads to a permanent change effect on output, the paper stated.

According to the authors, inflation originates as a supply shock but

becomes more demand-driven in the medium run due to the lagged effect of interest rate tightening that may be reducing supply more than it reduces demand. “Excess tightening would not improve credibility if excess demand due to supply-side deterioration causes inflation,” they said.

The six-member MPC has raised the policy repo rate by 140 basis points since May to bring down headline inflation. The RBI has been given an inflation targeting mandate, wherein they have an inflation target of 4 per cent with the upper tolerance level of 6 per cent and the lower tolerance level of 2 per cent.