

RBI INFLATION FIGHT NEEDS CHANGE IN STRATEGY

RBI has adopted Target Based Inflation Policy for last 10 years in which the base inflation has been kept at 4 % with band of +/- 2 per cent which means that the CPI inflation range is 2 to 6 %. Key issues in addressing inflation index and why this time RBI has failed to control the inflation ???

Inflation Index:- The Indian Inflation index has two main components which are Fuel and Food items.

The main difference between headline inflation and core inflation is that headline inflation includes food and energy prices, while core inflation does not:

- **Headline inflation**

The total inflation in an economy, including the prices of commodities like food and energy. Headline inflation is more volatile than core inflation because food and energy prices are volatile. Headline inflation is a raw figure that reflects changes in the consumer price index (CPI) throughout the entire economy. It differs from core inflation, which is CPI adjusted to exclude food and energy prices, which are volatile.

- **Core inflation**

The consumer price index (CPI) adjusted to exclude food and energy prices. Core inflation is also known as non-food-manufacturing or underlying inflation. Core inflation represents the long-run trend in the price level. Measurements of long-run inflation should exclude transitory price changes.

Difference Between the Headline Inflation and Core in Data Calculation:-

core retail inflation, excluding food and beverage and fuel and light, shot up to 3.7% in October this year even as headline consumer price inflation rose to a 14-month high of 6.2% in the month. Analysts highlighted that this was the highest in 10 months and retail inflation is now becoming more broad-based, moving away from just food items especially vegetables such as tomatoes, onions, and potatoes.

“Core inflation (excluding Food & Beverages and Fuel) rose 3.7% in October 2024, highest in 10 months, led by higher inflation in housing, education and personal care and effects categories.

Analysis:- The Head line inflation which is the total inflation came to 6.21% which is higher than the band of RBI Target inflation policy of 6 % which puts brake on the rate cut motive but if we go by Core inflation which is 3.9% in October and 3.7 % in September 2024 it is still less than the base inflation target of 4 % which means that if the core inflation is considered for the Monetary policy framework then RBI MPC (Monetary Policy Committee) can suggest rate cuts immediately and this will help the economy too.

Example of Russia Ukraine war:- This war started on 24 Feb 2022 which led to crude oil prices go to \$ 131 per barrel and thus the prices of petrol and diesel in India too had touched Rs. 100 per litre which had led to wide spread protest in the country too.

But the direct effect on the headline inflation was that CPI inflation went to 7.67% and thus RBI was forced to start increasing the Repo Rate from 4 % which was from 2020 to 2022 to 6.5 % a rise of 250 basis point in 2023. The point here is that how can RBI control the Crude oil prices internationally – the answer is direct NO. Hence the need of the hour is to change from inflation targeting from Head line inflation to Core inflation which is more long term and is less volatile.

Example of agriculture product price rise:- The recent monsoon pan India was much more than the usual rain fall and it created huge disruptions for agriculture production. For example the Onions which are staple food for most of the lower middle class population the prices went up from Rs. 40 per kg to Rs. 90 per kg as the crop was severely damaged by the excessive rainfall. In this kind of weather challenge how can RBI control inflation which is beyond its scope and means.

Suggestion:- Time has come that RBI shifts its stand from Headline inflation to core inflation since it will give RBI more elbow room to take decision about the Interest rate scenario and cut rate when the economy needs it the most. The Repo Rate which is at 6.5 % needs to be reduced immediately so that cost of capital comes down and industry can expand which will create job opportunities for the masses.