



RBI's Decision to Pause Interest Rate Hikes

Why in News?

Recently, The [RBI's Monetary Policy Committee \(MPC\)](#) decided to **pause [interest rate](#) hikes** and assess the impact of previous hikes.

- Since May 2021, [RBI](#) had been consistently raising interest rates to reduce [inflation](#), which was far above its target level of **4%**.

What is Inflation Targeting?

▪ About:

- Inflation targeting in India is a **monetary policy framework** that was adopted by the **Reserve Bank of India (RBI) in 2016**.
 - Under this framework, the **RBI sets a target for the inflation rate and uses monetary policy instruments to achieve it**.
- Currently, RBI's primary objective is to achieve the **4% inflation target**. RBI has a comfort zone of **+/- 2% within which inflation must remain**. This means that the RBI aims to keep the **inflation rate between 2% and 6%**.
 - The last two readings of inflation (January and February 2023) **were 6.5% and 6.4%, respectively**.

▪ Reasons to Pause Interest Rate Hikes:

- RBI's strategy of hiking interest rates to control inflation has limitations. According to the RBI, under the current circumstances, **monetary measures alone may not be sufficient to control inflation**.
 - [Fiscal policy \(government's taxes and spending\)](#) may be more effective in bringing down current inflation.

▪ Advantages:

- Increased central bank transparency and accountability.
- Allows investors and the public to anticipate interest rate changes.
- Lowers inflation expectations.

▪ Limitations of RBI's Inflation Targeting:

- **Limited Impact on Supply-side Factors:** Inflation targeting can **only control demand-side factors**, such as money supply and interest rates, and **may not be effective in addressing [supply-side shocks](#)** such as **crop failures, natural disasters, and global commodity price shocks** due to [disturbed geopolitics](#).
- **Limited Impact on Structural Issues:** Inflation targeting may not be able to address structural issues that contribute to inflation, such as **inefficient distribution systems, inadequate infrastructure, and bureaucratic hurdles**.
- **Conflict with Other Objectives:** Inflation targeting may conflict with other macroeconomic objectives, such as [economic growth](#), **employment, and income distribution**.

UPSC Civil Services Examination, Previous Year Question (PYQ)

Q1. With reference to India, consider the following statements: (2010)

1. The Wholesale Price Index (WPI) in India is available on a monthly basis only.
2. As compared to Consumer Price Index for Industrial Workers (CPI(IW)), the WPI gives less weight to food articles.

Which of the statements given above is/are correct?

- (a) 1 only
- (b) 2 only
- (c) Both 1 and 2
- (d) Neither 1 nor 2

Ans: (b)

Q2. Consider the following statements: (2020)

1. The weightage of food in Consumer Price Index (CPI) is higher than that in Wholesale Price Index (WPI).
2. The WPI does not capture changes in the prices of services, which CPI does.
3. The Reserve Bank of India has now adopted WPI as its key measure of inflation and to decide on changing the key policy rates.

Which of the statements given above is/are correct?

- (a) 1 and 2 only
- (b) 2 only
- (c) 3 only
- (d) 1, 2 and 3

Ans: (a)

Source: IE

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