INDIA NEWS

Panel Backs Inflation Targeting in India

Reserve Bank of India Panel Suggests Using a Consumer-Price Inflation Target

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MUMBAI—A Reserve Bank of India panel recommended Tuesday that the central bank start using a consumer-price inflation target to determine monetary policy.

The panel—set up soon after former International Monetary Fund chief economist Raghuram Rajan took over as RBI governor last year—was created to come up with ways to make the country's monetary policy more transparent and predictable.

In a 130-page report released Tuesday the panel recommended using a well-defined range of consumer-price index inflation to set monetary policy. The report suggested a CPI inflation rate target within two percentage points above or below 4%.

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By comparison, the U.S. Federal Reserve has an inflation target of around 2% over time.

The RBI panel said the central bank should move to lower India's consumer inflation, which has been close to 10% in recent months, to 8% within the next 12 months and to 6% in 24 months, before adopting the target.

"This transition path should be clearly communicated to the public," the report said.

If accepted, the report's recommendation would bring India in line with global norms by placing less emphasis on wholesale price inflation, which India has used until now as its main indicator of price movements.

Historically, the Indian central bank has followed a multifocus approach to monetary policy, setting interest rates based on how it sees inflation, growth and currency stability. It usually didn't have an official inflation target, which often left markets surprised by its moves.

Though RBI head Mr. Rajan wasn't part of this panel, its suggestions echo some of the governor's leanings.

"Focusing on a single objective—low and stable inflation—is ultimately the best way that monetary policy can promote macroeconomic and financial stability," Mr. Rajan said in a 2008 article that he co-wrote with Eswar S. Prasad, an economics professor at Cornell University and senior fellow at the Brookings Institution.

Mr. Rajan has reiterated this stance since taking over as the RBI chief, having raised interest rates twice to curb inflation.

Some economists say focusing on inflation isn't the best approach for a developing country like India. Worrying too much about inflation forces central banks to raise interest rates, which raises borrowing costs and hurts economic expansion.

"You can't lose sight of growth," said Sujan Hajra, chief economist for Mumbai brokerage firm Anand Rathi Financial Services Ltd.

The panel also suggested monetary policy be decided by a committee headed by the governor with final decisions through a vote of the committee members, as is the practice in some developed countries like the U.K.

Right now in India monetary policy decisions are made by the RBI governor alone, though he gets input from an advisory committee.

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