

RBI's Tightrope Walk: Balancing Inflation Control in India's Dynamic Economy

Moksha Kochar

Law student
MITWPU

Abstract- Control over inflation is the key to the maintenance of economic stability, and the Reserve Bank of India (RBI) exercises its influence through its monetary policy mechanism. According to Mishra and Patel (2017) , "the central bank's credibility and transparency are essential in anchoring inflation expectations" (p. 3). The present study examines the steps of the RBI in the regulation of inflation, and specifically its implementation of monetary instruments like the repo rate, reverse repo rate, Cash Reserve Ratio (CRR), Statutory Liquidity Ratio (SLR), Open Market Operations (OMO), and the Liquidity Adjustment Facility (LAF). The efficacy of these steps is evaluated in the context of achieving the dual objectives of price stability and economic growth (RBI, 2021). The article critically assesses the 2016 institutional change towards an inflation-targeting model, under which the Consumer Price Index (CPI) was officially established as the primary indicator of inflation. Under the Monetary Policy Framework Agreement (MPFA), this change was meant to "strengthen the RBI's accountability and enhance policy effectiveness" . The use of different case studies, including that of the COVID-19 pandemic, is used to demonstrate how the Reserve Bank of India (RBI) reoriented its strategies during crisis times to combat inflationary pressures as much as to promote economic recovery. Besides, the research analyses the complex interplay between monetary and fiscal policy in the context of inflation management against the backdrop of structural challenges such as global supply chain disruptions and external economic shocks. The findings determine the multi-dimensionality of inflation management in a heterogeneous and dynamic macroeconomic setting, providing us with food for thought with respect to the future trajectory of India's monetary policy over the next few years .

Keywords- Inflation, RBI, Cash Reserve Ratio, Monetary Policy, Repo Rate.

I. INTRODUCTION

In 2015, the Indian Parliament supplemented the Reserve Bank of India (RBI) Act of 1934 by embracing a more formal inflation targeting (IT) framework. Since the amendment came into effect on August 5, 2016, the RBI was required to achieve an inflation goal of 4% as measured by the Consumer Price Index (CPI) with a ± 2 percentage

point tolerance band (Government of India, 2016). The shift brought Indian monetary policy in line with best international practice and was also aimed at better anchoring inflation expectations. During the initial five years, inflation remained well within the targeted range, and the IT mandate was rolled over in 2021. Initial academic estimates attributed the RBI's inflation targeting with increased macroeconomic stability. Anand , Ding, and Tulin

(2018) believed that IT anchored household and business inflation expectations, thus improving policy credibility.

But this paper conducts a critical assessment of such assertions. For inflation targeting to be labelled effective, there must be evidence that Reserve Bank of India (RBI) has actually played an active role in influencing inflation dynamics—an assumption that is dependent on the empirical relevance of the New Keynesian Phillips Curve (NKPC) in the Indian experience. The NKPC model highlights the significance of forward-looking expectations in determining inflation ; however, some analyses of India's inflation targeting regime have not tested its appropriateness rigorously. This study addresses this lacuna by analysing the actual effects of inflation targeting on inflation and observing the post-2016 inflation experiences in an integrated framework.

The following is a brief and academically written version of the background section, including full APA-style citations and a clear structure:

Background: Anti-Inflation Policy Prior to Inflation Targeting Inflation targeting (IT) is only one of many strategies for inflation management and must not be interpreted as a rejection of inflation management as a priority macroeconomic objective. Friedman (1968) implies that control of inflation has been a focal point of economic policymaking for many years, with early monetarist models focusing on the management of money supply growth. Friedman is famously quoted as having stated that "inflation is always and everywhere a monetary phenomenon" , in defines of monetary aggregates as the ultimate tool for inflation management.

Conversely, inflation targeting is concerned with short-term interest rate adjustment, as opposed to the money supply, to gain price stability. This change is not a shift in the overall objective of inflation control but a shift in the instrument employed in operation . Proponents assert that interest rates are more exact control since they are under the direct authority of the central bank, in

contrast to the money supply, which can be manipulated by external variables .

While making such assertions, the empirical validation of the underlying economic model for inflation targeting—most commonly the New Keynesian model—has not yet been rigorously tested in the public discourse. Opponents have highlighted that the efficacy of inflation targeting depends on the model's ability to accurately portray inflationary real behaviour in the economy, an empirical validation and not a theoretical postulate . The current study reevaluates such very fundamental assumptions to determine whether inflation targeting in India has truly promoted price stability or whether results can be due to other policy or structural considerations.

Inflation Explained: Causes, Consequences, and RBI's Response Inflation refers to the persistent rise in the general level of prices of goods and services within a defined period, causing the purchasing power of money to decrease. The most frequent indicator of such an event is the Consumer Price Index (CPI) . Low inflation is generally regarded as an indicator of good economic performance, while high inflation reduces real income, discourages savings, and creates economic instability .

Key inflation causes include cost-push pressures (e.g., increase in input prices), monetary expansion (increase in money supply), demand-pull pressures (demand in excess of supply), and inflation expectations . In countries like India that are dependent on imports, currency depreciation and price shocks in the world economy also add to inflationary pressures.

The Reserve Bank of India (RBI) plays the role of maintaining price stability through the application of different monetary policy tools aimed at managing inflation to attain sustainable economic growth. As the Supreme Court of India recently emphasized, the RBI's inflation management role is crucial to maintaining macroeconomic stability .

Monetary Policy and Inflation Control in India

Monetary policy is the course of action by a nation's central bank to control the supply of money and interest rates in the economy with a view to attaining macroeconomic goals such as price stability, currency stability, and strong economic growth. In India, the Reserve Bank of India (RBI) is the major monetary body with the mandate of controlling inflation within a tolerable margin while fostering economic growth. As per RBI, "the primary objective of monetary policy is to maintain price stability while keeping in mind the objective of growth".

Inflation Targeting Framework: A Policy Regime Shift For the first time in 2016, the Government of India legalized the Inflation Targeting (IT) Framework under the Reserve Bank of India Act of 1934, as amended to require the Reserve Bank of India (RBI) to maintain, within a range of $\pm 2\%$, a Consumer Price Index (CPI)-based inflation rate of 4%. The adoption of the framework marked a landmark in India's monetary policy regime, bringing it at par with global best practices. As noted by Bernanke et al. (1999), inflation targeting "provides a transparent and accountable framework for monetary policy, helping to anchor expectations and reduce inflation volatility".

Tools of RBI for Controlling Inflation

For the purpose of implementing its mandate, the RBI uses a set of monetary policy tools. The tools affect the supply and price of credit, aggregate demand, and therefore the inflation rate.

Repo Rate: The Principal Instrument of Policy

The repo rate or repurchase rate is the interest rate at which the RBI lends short-term money to commercial banks. It is the benchmark rate in the economy. When there is inflation, the RBI increases the repo rate to discourage borrowing, thus lowering demand and preventing price increases. When there is recession, lowering the repo rate stimulates borrowing and investment. As Patra and Kapur (2012) describe, "the repo rate serves as an indicator tool, steering market interest rates and shaping inflation expectations".

Reverse Repo Rate: Absorbing Excess Liquidity

Reverse repo rate is the rate at which Reserve Bank of India (RBI) purchases funds from commercial banking institutions. An increase in the reverse repo rate prompts banks to place excess funds with the RBI, thus actually reducing liquidity in the economy and helping to stem inflationary pressures.

Cash Reserve Ratio (CRR): Credit Supply Restriction

The Cash Reserve Ratio (CRR) is the proportion of a commercial bank's total deposits to be kept as reservoirs with the Reserve Bank of India (RBI). A rise in the CRR tightens the money supply by restricting the funds to be used in lending operations, thus reducing inflationary pressures. According to the RBI (2022), "a higher CRR reduces the ability of banks to create credit, thus acting as a tool to moderate demand-pull inflation."

Statutory Liquidity Ratio (SLR): Promoting Fiscal Discipline SLR requires banks to hold a portion of their NDTL in liquid assets, for example, government securities. The SLR is varied to impact credit growth as well as liquidity, with the secondary impact of inflation. The instrument also serves to ensure banks' solvency and create demand for the government debt instrument.

Open Market Operations (OMO): Adjustments in Liquidity OMOs are government security transactions in the market. When the RBI sells securities, money is withdrawn from the system, removing inflationary pressures. When securities are bought, liquidity is injected and can be growth-inducing in deflationary or recessionary conditions.

Market Stabilisation Scheme (MSS): Targeted Liquidity Absorption The MSS was launched in 2004 to sterilize surplus capital inflows without affecting the normal borrowing program of the government. In MSS, the RBI sells special securities to mop up surplus liquidity. This instrument was especially helpful during the period of excess capital inflow or high government expenditure.

Data Analysis: Inflation Trends and RBI Interventions (2010–2023) Inflation in India over the

past decade has reflected a complex interplay between global economic developments, domestic supply-demand imbalances, and proactive monetary interventions by the Reserve Bank of India (RBI). From 2010 to 2023, the RBI has navigated multiple inflationary cycles using a dynamic mix of monetary policy instruments, especially the repo rate, under its Inflation Targeting Framework.

Annual Inflation Trends and Key Drivers

Table 1 outlines the annual Consumer Price Index (CPI) and Wholesale Price Index (WPI) inflation rates alongside macroeconomic events that influenced each year's inflation dynamics.

Table 1: Annual Inflation Rate in India (2010–2023)

Year	CPI Inflation (%)	WPI Inflation (%)	Key Events
2010	11.99	11.50	High food and fuel prices, global recovery post-2008
2011	8.87	9.60	Persistent high inflation due to supply-side shocks
2012	9.30	7.50	RBI raises repo rate to control inflation
2013	10.92	6.00	Oil price volatility, RBI intervention on liquidity
2014	6.00	5.60	Fall in oil prices, RBI focuses on inflation targeting
2015	4.91	2.00	Stable inflation due to low oil prices
2016	5.39	3.80	Launch of Inflation Targeting Framework (RBI)
2017	3.33	2.00	Decline in food inflation, stable oil prices
2018	3.69	4.30	Stable inflation despite moderate rise in fuel prices
2019	7.66	3.30	Spike in food inflation (vegetables, pulses)
2020	6.62	5.00	Impact of COVID-19, logistical challenges
2021	5.59	7.40	Supply chain disruptions due to COVID-19
2022	7.50	10.00	Surge in oil prices, global inflationary

			pressures
2023	6.51	8.70	Post-pandemic recovery, global inflationary pressures

From 2010 to 2013, India experienced persistently high inflation, largely driven by elevated food and fuel prices. In response, the RBI increased the repo rate multiple times, peaking at 8.5% in 2011, as a means to dampen demand and stabilize prices (RBI, 2011). As Subbarao (2013), then-Governor of RBI, stated, "tight monetary policy is a necessary pain to curtail inflation expectations and restore macroeconomic balance."

The introduction of the Inflation Targeting Framework in 2016 marked a significant policy shift. This institutionalized a medium-term inflation target of 4%, with a tolerance band of $\pm 2\%$ (RBI, 2016). The move enhanced RBI's credibility, enabling better anchoring of expectations, particularly during global disinflationary trends.

From 2017 to 2019, inflation remained relatively stable. However, a sharp rise in food prices—especially vegetables and pulses—in 2019 led to a CPI inflation spike to 7.66%, prompting tighter liquidity controls and signalling hikes.

Post-COVID Inflation Management (2020–2023)

The onset of COVID-19 in 2020 brought new challenges. Supply-chain disruptions, labour shortages, and fuel price volatility pushed inflation upwards while the economy contracted. The RBI responded with an accommodative stance, cutting the repo rate to a historic low of 4.00% to support growth (RBI, 2020). According to Das (2021), "monetary policy during the pandemic had to balance between inflationary risks and the urgent need to revive economic momentum."

In 2022, as global oil prices surged due to geopolitical tensions, CPI inflation rose to 7.50% and WPI to a staggering 10.00%. The RBI cautiously shifted toward policy normalization, gradually hiking the repo rate from 4.00% in early 2022 to 6.50% by late 2023.

Component-Wise Breakdown of Inflation Contributors

A deeper examination reveals that food and fuel consistently accounted for a significant portion of CPI inflation between 2015 and 2023. Table 2 demonstrates how food and beverage inflation frequently exceeded 40% of total inflation contributions, highlighting the supply-sensitive nature of inflation in India.

Fuel and light inflation spiked sharply in 2022–2023 due to global energy price shocks. The RBI, in response, used a combination of Open Market Operations (OMO) and reverse repo rate adjustments to manage liquidity and minimize second-round effects .

Table 2: Contribution of Various Components to Inflation (2015–2023)

Year	Food & Bever ages (%)	Fuel & Light (%)	Housi ng (%)	Miscella neous (%)	Core Inflatio n (%)
2015	30.10	10.00	12.50	47.40	4.91
2016	37.40	10.00	13.00	39.60	5.39
2017	27.00	11.00	14.00	48.00	3.33
2018	30.20	10.50	13.50	46.80	3.69
2019	38.10	12.00	11.00	38.90	7.66
2020	44.50	9.00	12.50	34.00	6.62
2021	42.00	12.00	11.00	35.00	5.59
2022	46.50	15.00	10.50	28.00	7.50
2023	43.00	16.00	11.50	29.50	6.51

Recent Trends and Monetary Response (2024–2025)

In December 2024, CPI inflation was recorded at 5.22%. Observing the downward trajectory and the need to boost consumption, the RBI reduced the repo rate by 25 basis points to 6.25% on February 7, 2025 (Reuters, 20 25). The inflation rate further declined to 4.31% in January 2025 and 3.61% in February 2025, demonstrating effective transmission of the monetary easing cycle (Trading

Economics, 2025). As Das (2025) remarked , “the easing was timely and measured, ensuring continued price stability while supporting growth in a recovering economy.”

Synthesis: Efficacy of RBI’s Monetary Strategy

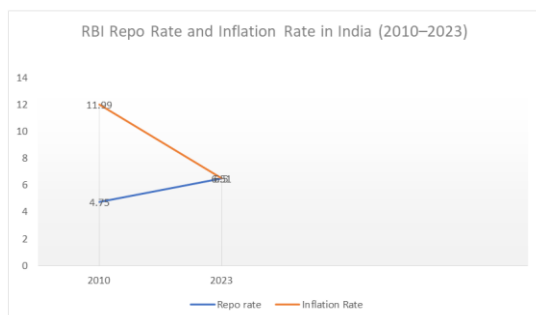
The RBI’s calibrated interventions between 2010 and 2023 showcase a pragmatic balance between inflation containment and growth facilitation. While structural inflation—particularly food-related—remains challenging, inflation targeting and real-time policy adjustments have strengthened macroeconomic stability. Academic literature supports this approach: “Clear communication and inflation targeting reduce inflation volatility by anchoring expectations”

As India continues its growth trajectory, future inflation management will likely require tighter coordination between monetary policy and fiscal instruments, especially as external shocks and climate risks impact food and fuel prices.

Repo Rate Adjustments and Inflation Control (2010–2023)

Repo rate adjustments have remained the cornerstone of the Reserve Bank of India’s (RBI) monetary policy framework, serving as the primary lever to influence inflation, liquidity, and overall economic activity. By altering the repo rate—the rate at which commercial banks borrow funds from the RBI—the central bank either tightens or loosens monetary conditions, thereby managing inflationary expectations and aggregate demand.

Between 2010 and 2023, India experienced multiple inflationary cycles driven by domestic supply-side constraints, international oil price volatility, and major global disruptions like the COVID-19 pandemic. During this period, the RBI strategically adjusted the repo rate in alignment with its evolving macroeconomic priorities.



In 2010, consumer inflation surged to 11.99%, driven largely by elevated food and fuel prices amid a global economic rebound post-2008 (World Bank, 2010). To rein in demand-side inflation, the RBI raised the repo rate aggressively, peaking at 8.50% in 2011. The central bank aimed to signal its commitment to price stability, with then-Governor Duvvuri Subbarao asserting that “monetary tightening, though painful in the short term, is essential to anchor inflationary expectations and ensure long-term growth ” (Subbarao, 2011, p. 4).

In contrast, 2015 and 2016 witnessed a significant moderation in global oil prices and a decline in headline inflation. Seizing the opportunity, the RBI pursued a more accommodative stance, reducing the repo rate to 4.75% in 2016—its lowest in several years. This dovish shift coincided with the adoption of the Inflation Targeting Framework in 2016, which formally committed the RBI to maintaining CPI inflation at 4% $\pm$ 2%, enhancing its policy transparency and accountability (RBI, 2016).

From 2020 onwards, the Indian economy faced unprecedented headwinds due to the COVID-19 pandemic. Lockdowns triggered a demand shock, while supply chain bottlenecks and logistical constraints led to sharp supply-side inflation, particularly in food and essential goods. During this phase, the RBI reduced the repo rate to an all-time low of 4.00% in 2020, prioritizing economic recovery over inflation containment (RBI, 2020). Governor Shaktikanta Das explained, “We are living in extraordinary times, and extraordinary times require extraordinary measures. The focus of monetary policy must remain supportive of growth while keeping a close watch on inflation” (Das, 2020).

However, by 2022, global inflationary pressures resurged due to skyrocketing oil prices and geopolitical tensions—particularly the Russia–Ukraine conflict. Consequently, CPI inflation rose to 7.50%, surpassing the RBI's upper tolerance limit. In response, the central bank shifted toward a calibrated tightening path, gradually hiking the repo rate from 4.00% to 6.50% by the end of 2023 (RBI, 2023). These actions signalled the RBI's intent to re-anchor expectations and curb generalized price pressures.

The Impact of External Shocks on Inflation and RBI Responses

India's inflation trajectory during this period was significantly influenced by global macroeconomic shocks. The COVID-19 pandemic in 2020 created simultaneous demand and supply shocks. The resultant inflation was primarily supply-driven, with food prices rising sharply due to transportation and labour shortages. The World Bank (2020) noted that “pandemic-induced bottlenecks caused persistent spikes in food inflation across emerging markets, including India.”

Similarly, international oil price fluctuations posed recurrent threats to inflation stability. In 2022, Brent crude soared above \$120 per barrel, increasing transportation and input costs across sectors. Despite these pressures, the RBI's calibrated tightening helped stabilize inflation expectations, demonstrating the effectiveness of its “gradualist” approach (IMF, 2023).

Inflation Targeting Framework (2016–2023): A Structural Shift

The adoption of Inflation Targeting (IT) in 2016 marked a pivotal shift in India's monetary regime. Anchored in the amended RBI Act (2016), the IT framework empowered the Monetary Policy Committee (MPC) to explicitly target inflation while considering output growth.

According to Mishkin (2019), “credible inflation targeting improves transparency and reduces inflation volatility by aligning public expectations with central bank goals.” This has largely held true for India, where the RBI's communication strategy,

forward guidance, and transparency post-2016 have helped build market confidence—even amid external shocks.

For example, in years like 2017 and 2018, headline inflation fell below 4%, reflecting both supply-side ease and the credibility of RBI's policy signalling. Even during inflationary surges in 2022–2023, RBIs measured tightening under the IT framework helped contain second-round effects and preserve macroeconomic stability

II. CONCLUSION

Repo rate adjustments have proven to be the RBI's most potent instrument for inflation control over the last decade. From aggressive tightening during demand-led inflation in the early 2010s to strategic easing post-2016, and cautious tightening during global oil price surges, the RBI has used the repo rate not just as a tool of price management, but as a signal of its evolving policy stance. Coupled with the Inflation Targeting Framework, these adjustments have reinforced the RBI's institutional credibility and helped balance the dual mandates of inflation control and growth promotion.

Inflation Targeting: Effectiveness, Challenges, and the Road Ahead

The Reserve Bank of India's adoption of the Flexible Inflation Targeting (FIT) framework in 2016 marked a transformative shift in India's monetary policy regime. This framework, which targets CPI inflation at $4\% \pm 2\%$, significantly enhanced policy transparency, predictability, and market credibility. Between 2016 and 2020, inflation largely remained within this tolerance band, with the RBI successfully mitigating pressures from supply-side shocks—particularly food price volatility (Reserve Bank of India, 2023). As RBI Governor Shaktikanta Das noted, "The inflation targeting regime has strengthened the credibility of monetary policy and enabled better anchoring of expectations" (RBI, 2021).

However, inflation control in India remains constrained by several persistent and emerging challenges:

- **External Shocks:** Global developments, such as crude oil price spikes and the COVID-19 pandemic, have had direct implications for domestic inflation. The World Bank (2021) observed, "India's inflation trajectory is increasingly influenced by global economic disruptions and commodity price volatility."
- **Structural Limitations:** Supply-side bottlenecks—ranging from inefficient logistics to inconsistent agricultural productivity—have continued to push food inflation beyond the RBI's immediate reach (Sharma, 2021). As Sharma writes, "Food inflation in India is as much a function of policy and infrastructure as it is of climate or global trends."
- **Imported Inflation and Global Pressures:** As Mohanty (2017) points out, "India, like other emerging economies, remains vulnerable to imported inflation through commodities and currency fluctuations." These global linkages often weaken the domestic impact of repo rate adjustments.

Despite these headwinds, the RBI's forward guidance, timely repo rate actions, and open communication have proven critical in anchoring inflation expectations. By signalling policy intentions, such as through policy stance shifts and rate guidance, the central bank has been able to stabilize market behaviour and sustain investor trust. According to Iyer and Patel (2019), "Transparent communication by central banks enhances the effectiveness of monetary policy by aligning market expectations with policy objectives."

Persistent and Emerging Challenges

Going forward, several structural and cyclical factors may continue to test the RBI's inflation management toolkit:

- **Oil Price Volatility:** With over 80% of its crude oil being imported, India's inflation is acutely sensitive to global energy markets (World Bank, 2021). This limits RBI's control over cost-push inflation.
- **Food Price Instability:** Monsoon variability and weak cold-chain infrastructure make food prices highly erratic. According to Sharma

(2021), "Food price inflation in India is often the result of avoidable supply chain disruptions and not just global food trends."

- **Transmission Inefficiencies:** The effectiveness of repo rate adjustments is often diluted due to structural rigidities in India's banking system, which hinder smooth and timely transmission to lending rates (Mohanty, 2017).
- **Currency Depreciation and Fiscal Constraints:** External borrowing pressures and domestic political commitments to populist spending can limit the scope for monetary manoeuvring.

Conclusion: Strategic Flexibility Amid External Volatility

The RBI's inflation-targeting strategy has played a pivotal role in preserving macroeconomic stability. By adopting a structured, rules-based policy anchored in inflation control, the central bank has gained credibility and effectively tamed inflation expectations during periods of domestic calm. Nevertheless, external vulnerabilities—especially global oil price movements, currency shocks, and geopolitical uncertainties—continue to present complex challenges.

Yet, the RBI's agility in adjusting its stance in response to evolving conditions has been commendable. As noted in the RBI's Monetary Policy Report (2023), "The key to effective inflation management lies not in rigid adherence to rules, but in adapting tools dynamically to changing realities."

To ensure future effectiveness, the RBI must work in tandem with the government to implement long-overdue supply-side reforms, improve financial transmission mechanisms, and bolster fiscal discipline. In an increasingly globalized and volatile economy, a coherent blend of monetary foresight, structural reform, and institutional coordination will be essential to navigating inflationary pressures and safeguarding India's economic resilience.

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