Discussion of "Inflation Targeting in India: An Interim Assessment"

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Main Results

- The authors provide a preliminary assessment of India's experience with inflation targeting
  - de facto adoption April 1, 2014; GoI signed the MPFA adopting FIT on Feb 20, 2015; RBI Act Amended in May 2016; First MPC Meeting October, 2016; MPFA extended on March 31, 2021, for another 5 years
- The paper estimates a reaction function for the RBI and how the reaction function changed with a shift to FIT. Authors find that the RBI was true to it's mission of being a flexible inflation targeter between October 2016 - May 2020
  - I.e., the RBI did not neglect changes in the output gap when setting policy $\Rightarrow$ not an inflation nutter

Main Results

- Food price inflation has a larger and consistent impact on core-inflation and not vice versa
- Second moments of a number of inflation related outcomes (inflation, inflationary expectations, other variables such as the stock market, WACR, stock market) were more lower/more stable post IT adoption. Volatility of output growth also lower.
- Inflationary expectations (π^e) (both SPF and Household) better anchored both ways
  - Pass through from π to π^e for the SPFs have declined significantly (Table 15)
  - From π^e to π, authors find that no impact from household π^e, and generally muted for SPFs.

Main Results

- In COVID, greater anti-inflation credibility allowed the RBI more space to move "big and early", i.e., more policy room to maneuver
- The authors also find that monetary transmission (from money market rates to bank lending and deposit rates) did not improve with the adoption of FIT
  - In October 2019, the RBI shifted to external benchmarking. $\Longrightarrow$ *all* SCBs have to link all new floating rates to an external benchmark (e.g., RBI's repo rate, GoI 3-6 month T Bill rate etc.) published in by the FBIL
  - External benchmarking means that transmission to lending rates is not contingent upon interest rates on deposits

General Comments

- Important paper, well written, detailed
- The authors results obtain despite
  - The large number of shocks during the period (AQR in 2015, Demonetization in 2016, Implementation of the GST in 2017, Shadow Banking Crisis, 2018-2019), Terms of Trade, Covid (2020-)
  - Data problems (Measurement issues, informality)
  - Channels of transmission weak (various chapters of Ghate and Kletzer (2016))
- What is missing however is *a discussion of why* they get the results they do.
  - Increased credibility ? Brainard Attenuation Principle ? Change in Governor ?
- First version of this paper appeared around July 2020
  - Needs to be updated/differentiated in light of RBI's Report on Currency and Finance (March 2021)

Specific Comments: Reaction Function

- Authors estimate

$$i_t = \alpha_0 + \alpha_1 \tilde{y}_t + \alpha_2 \pi_t + \alpha_3 i_{t-1} + \nu_t$$

- Estimated coefficients are small but significant under OLS and GMM
- GMM has been shown to be biased in small samples.
  - Robustness could be established using Max. Likelihood / Iterative GMM. See Florens et al. (2001)
- What channel of transmission do the authors have in mind ? Interest Channel ? Credit Channel ?. But the authors talk about an expectations channel.
- Why not estimate

$$i_t = \alpha_0 + \alpha_1 E_t\{\tilde{y}_{t+1}\} + \alpha_2 E_t\{\pi_{t+1}\} + \nu_t$$

- Also re-estimate a forward looking version of the Var.of interest regression with pre-post GFC Dummies

Specific Comments: The role of credibility

- Lots of ways to measure credibility
  - Direct tests / Indirect tests
- Sometimes a well functioning Central Bank adopts FIT just as a bona-fide
  - High and variable π in India before the adoption of inflation targeting$\Rightarrow$ FIT adopted to deal with a credibility challenge.
- Credibility signal was stronger not just because of divine co-incidence but because the MPC was willing to accept a high negative output gap when it reduced $\pi \Rightarrow$ lent the RBI more credibility as an inflation targeter
- For indirect tests, should check that periods of disinflation should not have a large sacrifice ratio in later years (Erceg and Levin, 2003)
- Credibility of a Central Bank can also be gauged by its ability to anchor inflationary expectations
  - Time invariant models clash into the Lucas critique. See Alex (2021) who uses a time varying trend (UC-SV) model through which one can capture long term π^e.

Specific Comments: Policy Efficiency

- Schmidt-Hebbel and Carrasco (2016) provide a nice review of IT in EMDEs
  - IT has contributed to significantly reduce long term inflation rates both in comparison to NIT EMDEs and to their own pre - IT history
  - IT has contributed to a better anchoring of IE
  - Evidence on monetary policy efficiency shows large gains for EMDEs on IT. See Chechetti et al. (2006).
- Overall, comparative advantage of IT is generally not reflected in improved first and second moments of inflation and output but in the above factors
- Using Chechetti et al. (2006), the authors should also construct a policy efficiency frontier for India, and see if the distance between India's performance pre FIT and the efficiency frontier declined in the post FIT period. This would reflect gains in monetary policy efficiency.

Specific Comments: Econometrics

- Robustness with respect to credit growth / credit channel
  - Role of NBFCs versus SCBs.
- (Table 17-18) Cut in policy rates was -1.31% for ITers compared to -0.90 for Non-ITers; India cut by -1.15% between December 2019 - May 2020 during COVID
  - Is this the effect of FIT per se ? Have other characteristics in DEs been adequately controlled for ? Endogeneity ?
  - Broad instruments are used but not clear how these instruments control for country specific characteristics. Country FE ? Month FE ?
- The paper claims that "Food price inflation has a larger and more consistent impact on core inflation than vice-versa"
  - Granger causality tests mean that the explanatory variables can help to *predict* the dependent variable; but it is not sufficient to establish causality. This test could be passed even if there is a third factor affecting both variables
  - Discussion of results needed (see Aoki (2001), Ghate et al. (2018), Bahl et al. (2020))

- Thank you