Structural Factors vs. Monetary Tools

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Structural Factors vs. Monetary Tools: Rethinking Inflation Control

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Context:

In **May 2025**, India's **inflation rate dropped below 3%**, celebrated as a sign of successful monetary policy by the **RBI**. However, a deeper analysis reveals that this decline masks **rising unemployment** and a **broad economic slowdown**, raising concerns about the **true health of the economy**.

Inflation vs. Unemployment: A Contradictory Trend

- **Inflation** fell from **3.2% (April)** to **2.8% (May 2025)**.
- **Unemployment** rose from **5.1% to 5.8%** in the same period (PLFS data).
- While lower inflation benefits those already employed, it **does nothing for the unemployed**, especially those in **informal and migrant sectors**.
- Dominant economic narratives often **exclude these vulnerable groups**, creating a **class-based bias** in policy celebrations.

Growth Slows Down Sharply

- **GDP growth** fell from **9.2% (2023–24)** to **6.5% (2024–25)**.
- This slowdown is consistent with rising unemployment.

- According to **NSO**, nearly **all sectors decelerated**, **except agriculture** and **public administration**.

- Despite this, media focus remains largely on inflation, **ignoring growth and employment concerns**.

Why Did Inflation Fall? Not Due to Monetary Policy

- **Food inflation** dropped from nearly **11% (Oct 2024)** to under **1% (May 2025)**.

- This is due to **strong agricultural output**, narrowing the supply-demand gap.

- The **repo rate** has been unchanged since **June 2022**, indicating that **RBI policy wasn't the direct cause** of this decline.

- Even **service sectors**, less affected by credit, showed a slowdown—further weakening the argument for monetary policy effectiveness.

Limits of Monetary Policy in Indian Context

- India follows an **inflation targeting model** that adjusts **interest rates to control demand**.

- However, inflation in India is often driven by **structural supply-side issues**, especially in **agriculture**.

- **Monetary tightening** may offer **temporary relief**, but it's **ineffective long-term** in addressing such structural factors.

- A 2025 study (Structural Change and Economic Dynamics) shows **interest rates have little impact** on inflation; **agriculture plays a larger role**.

Inflation Expectations & RBI Credibility

- RBI argues that its policy shapes **inflation expectations**.

- However, **household expectations** remained **high and stable** from **March 2024 to May 2025**, **well above the 4% target**.
- This undermines the idea that RBI policy has anchored expectations.
- RBI's stance to **lower repo rates further** if inflation continues to fall suggests a **reactive, not proactive**, policy approach.

Conclusion: Inflation Alone Does Not Reflect Economic Health

- The recent fall in inflation must be viewed **alongside rising unemployment and slowing growth**.
- Data indicates the **real driver of low inflation** is **agricultural growth**, not **monetary policy**.
- Overemphasising interest rates while **ignoring job losses and sectoral imbalances** offers a **misleading picture**.
- A **balanced approach** is needed—one that:
    - **Acknowledges monetary limits**,
    - **Strengthens structural reforms**, and
    - **Bridges the gap between agricultural and non-agricultural sectors**.