Indian Economy · GS - III

Examine the challenges faced by central banks in responding to inflation caused by geopolitical energy-supply shocks. Should monetary tightening be the primary response to such inflation?

EXAM YEAR	PAPER	SUBJECT
DAILY PRACTICE 13/11/2026	GS - III	Indian Economy

MARKS	WORD LIMIT
10	~150 words

Answer Hint

Cost-push inflation, imported inflation, headline and core inflation, supply-side disruption, monetary transmission, inflation expectations, growth-inflation trade-off, fiscal intervention.

Model Answer

Introduction

Geopolitical conflicts can disrupt energy supplies and increase international crude oil prices, transmitting inflationary pressures across economies. Such inflation presents a challenge for central banks because its origin lies primarily on the supply side.

Monetary Policy Challenges

Higher energy prices increase transportation, manufacturing and electricity costs, creating cost-push inflation. Monetary tightening may moderate aggregate demand and prevent inflation expectations from becoming entrenched, but it cannot directly restore disrupted energy supplies.

Excessive tightening may also increase borrowing costs, discourage investment and weaken economic growth. Central banks must therefore distinguish temporary headline inflation from persistent core inflation.

Appropriate Policy Response

A balanced approach should combine calibrated monetary policy with supply-side interventions. Diversifying energy imports, strengthening strategic petroleum reserves, improving renewable energy capacity and rationalising supply-chain bottlenecks can reduce vulnerability. Targeted fiscal support may protect vulnerable households without generating excessive demand.

Conclusion

Monetary tightening should depend on the persistence and second-round effects of inflation rather than temporary price fluctuations alone. Policy coordination is essential to balance price stability with economic growth.

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