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As the Indian economy recovers from significant volatility in FY25, only to start FY26 with further escalation in global uncertainties, the RBI's Monetary Policy deliberations next week will be closely watched for policy signals to navigate the challenging economic landscape.

Minutes of the MPC deliberations in February, when the MPC decided to pivot towards a rate cut, indicate a clear shift in the MPC's focus towards supporting economic growth. Since then, inflationary concerns have further receded and the projected inflation trajectory for the next seven to eight months remains benign as well.

As MPC's focus shifts from concerns about inflation to supporting growth, lower headline inflation opens up policy space for deeper rate cuts. Besides, with headline inflation level trending below 4% now, real interest rate in the economy is currently running at over 2.25% levels, well over RBI's indicated neutral real rate range of 1.4-1.9% for India. From that perspective, real interest rate in the economy is impinging on growth impulses. Minutes of last MPC show that one of the members even argued that the policy repo rate might soon become excessively restrictive, increasing the risk of damaging growth impulses. Policy rates thus must be moved lower by 50-75 bps further to bring real interest rates in neutral range.

From domestic perspective, hence, there is both a need and policy space to cut interest rates by 25 bps next week and follow it up with a few more rate cuts later in the year. Global backdrop however remains uncertain. Liberation day tariff announcements by US president have further escalated global uncertainties.

The 10% baseline tariff on all countries and reciprocal tariffs on 180 countries are well above prior market expectations. Use of bilateral deficit, currency manipulation and non-tariff barriers to estimate tariffs faced by US makes it difficult to measure the degree of disruptions. It can potentially trigger responses from various countries and rewire global trade flows.

The likely impact on the Indian economic parameters such as exports and growth will remain uncertain for the time all these tariff and trade uncertainty take to settle. As RBI calibrates monetary policy responses to changing geopolitical dynamics, it would be prudent to continue with its Neutral stance.

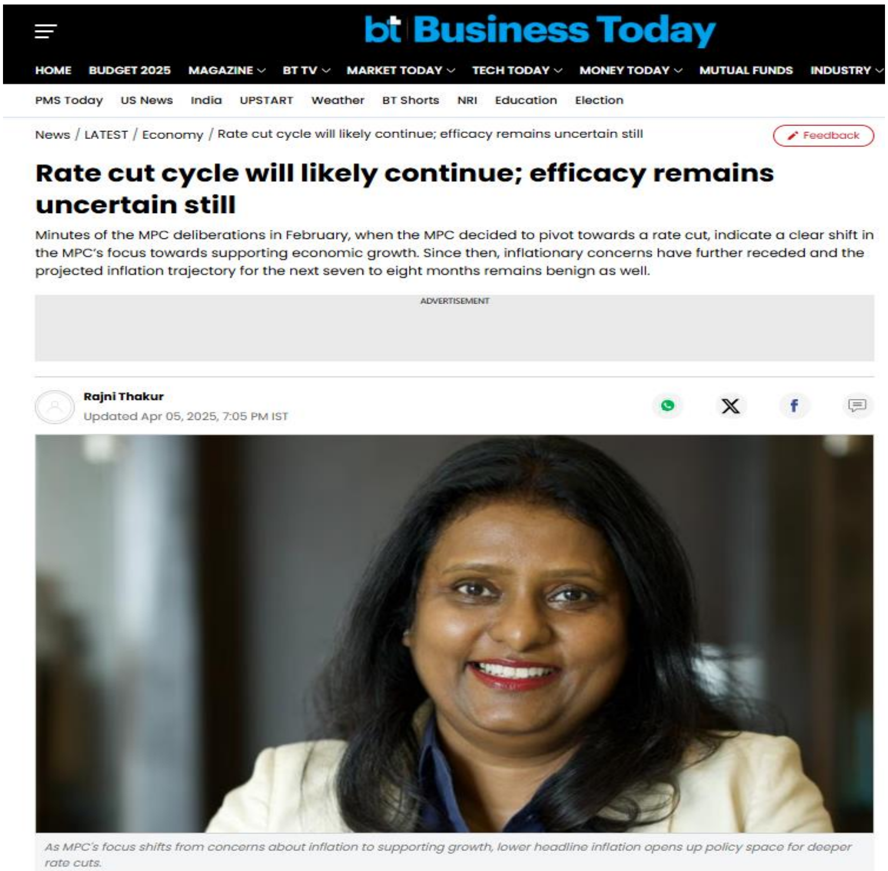
The real question facing MPC is not if they should cut interest rate in April, rather, how deep should current rate cut cycle go, to protect growth impulses from domestic and global challenges. Terminal interest rate for the rate cut cycle that RBI started in February 25, is the big unknown and MPC's assessment of current economic conditions should provide some clarity on cumulative rate cut over the cycle.

Another challenge facing MPC when they meet next week is to increase the efficacy of policy rate cuts. Any decision to lower rates should reduce borrowing costs, spur investment, and provide relief to consumers grappling with high interest rates on loans. However, liquidity needs to be positive in a meaningful way for the rate cut transmission to happen.

Liquidity in the banking system has been in deficit since mid-December 2024, despite various measures to infuse the long-term liquidity in the system. While we expect liquidity measures from the RBI to continue in the early part of FY26 as well, we also expect RBI to double down on increasing transmission and lowering borrowing costs.

Overall, MPC is likely to continue the rate-cutting cycle, with another 25 bps reduction in the repo rate in the April MPC meeting, while maintaining a neutral stance amid global headwinds. RBI will also likely continue with a dovish policy tone, and assurance on liquidity. Any signal on durable liquidity infusion and terminal policy rate will be an added bonus.

The author is Chief Economist, L&T Finance Ltd.
Views expressed by the expert are his/her own.



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Rajni Thakur
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