Portal:	ET BFSI	Edition: NA	Online
Published Date	10th April 2025	Category:	A
Headline: RBI emphasises on relative insulation of Indian economy amidst global volatility			

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https://bfsi.economictimes.indiatimes.com/blog/rbi-emphasises-on-relative-insulation-of-indian-economy-amidst-global-volatility/120150029

With the global backdrop of trade war, potential supply chain disruptions and general uncertainty, Central banks across the globe are pressed to calibrate their responses and policy actions. Emerging market central banks, in particular, are faced with tough choice between supporting economic activity and fragile financial stability amidst volatile global economic scenario. With less than a week since U.S tariff announcements triggered global markets sell off, RBI stepped up as a first-mover among the doves, with its bold stance of focus on domestic economic fundamentals amidst external challenges.

As tariff war starts to hurt global growth, doubling down on supporting domestic consumption and investment seems to be the most appropriate risk minimization strategy. Global uncertainties can potentially amplify already flagging growth trends domestically, and on other hand, long-running worries about inflation and currency weakness have started to ease in recent weeks. The Monetary Policy Committee was thus faced with economic conditions where both inflation and growth outcomes can undershoot target levels. Inflation projections below the targeted 4% level for most part of the year, opens up more policy space to cut as well. Policy action in terms of 25 bps rate cut and stance change to ‘accommodative’, were hence, broadly along the expected lines.

It was the all-out dovish tone of the policy statement that really delivered its punch. The tariffs' hit to Indian GDP growth is estimated to be 20 bps for now, bringing down FY26 GDP growth projection from 6.7% to 6.5%. RBI’s broad comfort with domestic growth signals despite hit on exports, durable softening in inflation levels and relative insulation from global tariff war, indicates calm policy response in contrast to agitated markets reactions to global developments. Promises to act pro-actively as global uncertainties pace out were reassuring as well. There were plenty of assurance of adequate and predictable liquidity. Since December, RBI has unleashed its full toolkit for liquidity management, ensuring liquidity on demand and pushing the financial system liquidity into surplus in the new fiscal year. As economy starts to adjust to lower rates, and with continued surplus liquidity, medium term interest rates should start coming down as well, helping lower rate transmission to broader economy.

All out dovish tone and stance change is also suggestive of more monetary policy support going ahead. Broader markets will pivot away from shallow rate cut expectations to deeper easing cycle this year now. RBI has lowered its inflation forecast for FY26 to 4% from 4.2% earlier and short of sharp depreciation of the rupee or a significant price shock, we will likely see policy rates going further lower in coming months. However, global conditions are very dynamic and Central Bank will likely stay cautious in favour of a calibrated and measured monetary policy response. Terminal rate level expectations are hence likely to stay volatile in line with market sentiments. At this point, however, cumulative 50-bps rate cut in 2025 seem to be most plausible and each MPC meeting will remain live in the year.

For the risk assets, two back-to-back interest rate cuts will have limited impact, given the concerns on ripple effects of US tariffs. Markets will remain cautious and reconfiguration of economic priorities is likely to add headwinds to domestic currency. Sovereign bond yields however should trend downwards, with constant interplay of currency and liquidity pressures adding bouts of volatility. As one of the first few Central Banks across the globe to decide on monetary policy response post U.S. tariff trigger, RBI's statements and tone has hit all the right notes. We are probably not past the last of GDP projections cut and hence rate expectations remain fluid as well. In the clouded visibility scenario, the only certainty that economy can take comfort in, for now, is the all-out policy support.

RBI emphasises on relative insulation of Indian economy amidst global volatility

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Rajni Thakur • ETBFSI
Updated On Apr 10, 2025 at 06:38 PM IST

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