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FED'S MARCH POLICY AND ITS RAMIFICATIONS IN INDIA

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The Fed considers multiple things in its risk matrix, such as setting interest rates to check inflation and promote economic growth, managing the money supply in the financial system, regulating financial institutions like banks, and maintaining financial stability during an economic crisis.

However, the Fed is charged with the twin goals of maintaining full employment and low prices. In the wake of heightened global uncertainty and increased business complexities stemming from President Donald Trump's significant policy changes, including sweeping duties, the Fed held the rates steady. This was fully anticipated because "*uncertainty around the economic outlook has increased*". But "*the Committee is attentive to the risks to both sides of its dual mandate*."

Double Whammy

In this disconcerting overarching environment of incessant change and churn, a world marked by intensifying rivalries, shifting alliances, and emerging technological and economic power plays, some analysts fear the dreaded specter of stagflation, which could be the worst of both worlds. Given the double whammy of rising inflation and sluggish growth, the US Fed held the rates steady for a second straight meeting because of decelerating growth and persistently sticky inflation.

Accordingly, the Federal Open Market Committee (FOMC) voted on March 19, 2025, to keep the benchmark federal funds rate at 4.25%-4.5%. Chair Jerome Powell acknowledged that tariff impacts are not amenable to prescient forecasts. Hence, there was a need for greater clarity on the effects of a blitz of policy changes on trade, immigration, fiscal policy, and regulation by President Trump influencing the economic landscape.

Powell held that "*hard data*" show the economy is still solid and long-run inflation expectations remain well anchored. However, a University of Michigan survey revealed that consumers expected prices to rise at an annual rate of 3.9% over the next five to 10 years, the highest in more than three decades- not "*an outlier*" as Powell said derisively. The truth may be harsh and aggressive, but a state of denial is meaningless. The reality, however unpleasant, must be faced squarely to devise appropriate policy formulations in a rapidly changing world of "*tariff turmoil*". The Fed announced a further scaling back of its "*quantitative tightening*" program. From April 2025, it will allow only USD 5 billion of maturing treasury security bonds to run off its balance sheet, and the remainder will be reinvested from the USD 25 billion rate of running off from the balance sheet that is occurring now. The Fed will continue to allow USD 35 billion of bonds under its mortgage-backed securities to run off its balance sheet. Governor Christopher Waller, who supported steady rates, dissented from the balance sheet decision.

Sliding Growth, Rising Inflation

The American economy today is characterized by extensive transformation in almost all spheres of life and economic activity, viz., technology, demographics, climate, and infrastructure. Such tectonic changes are changing the form and substance of the American economy in ways that were not even visualized earlier. Such changes are manifested across the development spectrum, including the rise of AI-driven industries and the geographic migration of talent and capital.

In this transforming socio-economic milieu, the Fed forecasted two rate cuts for this year and expected the core personal consumption expenditures price index, the Fed's preferred inflation gauge, to rise to 2.8% in 2025, up from a prior forecast of 2.5%. It also expects GDP at 1.7% this year, down from the earlier forecast of 2.1%. A granular analysis reveals that the lowering of the growth estimate exceeds the raising of its inflation estimate and causes widespread concern.

Reading Between the Lines - Fed Behind the Curve?

Sometimes not taking a decision, as PV Narasimha Rao, former India's Prime Minister, stressed, is also a decision. Powell's use of the jettisoned word "*transitory*" for inflation baffled most people because the Fed used this word when inflation spiralled post the Covid-19 pandemic.

Are we reading it wrong or focusing on "*the initial shift in the price level — a one-time increase arising from tariffs — but not on the possibility that tariffs could result in persistently higher inflation*" is wrong as cogently argued by Professor Ellen Meade, Duke University? We have argued elsewhere that this escalation of US tariffs under the Trump administration will hurt growth, raise prices, and worsen inequality. But it's still unclear who will get hit, and by how much.

Roadmap Ahead

Going ahead, the Federal Reserve indicated the possibility of two interest rate cuts this year. Chairman Jerome Powell averred, "*We're not going to be in any hurry to move.*" He also said that the "*current policy stance is well-positioned to deal with the risks and uncertainties we face… (and that) the right thing to do is to wait here for greater clarity about what the economy is doing*".

The 'dot-plot' showed the median of members expected a 50-bps cut in 2025 and a 50-bps cut in 2026. However, more members called for the FOMC to effect fewer rate cuts for 2025 than in the earlier meeting.

Indian Standpoint

"*In any moment of decision, the best thing you can do is the right thing, the next best thing is the wrong thing, and the worst thing you can do is nothing*". Theodore Roosevelt

The inexorable forces of globalization have increasingly unified the world economy, what we in India have called for thousands of years "*vasudhaiva kutumbakam*", i.e., the world is a community. In the present-day world, no country, more so a large and growing economy like India, can be "*an island in the stream*" (to paraphrase Nobel Laureate Ernest Hemingway) because of the elaborate interdependencies and interlinkages.

Until a few months back, India was estimated to surpass Japan to become the fourth-largest economy in 2026. But given the virtual stagnation in the Japanese economy and the steep depreciation in the Yen's external value, it is given that India will overtake Japan to become the fourth-largest global economy by 2025. What lends credence and significance to this assessment is that apart from multilateral institutions, this assessment has been accepted in Japan.

The impact of the Fed's move is manifested in the Indian economy via stock markets, rupee value, trade balance, and monetary policy channels. This Policy led to the strengthening of the Indian rupee because of the sale of US Dollars by foreign banks, March-end bumped up transactions and higher inflows, and improved market sentiment towards emerging markets in general and India in particular

It's hard to overstate the significance of the fact that the US Fed rate decision impacts inflation in India through its effect on global commodity prices and exchange rates. Stable or decreasing US interest rates can help check inflation, but external risks persist.

The Bigger Picture*:* Indian Financial Markets

The US interest rate and Indian financial markets are inextricably linked through liquidity, capital flows, and investor sentiment. The stock market gyrations are a function of various forces and factors. While other things remain the same, some plausible scenarios can be isolated and identified. Such scenarios include a stable or declining US interest rate making Indian equities more appealing and investors exploring growth opportunities, Foreign Portfolio Investors (FPIs) enhancing their investments in Indian stocks, reinforcing indices like NIFTY 50 and SENSEX, and increasing foreign inflows to sectors like IT, banking, and capital goods.

A disaggregated analysis reveals the positive impact of the Fed Policy on IndiGo Airlines because of new international expansion plans; defence Stocks, viz., Mazagon Dock, Cochin Shipyard, and Garden Reach; sugar industry because of low production forecasts; and National Thermal Power Corporation (NTPC) because of high growth potential in India's energy sector. Should the Fed raise interest rates, the investors will withdraw money from the Indian markets, causing a debilitating hit to the stock market.

In the case of bond markets, reduced US rates could boost interest in Indian government and corporate bonds, decreasing bond yields could lower borrowing costs for Indian businesses, and the Fed's delayed rate cuts could make bond yields in India volatile.

High US rates could induce global corporations to reduce investments in India. A more accommodative Fed stance in 2025 could increase foreign direct investment (FDI) in infrastructure, manufacturing, and technology sectors. Stable or declining US rates make Indian asset classes more attractive and are, therefore, amenable to greater FPI in Indian equities and bonds.

Trade Relations and Balance of Payments

The Fed rate action impacts India's trade competitiveness and balance of payments. A weaker US dollar, stemming from stable or declining US interest rates, makes Indian exports more competitive globally. Industries like IT, textiles, and pharmaceuticals could benefit from this move, improving India's trade balance. However, if the rupee appreciates significantly against the US dollar, Indian exports may become less competitive, reducing demand abroad and impacting export revenue.

A stronger rupee can make imports cheaper, particularly essential commodities like oil and raw materials. This can help to manage inflation, but if import growth exceeds export growth, India's triple deficits, viz., trade deficit, current account deficit, and fiscal deficit, will widen.

Rupee Depreciation

A lower interest rate by the Fed provides stability to the rupee and reduces India's import costs. Should global economic conditions worsen or external risks like supply chain disruption or geopolitical tensions arise, inflation may rear its ugly head again, making the pursuit of price stability onerous.

Considered in a proper historical and comparative perspective, the Rupee depreciated against the Dollar from 3.30 in 1947 to 85.76 now. More specifically, the Indian rupee has depreciated against the US dollar by 5% every year since 2011, i.e., from 44 to 85.76 in 14 years.

The Rupee fell against the US Dollar. But it did not fall against other currencies. In its analysis of the currency movement, the RBI examines India's Real Effective Exchange Rate (REER: 2005=100: Month Average: India). The REER, which is defined as a weighted average of nominal exchange rates adjusted for relative price differential between the domestic and foreign countries, relates to the purchasing power parity (PPP) hypothesis. The Rupee is considered fairly valued if the REER is close to 100 or the base-year value.

The Rupee depreciation has both negative and positive features. It makes India's imports costlier (e.g., oil, electronics, and machinery), but it also makes India's exports more competitive. Consequently, several countries depreciate their currencies to step up their exports. When India embarked on a process of Structural Adjustment Programme (SAP) in 1991 under the Prime Ministership of PV Narasimha Rao, Dr. Manmohan Singh as the FM depreciated the Rupee heavily.

In times of crisis, Gold and the USD are universally considered safe havens. This has been the observed historical pattern the world over, down through the decades. Hence, an appreciation of the USD is not surprising.

Repo Rate

A steady rate by the Fed may induce the RBI to maintain its Repo rate to straddle the growth-inflation trade-off. A rate cut by the Fed in 2025 may influence the RBI to follow suit to strengthen the growth impulses.

Liquidity Management

The RBI calibrates liquidity to manage capital flows and maintain financial stability. If foreign portfolio investment rises because of a supportive Fed Reserve, the RBI might intervene in the forex markets to stabilize the Rupee.

Where Do We Go from Here?

The Fed's decision to keep interest rates unchanged in March 2025 led to a temporary appreciation of the Indian Rupee. However, long-term depreciation risks persist. Indian stock markets may gain from more foreign investment because the Fed's interest rate decision provides cues to foreign investors to invest in India. This view can be substantiated by the fact that the Fed's earlier decision to keep interest rates low led to a surge in foreign investment in technology, real estate, and manufacturing.

FPIs withdrew $28 billion from India between October 2024 and March 2025, but the emerging scenario might buck the trend. Bond markets might see higher demand, resulting in lower borrowing costs. The Fed decision impacts trade competitiveness, inflation, and the RBI's monetary policy. Hence, investors, businesses, and policymakers must monitor US interest rates and inflation and their ramifications on India on a constant real-time basis.

In sum, extensive global uncertainty because of Trump's tariff wars led to a status quo by the Fed, even though data suggest decelerating US growth and rising inflation. This warrants a pause in rates in the US. Defying conventional wisdom, the Fed envisages two rate cuts in 2025 and 2026, which may not materialise if the reciprocal tariff advocated by President Trump from 2 April 2025 kicks in. The world will be characterized by a maelstrom of uncertainty, which makes it difficult to help shape a more secure, transparent, and resilient financial ecosystem and goes against the grain of orderly growth and globalisation.