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# HEIGHTENING GLOBAL TENSIONS, RISING GEOECONOMIC FRAGMENTATION- COMPELLING CASE FOR A RATE CUT

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With almost 30 per cent of total global spending and about $ 5 trillion stock of foreign direct investment (FDI) (the largest globally), the USA remains the pivot of the global economy- the real mover and shaker, so to speak. Accordingly, President Donald Trump's stern measures have thrown the world into a tailspin, marking a tectonic shift and the collapse of rules-based globalization and free trade — the kind seldom seen in global history.


## Tariff Whiplash

Trump's fulfilment of his promise to "*make America great again*" (MAGA) is helping the world work again. Such aggressive views and evident backsliding can be substantiated by the theoretical underpinnings provided in a book called No Trade Is Free (2023) by Robert Lighthizer, who was the former US Trade Representative (USTR) in the first Trump administration. Lighthizer made a strong case for "*fair trade*" rather than free trade since the untrammelled play of market forces hurt American strategic interests.

Contrary to Trump's perception of catalyzing manufacturing and turbocharging foreign investment in America, this ill- conceived system of reciprocal tariffs, country by country, will lead not to a win-lose situation but a lose-lose scenario with all participants in the process of global trade becoming worse off in a vicious cycle of the higher cost of imported goods, concomitantly higher inflation, fragile trade relations, lower volume of trade, and reduced economic growth and declining confidence from both investors and consumers.

The Latin expression *res ipsa loquitur* (the thing speaks for itself), which is a doctrine in common law and Roman-Dutch law jurisdictions, suggests that one of the basic reasons for America's prosperity is the humongous, internal, free trade area. It would, therefore, be unreasonable and illogical to be oblivious to *the Smoot-Hawley Tariff of 1930*, which greatly worsened an already bad recession, plummeting the American economy into a deep depression. A recession is defined as two consecutive quarters of negative GDP growth. An economic depression is a severe and sustained downturn in economic activity, marked by high unemployment, low production, and a significant decline in GDP, lasting for several years, far more severe and prolonged than a typical recession.

What is prognostically alarming is that this complete rejection of the WTO framework, with the dreaded possibility of a full-blown global trade war, will become an exercise in futility with the treatment being worse than the disease. Such short-sighted, myopic policies strike at the fundamental tenet of capitalism and free trade. Theoretical foundations of Economics and cross-country empirical evidence reveal that shared prosperity necessitates a more connected, secure, and efficient trading environment - an environment, where the size of the global pie does not only increase but is also more equitably distributed.

It has been justifiably argued that the underlying reasons for the ostensible '*tariff terrorism*' include internal debilities, such as asset monetization, lower crude prices, lower rates, a weaker dollar, and a return of manufacturing to the US.

## Global Ramifications - Wide and Profound Consequences

Grim portents abound. The significant scaling back of American policy architecture and operational framework marks a watershed moment in global history, reminiscent of William Shakespeare's powerful observation in his classic play *The Hamlet* "*Though this be madness, yet there is method*".

In case of such sweeping across-the-board tariffs, the jury is still out on whether there is a method in the madness, and there is widespread concern and consternation about the implications of such measures.

There is a real and worrisome concern that the US stock market's recovery from a slew of aggressive trade measures against allies and partner countries (friends and allies included) and a possible tariff-induced trade war could be fragile. UBS strategist Maxwell Grinacoff expressed "*concerns of renewed weakness*" in the stock market unless "*policy uncertainty abates*". Similarly, Barclays strategists slashed their end-of-year price target for the S&P 500 by over 10 per cent, predicting that "*earnings [will] take a hit as tariffs contribute to material slowing in U.S. activity*."

Heightened uncertainty about trade policy is manifested in the extraordinary rise of an index created by Scott Baker of Northwestern University, et al, to its highest point ever recorded by their series in four decades. Furthermore, a separate index devised by Federal Reserve economists reached an even worse conclusion, with trade-policy uncertainty at its highest level in over half a century.

With weak U.S. confidence data and concerns over the impact of new tariffs on sectors across a wide development spectrum, the dollar experienced a modest fall. Lacking large cash cushions or leverage with suppliers, these "*reciprocal tariffs*" with a narrow self-interest rather than Adam Smith's "*invisible hand*" are pushing entrepreneurs to slash costs and delay expansion plans, thereby imperilling America's economic prosperity, with repercussions on global markets.

## Double Whammy of Stagflation

In this disconcerting overarching environment of decelerating growth and surging inflation caused by supply shocks, some analysts fear the dreaded specter of stagflation, which could be the worst of both worlds. What makes it prognostically alarming is that a recession together with an inflationary spiral seems to be on the cards in the US with deleterious global consequences. The overarching scenario reminds me of the centuries-old Chinese curse, "*may you live in interesting times"*! These are truly interesting times-times of plummeting global growth and a calamitous fall in global trade, and investments.

## 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 the sales and profits of all companies with export-orientation taking a hit necessitating a re-rating, the pharma companies though out of Trump's "*reciprocal tariff*" list could be hit by a general environment of uncertainty and thus ending up with lower top lines and bottom lines.

There are also contextually significant aspects, such as the impact of a stuttering US economy and volatile interest rates on Indian equities, the role of Foreign Portfolio Investors (FPIs) and foreign inflows to sectors like IT, banking, and capital goods. These are early days. Yet, given India's wide tariff differential with the US, such tariffs are estimated to lead to a hit to India's exports by 3 to 3.5 per cent and GDP growth in FY26 by 40-60 bps. At the sectoral level, nearly $14 billion worth of electronics products and over $9 billion worth of gems and jewellery would be dented. While the 26per cent tariff is inapplicable to auto parts and aluminium products, those will still attract the 25per cent  tariff announced earlier.

## All's Not Lost - Silver Lining

Ø The Pharma sector, semiconductors, and critical minerals have been excluded from these tariffs.

Ø Higher reciprocal tariffs on China, Vietnam, Bangladesh, and Indonesia may give India a competitive edge.

Ø With expanded Production Linked Incentive (PLI) schemes covering a wider range of products, anticipated supply chain shifts could open new export opportunities, thereby enhancing domestic industries' investment and global competitiveness.

Ø India's agricultural exports (e.g., seafood and rice) to the US could rise because while India faces 26 per cent tariffs, China faces 34 per cent , creating an 8 per cent differential advantage for Indian exporters. Other competitors face even steeper barriers, with Vietnam at 46 per cent , Bangladesh at 37 per cent, Thailand at 36 per cent, and Indonesia at 32 per cent.

In sum, the world is characterized by a maelstrom of uncertainty, which goes against the grain of macroeconomic stability, orderly growth, and globalisation.

## Economic Growth in India

India's macroeconomic growth is yet to gain traction, with GDP growth expected to be 6.7 per cent by the RBI in FY 26. But as things unfold quickly in the aftermath of Trump's tariffs, the GDP growth could be dented by global real and worrisome concerns by 20-25 basis points though India, unlike China, is largely a domestically driven economy.

## Inflation Trajectory

Inflation is consistently softening with retail inflation falling steeply to a 7-month low of 3.6 per cent  in February 2025 (inflation was at 4.31 per cent  in January 2025).

To place matters in perspective, CPI inflation fell to 5.22 per cent in December 2024, down from 5.48 per cent in November 2024 and 6.21 per cent in October 2024. Clearly, then, this decline is not a one-off case but is part of a welcome pattern of low and stable inflation- a pattern, which provides space for a rate cut and comfort to the central bankers.

## Banking Liquidity

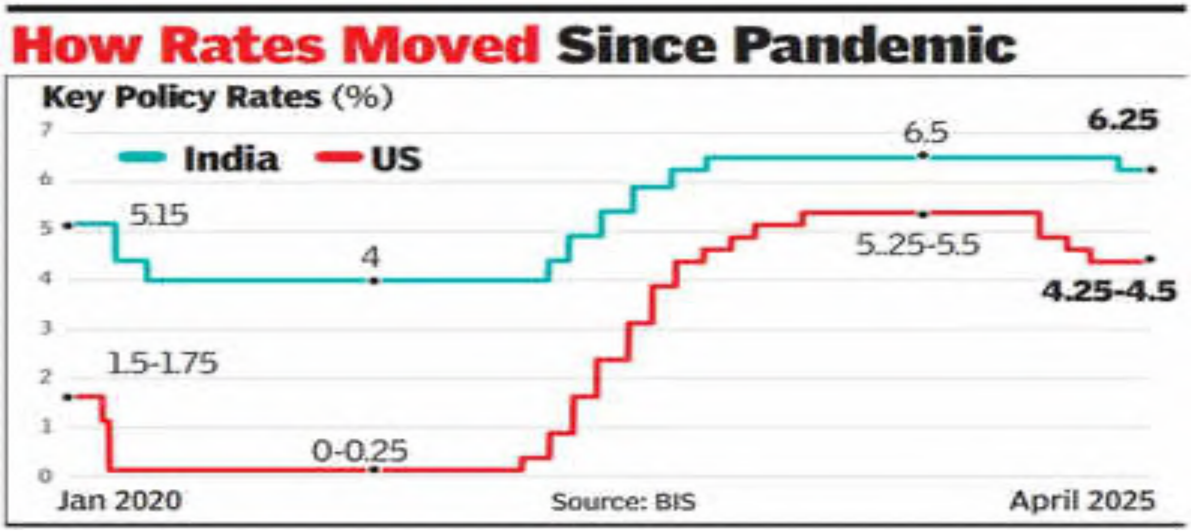
Deficit banking liquidity since mid- December 2024 zoomed to Rs. 3.3 lakh crore on January 23, 2025. Since then, it eased to Rs. 2.26 lakh crore on March 18, 2025, and to a modest Rs. 0.13 lakh crore on March 27, 2025. The RBI has initiated a slew of measures to contain the liquidity deficit within manageable proportions. Such measures included forex buy/sell swaps of $ 25 billion, purchase of government securities via open market operations (OMOs) of Rs. 2.83 lakh crore, and long-term variable repo rate (VRR) auctions of Rs. 1.83 lakh crore, apart from its daily VRR. Such liquidity infusion measures are likely to continue to prevent the liquidity deficit breaching the RBI’s tolerance threshold.

## Gazing into the Crystal Ball

Let us now try to succinctly sum up the main points emerging from this analysis of the global setting and the macroeconomic landscape, and highlight the likely Policy action in the 54th meeting of the MPC scheduled from April 7-9, 2025:

1. Easing inflation, the manifest need to shore up economic growth, and the evolving growth inflation trade-off necessitate 25 bps in the Repo Rate to 6 per cent on top of the 25-bps cut in February 2025) - the first such cut in almost five years (unchanged at 6.5 per cent since February 2023; the last time the RBI reduced the rate was during May 2020, i.e., the Covid times), and thereafter, it was gradually raised to 6.5 per cent) to stimulate growth.

As a consequence of this measure, all external benchmark lending rates would fall by 25 bps, thereby providing welcome relief to the borrowers in the interest rate sensitive segments, viz., housing loans, auto loans, education loans, and other personal loans.




2. In a future guidance measure, the Monetary Policy stance is expected to be shifted from "*neutral*" to "*accommodative*". This will be an unmistakable indication of further reductions in the Repo Rate. To my mind, I see a Repo Rate reduction of 75-100 bps in FY 26.

3. Given the evolving macroeconomic growth and inflation trajectories, the growth and inflation projections could be tempered.