Foggy Outlook, Steady Outcomes: RBI's Record

28-June-2025

Central banking is often compared to driving a car with no brakes and a hazy windshield. Decisions on when to accelerate or slow down depend heavily on economic forecasts—projections that are rarely precise and often subject to change. The goal isn't perfect control but to avoid hard landings and sudden accidents.

This is a challenge faced by central banks globally—regardless of size or sophistication. Even those with advanced models and vast resources, like the US Federal Reserve (Fed), often struggle with forecasting accuracy. Predicting key variables like interest rates, inflation, and GDP growth involves navigating a landscape shaped by geopolitical shocks, supply chain disruptions, and sudden policy shifts—all of which add layers of complexity for central banks.

A Glimpse into the FOMC Forecast and Actual Outcomes:

The table below highlights the deviation between the actual outcomes and the FOMC's median projections made a year earlier. For instance, the Fed's rate forecast for December 2024, made a year earlier, was 4.60%, but the actual rate came in at 4.38%, a deviation of -0.22%. PCE inflation was projected at 2.40%, yet the actual figure rose to 4.00%, a gap of 1.60%. Similarly, real GDP growth was forecast at 1.40%, but the economy expanded by 2.40%, showing a variance of 1.00%.

	Forecast - 1 Year Before Summary Of Economic Projections (SEP)			Actual		
Period	**Fed Rate**	**PCE**	**RGDP Growth**	**Fed Rate**	**PCE****	**RGDP Growth***
Dec'24	4.60%	2.40%	1.40%	4.38%	4.00%	2.40%
Dec'23	5.10%	3.10%	0.50%	5.38%	3.50%	3.20%
Dec'22	0.90%	2.60%	4.00%	4.38%	1.20%	3.40%
Dec'21	0.10%	1.80%	4.20%	0.13%	4.40%	7.40%
Dec'20	1.60%	1.90%	2.00%	0.13%	5.80%	4.40%
Dec'19	2.90%	1.90%	2.30%	1.63%	2.70%	2.80%
Dec'18	2.10%	1.90%	2.50%	2.38%	1.30%	0.60%
Dec'17	1.40%	1.90%	2.10%	1.38%	4.40%	4.60%
Dec'16	1.40%	1.60%	2.40%	0.63%	2.10%	2.20%
Dec'15	1.13%	1.30%	2.80%	0.38%	1.60%	0.70%

The actual values marked in red indicates a deviation in the projected outcome by more than 50 bps

**PCE Actual data sourced from Bureau of Economic Analysis (BEA)

*Actual GDP data from BEA

Source: Bloomberg, Bureau of Economic Analysis (BEA), KMAMC Internal Research | Real Gross Domestic Product (RGDP), Personal Consumption Expenditures (PCE)
The data are as of June 27, 2025.| Details as per latest data available publicly.

Over the years, central bankers have struggled with growth and inflation projections. A widely cited example is the 2021 inflation episode, when the Fed described inflation as “transitory” even as it soared well beyond 2%, eventually peaking above 9%. This misjudgment led to widespread criticism of the Fed’s models and communication.

Why Forecasting Remains Challenging?

Several factors contribute to the Central Bankers’ forecasting difficulties.

- Global economic events, such as geopolitical tensions or unexpected pandemics, can dramatically alter economic trajectories.

- Consumer behaviour and business confidence are notoriously hard to predict, influencing Inflation and Real GDP growth in unforeseen ways.

Difficulties in accurately forecasting inflation and Real GDP growth reflect the limitations of existing economic models, which tend to rely on historical patterns that may not always apply in fast-changing conditions in an event driven world.

Well Played RBI

On the domestic front, the RBI faces similar forecasting challenges. India, being one of the world’s most diverse economies, coupled with limitations in the availability of high-frequency, reliable data, adds to the complexity. Hence, any criticism on the RBI missing its economic variable projections would be unjustified and at best avoided.

Michael Patra, a former Deputy Governor of the Reserve Bank of India, once aptly remarked, “As regards forecasts, monetary policy makers were created to make weather forecasters look good, to draw on an analogy on economists. In fact, it is said that monetary policy makers do have a sense of humor – that is why they put a decimal point on their forecasts."

Despite the challenges of economic variable forecasting, the RBI has managed the economy reasonably well, albeit with a cautious and gradual approach. It has broadly managed to keep inflation within its 4% ± 2% target band for most years. During the COVID-19 period (2020–21), the RBI responded swiftly with rate cuts and ample liquidity measures to support the economy. However, as excess liquidity and supply-side disruptions led to rising inflationary pressures in the post-COVID phase (2022-23), the RBI shifted its stance and tightened policy to bring inflation back within target levels.

The Reserve Bank of India showcased remarkable flexibility, seamlessly transitioning between accommodative, tightening, and easing stances in response to shifting macroeconomic landscapes. Ben Bernanke's insight that "monetary policy is 98% talk and only 2% action" underscores the significance of effective communication in central banking. **By adopting transparent communication strategies, including consistent policy announcements, forecasts, and detailed press conferences with meeting minutes, the RBI bolstered market confidence and predictability.**

Disclaimer

The information contained in this (document) is extracted from different public sources/KMAMC internal research. The document includes statements/opinions which contain words or phrases such as "will", "believe", "expect" and similar expressions or variations of such expressions that are forward looking statements. Actual results may differ materially from those suggested by the forward looking statements due to risk or uncertainties associated with the statements mentioned with respect to but not limited to exposure to market risks, general economic and political conditions in India and other countries globally, which may have an impact on services/investments, the monetary and interest policies of India, inflation, deflation, unanticipated turbulence in interest rates, foreign exchange rates, equity prices or other rates or prices etc.

All reasonable care has been taken to ensure that the information contained herein is not misleading or untrue at the time of publication. This is for the information of the person to whom it is provided without any liability whatsoever on the part of KMAMC or any associated companies or any employee thereof. This should not be considered as a recommendation of any kind. Investors may consult their financial advisors and/or tax advisors before making any investment decision. Past performance may or may not be sustained in future. Investors should make any investment decision post considering their risk appetite. KMAMC / Kotak Mutual Fund is not guaranteeing or promising any future returns/performance. These materials are not intended for distribution to or use by any person in any jurisdiction where such distribution would be contrary to local law or regulation. The distribution of this document in certain jurisdictions may be restricted or totally prohibited and accordingly, persons who come into possession of this document are required to inform themselves about, and to observe, any such restrictions.

MUTUAL FUND INVESTMENTS ARE SUBJECT TO MARKET RISKS,
READ ALL SCHEME RELATED DOCUMENTS CAREFULLY.