

West Asia Turmoil Tests RBI's Policy Resolve Ahead of April MPC

Factors That May Influence RBI's Decision:

External Factors: April's MPC comes at a more fragile juncture versus February. Since then, escalation in West Asia has sharply altered global risk sentiment. Brent crude has risen ~40% (as of April 1, 2026) amid supply and shipping concerns. Simultaneously, capital flows to EMs have turned cautious, exerting pressure on the rupee, which has led to depreciation of rupee vis-a-vis dollar.

Liquidity Conditions: RBI has maintained comfortable system liquidity through OMOs and VRR operations. As of April 1, 2026, liquidity stands at ~₹1.84 lakh crore, keeping overnight rates comfortable. However, global risk aversion and intermittent capital outflows have introduced volatility in domestic markets.

Inflation: Headline CPI increased from 2.74% (Jan'26) to 3.21% (Feb'26), remaining within the RBI's 4% target. However, elevated crude prices pose upside risks via fuel, LPG, transport, and broader input costs.

Growth: Growth has remained steady so far, with GDP at 7.8% YoY in Q3FY26 (vs. 8.4% in Q2, 6.7% in Q1). That said, sustained high energy prices could compress corporate margins and weaken household purchasing power. External demand remains uncertain amid slowing global growth, while higher fuel and fertilizer costs may weigh on rural demand and manufacturing sentiment.

Indian Bond Market: The 10Y G-Sec yield is trading above ~7%, while US 10Y stands at ~4.30%, implying a spread of ~270 bps. Widening spread reflects a higher risk premium amid external uncertainty. Indian Markets appear to be pricing in >100 bps of potential tightening, indicating that a significant portion of risks may already be priced in.

Policy Expectation:

- **We expect the most likely outcome to be a continuation of the status quo, with policy repo rate held unchanged at 5.25% and monetary stance remaining neutral, while preserving flexibility to respond if external pressures intensify.**
- **RBI is likely to revise its growth projection lower to 6.5% from 7.0% for H1FY2027, while raising its inflation forecast to 4.5% from 4.1% for same period.**
- Given that current risks are largely externally driven, aggressively tightening financial conditions could impose disproportionate costs on domestic growth. **Accordingly, the RBI is likely to tone the policy with carefully balancing inflation management with the need to sustain underlying economic momentum.**

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