Trade war may fuel inflation: RBI bulletin

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Escalating trade tensions amid a tariff war after Donald Trump took over as President of the United States (US) could adversely impact global growth and fuel inflation, an article on the "State of the Economy" in the Reserve Bank of India (RBI) monthly bulletin said.

Citing estimates, the report said a full-blown tariff war could raise prices by 1.0-1.2 per cent in the US, reduce growth in real gross domestic product (GDP) by 0.6 percentage points in 2025, and leave the American economy persistently 0.3-0.4 per cent smaller in the long run.

"... trade wars and escalating tariffs could have a deleterious impact on growth and fuel inflation, not just in the countries directly involved but for the global economy as a whole," the article said, while observing that financial markets were increasingly pricing in the anticipated slowdown in global economic growth.

"As of March 17, 2025, the US dollar has given up all of its gains since mid-November 2024, weighed by US trade policy and growth uncertainties," the article said.

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The report noted that tariff concerns and safe-haven demand drove gold prices to a historic high of $3,000 per ounce on March 14 this year. Notwithstanding the innate strength of the Indian economy, the reverberations of a tumultuous external environment are reflected in various segments, the report said.

"Sustained foreign portfolio outflows exerted significant pressures on domestic equity markets in February and engendered currency depreciation," it said.

The Indian economy, the report said, continues to demonstrate resilience in this global environment, and the recent fall in the inflation rate will support further economic recovery and bolster macroeconomic strength, which would act as a bulwark in warding off external-sector challenges.

The headline-inflation rate declined to a seven-month low of 3.6 per cent in February from 4.3 per cent in January, mainly due to a drop in food prices though the core-inflation rate firmed up to 4.1 per cent in February from 3.6 per cent in January.

"... the growth momentum is supported by robust sectoral performance and improving consumption trends," the report said, noting the expansion in real GDP at 6.2 per cent in Q3 FY25, shaking off the sluggishness of the previous quarter. The report noted private consumption expenditure was going up, signalling strong consumer confidence and sustained demand.

The report highlighted government spending had picked up in recent months, providing a further fillip to growth. Key sectors, including construction, financial services, and trade, continue to thrive.

"Various high-frequency indicators of economic activity point towards a sustained momentum in growth during Q4 as well," it said.

The monetary policy committee of the RBI reduced the policy repo rate in February after almost five years, and the reduction was of 25 basis points. It is widely expected the repo rate would further be reduced in April.

Commenting on the tight liquidity conditions in financial markets, mainly due to tax and foreign portfolio investor outflows, the report said the central bank had deployed a strategic mix of interventions, including open market operations (OMOs), daily variable rate repo (VRR) auctions, and dollar/rupee buy-sell swap auctions, to infuse liquidity.

During the quarter so far, the RBI injected around ₹5.5 trillion of durable liquidity into the banking system through a combination of OMO purchases, longer-duration VRR auctions, and forex swaps.

Amid liquidity tightness, banks continue to rely on certificates of deposit (CD) for funding, causing the issue of CD to reach an all-time high.

According to the data, in the primary market, the issue of CD grew 34 per cent year-on-year to reach an all-time high of ₹10.58 trillion during 2024-25 (up to March 7, 2025).