

### **Federal Open Market Committee (FOMC) announcement**

The US Federal Open Market Committee (FOMC) in the March 19, 2025 meeting decided to keep the key policy rates unchanged in the range of 4.25-4.50% and renewed its commitment to decide the future course of action based on emerging data. In its commentary, the FOMC stated that

1. It intends to achieve maximum employment while for inflation, the target rate is 2 percent over the longer run.
2. It will slow down the pace of Fed balance sheet reduction by reducing the monthly redemption cap on treasury securities from \$25 billion to \$5 billion starting April 1, 2025.

**Table 1: US Fed Economic projections**

<b>Median projections (%)</b>	<b>2025</b>	<b>2026</b>	<b>2027</b>	<b>Long run</b>
Real GDP growth	1.7	1.8	1.8	1.8
December projections	2.1	2.0	1.9	1.8
Unemployment rate	4.4	4.3	4.3	4.2
December FOMC projections	4.3	4.3	4.3	4.2
PCE inflation (retail)	2.7	2.2	2.0	2.0
December projection	2.5	2.1	2.0	2.0
Core PCE inflation	2.8	2.2	2.0	
December projection	2.5	2.2	2.0	
Federal Fund rate	3.9	3.4	3.1	3.0

Source: US Federal Reserve

It is pertinent to note that though lingering uncertainties with regard to trade wars and tariffs are expected to reduce growth and lead to possible reflation of the US economy, Fed Chair has chosen to downplay the inflation impact passing it off as a transitory phase. Apparently, this is intended to soothe markets and prevent sharp volatility in equity and fixed income markets. However, it needs to be noted that Fed's own economic projections clearly indicate Personal Consumption Expenditure (PCE) inflation surging above the December forecasts.

**During Covid period when fiscal stimulus and paycheck protection programmes had caused inflation to surge to unprecedented levels that too was passed off as a transitory phase by the Fed. Though circumstances are different now, the exact impact of tariffs are not yet fully known. Viewed in this perspective it should not surprise us if actual inflation trends goes beyond these estimates. Though a recession in a strict theoretical sense may not occur a deep slowdown could indeed be imminent and a painful stagflationary phase might set in.**

There is also wide dispersion observed in the 'dot plots' which indicates rate cut views of policymakers even though the median forecast is for 2 rate cuts in 2025.

- 9 members expect 2 cuts compared to 10 in December 2024

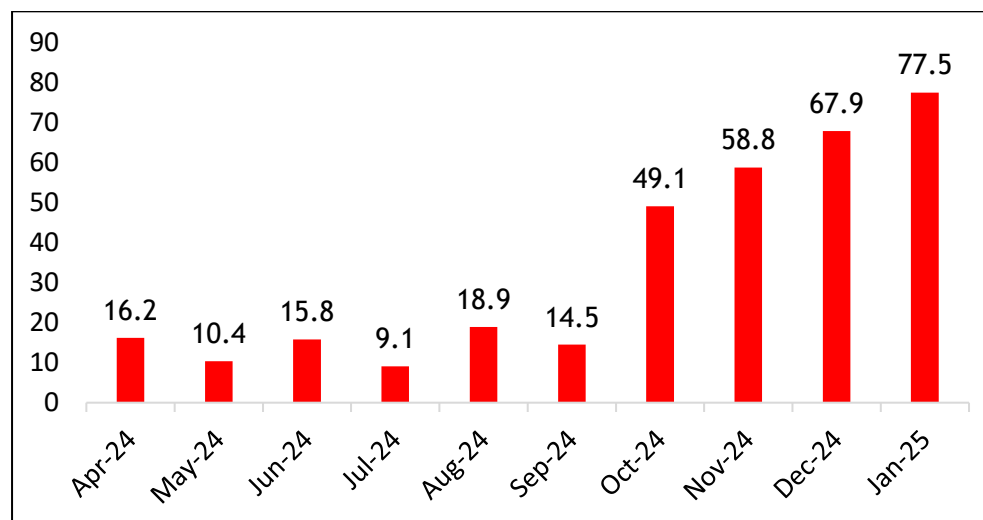
- Eight see one cut or no cut compared to just 4 in December
- Two opine that there will be 3 cuts and none expect more than that compared to 5 expecting 3 or more cuts in December.

It is clear that overall expectation regarding the frequency of rate cuts have come down since December 2024 which is not surprising in the light of looming trade and tariff wars.

### **Overall implications**

Dollar index weakened considerably since the onset of Trump regime. While DXY was hovering in the 107-108 levels coinciding with spike in US treasury yields, tariff threats and trade wars, it has lost all gains and now looks range bound between 103-103.5 as a potentially stagflationary scenario looms large. Even if the transitory inflation comment out runs its course and reflation becomes more secular, the positive correlation between yield spikes and DXY strength may not be as strong as before due to growth concerns outweighing safe haven status of US treasuries. This could potentially lead to a resurgence of FII flows to India from H2 FY26 providing stability to INR at 86-86.5 levels. The biggest beneficiary of this scenario will be the banking system as the spectre of liquidity tightness due to FX interventions might become less frequent.

**Figure 1: Outstanding net short position in RBI forwards (\$Bn)**



Source: RBI Bulletin

However, RBI will still have to manage liquidity shortfalls due to maturing forward positions. According to the latest RBI bulletin, its net short position in forwards increased to \$77.5 billion in January 2025 against \$67.9 billion in December and is likely to have increased further due to \$15bn forex swaps.

To the extent these positions mature in FY26, rupee liquidity that is drained out will have to be replenished using fine tuning operations and/or OMO purchases. Even a further CRR cut cannot be ruled out as RBI has recently shown inclination towards injection of more durable liquidity through FX swaps.

G-Seec yields will be influenced more by domestic conditons like liquidity, government finances, demand for long dated governemnt bonds and inflation trajectory. **The outlook is tilted towards benign yields in FY26 if these metrics are considered.** Though corporate tax buoyancy is an indeterminate variable, buoyancy in personal income tax (despite Rs 1 trillion foregone due to tax cuts) from high earners and dividend from RBI should help the fiscal maths.

To conclude, the FOMC outcome and projections on growth and inflation should have the effect of keeping the US Dollar weak providing stability to EM currencies like INR. However, the connection between Indian and US treasury yields is slowly becoming weak as domestic liquidity and fiscal concerns weigh more. While we may expect INR to exhibit more stability due to some reversal of FII flows in H2 of FY26, managing liquidity dynamically would be crucial to ensure the smooth transmission of monetary policy in the event of rate cuts.

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