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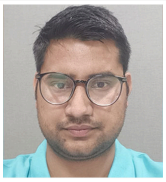

"India's 5.1% Fiscal Deficit Target Seems Optimistic; Actual Deficit May be Higher"

Yogesh Kumar,
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"RBI Treading Cautiously as Global Uncertainty Weighs On Rate Decisions"

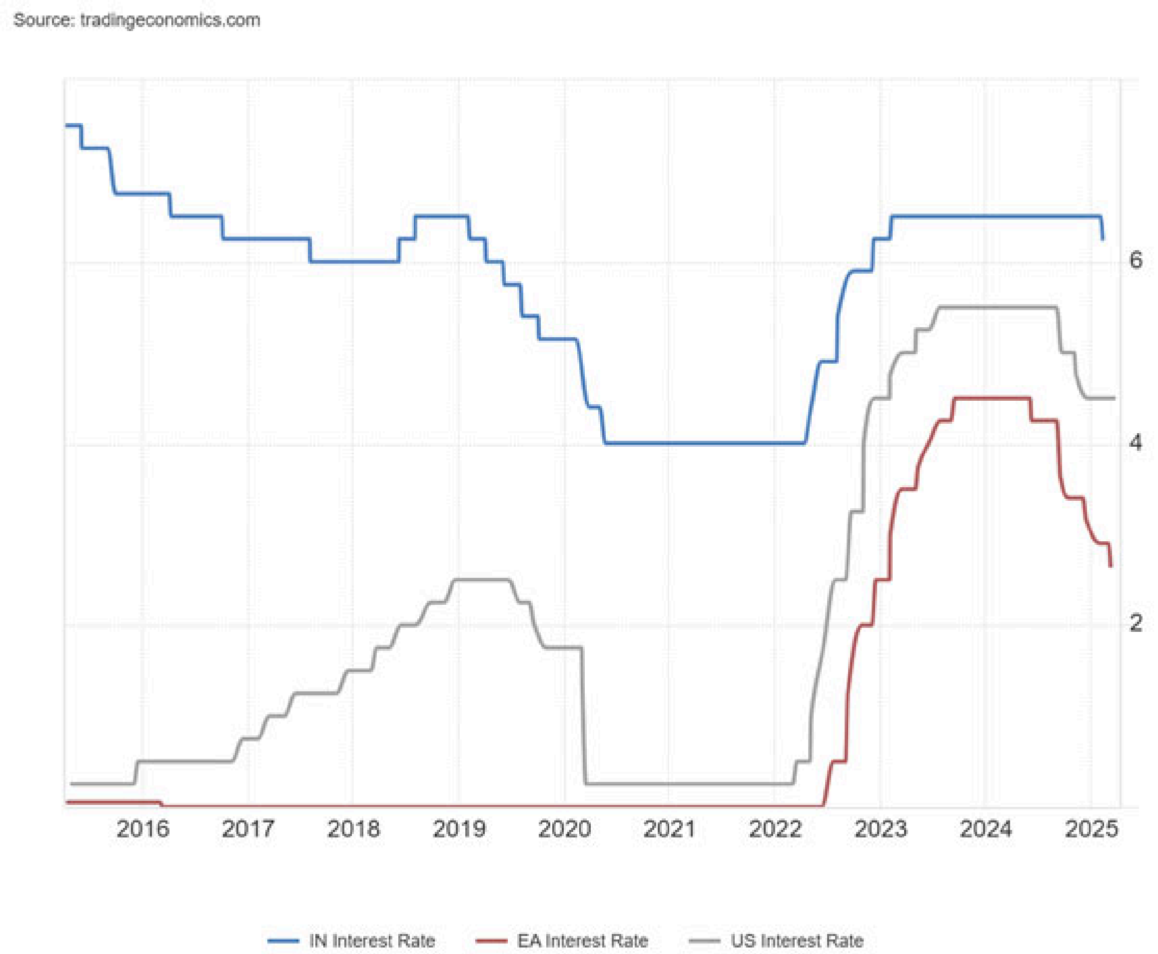
Intro: At a time when global economies are navigating heightened uncertainty, India stands at a critical policy crossroads. The Reserve Bank of India has opted for caution—holding interest rates steady despite cooling inflation-amid concerns over capital outflows, currency pressures and fragile global sentiment. Yet, private investment remains subdued, food inflation stubborn and the rupee vulnerable to global monetary shifts. In this **exclusive conversation on Socio-economic Voices, Country Risk Economist Yogesh Kumar** unpacks the rationale behind the RBI's stance, the deeper causes behind India's investment slump and the tightrope the central bank must walk between growth and stability. He informs **Mahima Sharma** of **Indiastat** that with fiscal targets under scrutiny and global headwinds mounting, the stakes for India's macroeconomic strategy have rarely been higher. Read the full interaction...

MS: The RBI recently kept interest rates unchanged, even though inflation is moderating. Do you think the central bank is being too cautious or is it the right approach?

YK: The RBI's decision to maintain interest rates despite moderating inflation appears justified given prevailing global macroeconomic uncertainties. Heightened geopolitical risks, trade disruptions and an uptick in inflation across major economies such as the U.S., Eurozone and Japan create external vulnerabilities for India.

A premature rate cut could exacerbate capital outflows and lead to rupee depreciation, particularly as India relies on maintaining a sizable interest rate differential to attract foreign investment and mitigate capital flight risks relative to developed economies.

Domestically, while headline inflation eased to just below 4% in February 2025, the central bank remains wary of supply-side risks, including food price volatility and global commodity price fluctuations. At the same time, the RBI acknowledges the potential downside effects of elevated interest rates on investment and consumption. This recognition was evident in its initiation of a rate-cut cycle in February 2024 with a measured 25bps reduction. **However, any further monetary easing is likely to be gradual and contingent on evolving macroeconomic conditions,** ensuring inflation remains well-anchored while safeguarding financial stability.



MS: Some economists argue that India's high interest rates are hurting private investment. Do you think RBI's stance is discouraging corporate borrowing?

YK: Gross fixed capital formation—comprising investments in physical assets such as factories, machinery and construction—accounts for approximately 30% of India's GDP, making it the second-largest contributor after private consumption. However, private investment as a share of GDP has been in secular decline since the 2007 global financial crisis, even as India's economy registered world-leading growth rates. Although the investment rate saw a modest recovery in 2022 and 2023, recent data indicates a renewed downturn, with private sector investment falling to a decadal low of 33% of total capital expenditure in the current financial year. **A key indicator of this cautious stance is the cash accumulation by Indian non-financial corporations, which hold liquid assets equivalent to 11% of their total balance sheets, reinforcing the notion that firms remain hesitant to deploy capital for fresh investments.** Notably, while capital expenditure by listed firms slowed, investments by unlisted businesses—typically a more dynamic segment of the economy—contracted outright. Several cyclical and structural factors have constrained corporate investment in addition to higher borrowing cost.

Weak urban consumption demand, subdued export growth and competitive pressures from cheap Chinese imports in select industries have dampened the incentive for capacity expansion. However, beyond these proximate causes, a more entrenched reluctance to invest stems from persistent global uncertainties and sectoral overcapacity, which continue to weigh on corporate risk appetite.

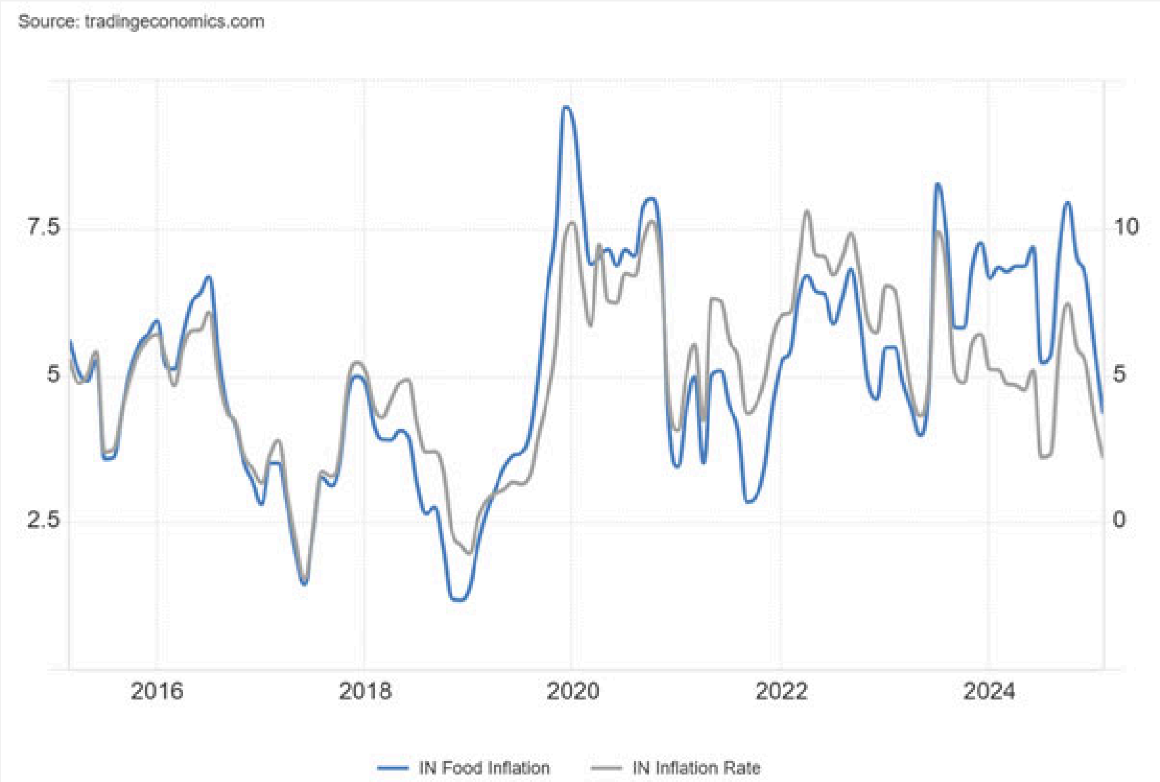
MS: The US Federal Reserve and other central banks have been adjusting their monetary policies aggressively. How should the RBI navigate interest rate decisions in such a global environment?

YK: The Reserve Bank of India (RBI) must navigate a delicate trade-off among inflation control, financial stability and economic growth while formulating its interest rate policy. Given India's external vulnerabilities and evolving global monetary conditions, the central bank must strike a balance between domestic economic imperatives and international spillover risks. A significant rate cut could intensify capital outflows, exert downward pressure on the rupee and amplify imported inflation, particularly in energy and commodity-dependent sectors.

On the other hand, prolonged high interest rates risk dampening domestic demand and further constraining private capital expenditure, which has already been sluggish. Beyond conventional rate adjustments, the RBI can deploy additional policy tools to fine-tune its response. **Liquidity management measures, such as open market operations and targeted credit support, can help sustain growth without undermining inflation control. Similarly, foreign exchange market interventions can mitigate excessive currency volatility,** ensuring external stability even as global monetary policies shift.

MS: Food inflation has been a recurring issue due to climate shocks affecting crops. Do you think India's inflation is more structurally driven or supply-side driven? (Reference: Inflation eased to 5.1% in February, but food inflation remains a concern).

YK: India's inflation dynamics are primarily supply-side driven, largely due to insufficient investment in modern agricultural technology and structural inefficiencies in the food supply chain. **The country's food prices remain highly vulnerable to climate variability, with monsoon dependence, heatwaves and unseasonal rains** frequently disrupting crop yields. Extreme weather events, including erratic rainfall patterns and El Niño-induced droughts, have historically triggered sharp price spikes in essential commodities such as vegetables and cereals. Beyond climate-related shocks, systemic weaknesses in storage, distribution and logistics infrastructure further exacerbate inflationary pressures. **Limited cold storage capacity, inefficient supply chains and fragmented transportation networks contribute to post-harvest losses and periodic price volatility.** These bottlenecks not only amplify short-term price fluctuations but also hinder long-term food security and price stability, reinforcing India's susceptibility to supply-side inflation shocks.



MS: The Indian rupee's performance is increasingly influenced by the U.S. Federal Reserve policy decisions and commentary, especially concerning new U.S. trade policies. How should the Reserve Bank of India (RBI) navigate its monetary policy to stabilise the rupee amid these external pressures?

YK: The Reserve Bank of India (RBI) has effectively managed monetary policy despite the rupee's depreciation, which has been driven by structural factors such as trade deficits and heightened global uncertainty. Currency fluctuations are not solely a function of domestic monetary policy but are also influenced by external risk sentiment and capital flow dynamics. During periods of heightened global risk, investors tend to shift capital toward safe-haven assets, particularly U.S. Treasuries, leading to capital outflows from emerging markets like India. This exerts downward pressure on the rupee, independent of RBI's policy actions. **Given these conditions, the RBI should adopt a data-driven and independent monetary policy approach, focusing on inflation trends, capital flow conditions and domestic economic fundamentals, rather than reacting preemptively to U.S. Federal Reserve decisions.** A measured and phased approach to rate adjustments—synchronised with global monetary easing—would help mitigate excessive currency volatility while maintaining macroeconomic stability.

MS: In February 2025, India's merchandise trade deficit narrowed to $14.05 billion, the lowest in over three years, primarily due to falling imports amid global uncertainties. How might this trend impact India's economic growth in the coming months?

YK: India's growth momentum remains contingent on external stabilisation, with the country's trade deficit narrowing to $14.05 billion in February 2025, the lowest since August 2021. This improvement, down from $18.7 billion in February 2024, was driven primarily by a sharp 16.3% decline in imports, reflecting lower energy prices and subdued domestic demand. Given that India imports nearly 90% of its crude oil and fuel requirements, the pullback in global commodity prices has significantly reduced the import bill.

However, the 10.9% contraction in exports, although less severe than the import decline, raises concerns about weak external demand and slowing industrial output. **The relative strength of the rupee, bolstered by the Reserve Bank of India's (RBI) forex interventions, may have further weighed on export competitiveness,** making Indian goods relatively more expensive for key trading partners.

While a narrowing trade deficit improves external stability, its impact on growth depends on the underlying factors driving the trend. If the import decline reflects temporary global uncertainty and energy price adjustments, India's growth momentum could recover as global conditions stabilise. However, if it signals structural weakness in domestic investment and consumption, it may indicate slower economic expansion in the near term, necessitating targeted policy interventions to support demand and industrial activity.

MS: The World Bank's Global Economic Prospects report indicates that global growth is expected to hold steady at 2.7% in 2025-26, suggesting a settling at a low growth rate insufficient for sustained economic development. How should India respond to this prolonged period of subdued growth?

YK: While subdued global growth poses challenges, India can mitigate risks by prioritising consumption-driven and investment-led expansion, with a strategic emphasis on rural demand, infrastructure spending and enhanced credit access to sustain economic momentum. Public capital expenditure in transport, energy and digital infrastructure can serve as a catalyst for private sector investment, fostering long-term productivity gains and industrial competitiveness. **By implementing a balanced policy mix—combining structural reforms, targeted fiscal support and financial market deepening—India has the potential to outperform its global peers,** positioning itself as a key driver of economic resilience and sustainable growth in an era of prolonged global uncertainty.

MS: The recent budget set a fiscal deficit target of 5.1%, lower than expected. Do you think this is realistic or will off-budget borrowing push the actual deficit higher?

YK: A 5.1% deficit target seems optimistic, given execution risks, off-budget borrowing and external vulnerabilities. The actual fiscal deficit may be higher, especially if revenue disappoints or spending pressures intensify given lower growth outlook and global uncertainty.

MS: With countries like the US, Japan and Italy facing record-high debt-to-GDP ratios, does India's rising public debt pose a long-term macroeconomic risk?

YK: The broader concern is India's rising public debt, particularly its growing foreign currency obligations. A higher reliance on external debt increases exchange rate vulnerability, while elevated global interest rates exacerbate refinancing risks. If growth falters or capital inflows slow, India could face a deteriorating debt profile, leading to higher borrowing costs and increased pressure on fiscal sustainability.

MS: Some analysts believe that India's capital expenditure boost is not leading to proportionate private sector investment. Why do you think private investment is lagging, despite government spending?

YK: While the government is pushing for manufacturing incentives (PLI schemes) and infrastructure development, structural issues continue to weigh on private investment recovery. Addressing labour market inefficiencies, reducing regulatory bottlenecks and ensuring policy consistency are crucial to unlocking higher private sector participation.

About Yogesh Kumar

Yogesh Kumar is a country risk economist at NatWest Group, specialising in sovereign risk, macroeconomic analysis and financial markets. His work focuses on credit risk assessment of sovereigns and their related entities, where he evaluates economic and political conditions to determine credit grades based on quantitative data and expert judgment. Yogesh's expertise lies in analysing fiscal sustainability, monetary policy and geopolitical risks, providing key insights that drive risk management and investment decisions.

About the Interviewer

Mahima Sharma is an Independent Journalist based in Delhi NCR. She has been in the field of TV, Print & Online Journalism since 2005 and previously an additional three years in allied media. In her span of work she has been associated with CNN-News18, ANI - Asian News International (A collaboration with Reuters), Voice of India, Hindustan Times and various other top media brands of their times. In recent times, she has diversified her work as a Digital Media Marketing Consultant & Content Strategist as well. Starting March 2021, she is also a pan-India Entrepreneurship Education Mentor at Women Will - An Entrepreneurship Program by Google in Collaboration with SHEROES. Mahima can be reached at media@indiastat.com