Embracing the Era of Unconventional Volatility and Great Uncertainty[1]

Good afternoon.

2. Distinguished speakers, esteemed panellists, office bearers of FIMMDA and PDAI, delegates, ladies and gentlemen. At the outset, it gives me great pleasure to be here amidst you today at the 24th Annual Conference of FIMMDA jointly organised with the PDAI. It is a pleasure to address the young market practitioners and market veterans at the same time. My sincere thanks to both FIMMDA and PDAI for this opportunity.

3. I have titled my address as "**Embracing the Era of Unconventional Volatility and Great Uncertainty".** But allow me to first reflect upon two specific remarks I had made in the previous two FIMMDA annual conferences at Dubai and Barcelona.

(i) At Dubai in January 2023, I had said – "*The current macro-financial setting is completely different from what we have seen earlier. This polycrisis on a global scale refuses to abate and continues to act as disruption multiplier causing a VUCA environment. We are yet to see the secondary effects of the unusual twin sell-offs*[2] *recorded last year*[3] *pop up anywhere. While well-regulated conventional markets may remain less vulnerable going ahead, the* ***less regulated and less transparent*** *private markets may see massive write-downs fuelling contagion risk".* Two months later, in March 2023, Silicon Valley Bank collapsed because of a digital bank-run.

(ii) At Barcelona in April 2024, I had remarked – "*The Indian financial market landscape is at the cusp of a new era of massive transformation. It is undeniable that India has witnessed a period of "great resilience" in the recent years amidst unprecedented global shocks."* One year later, while global shocks continue, the resilience of the Indian economy is there for everyone to see.

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[1] Address delivered by Shri Radha Shyam Ratho, Executive Director, Reserve Bank of India at the 24th FIMMDA - PDAI Annual Conference 2025 held in Bali, Indonesia on April 18, 2025. The contributions of Shri Sabyasachi Sarangi, Assistant General Manager are gratefully acknowledged.

[2] Both equity and bond indices tanking at a pace not seen since the records began in 1990

[3] Referring to the Calendar Year 2022

4. Coming back to Unprecedented Volatility and Great Uncertainty, it is clear that the volatility that we are witnessing currently in financial markets is not the volatility of earlier days. It is unconventional in the sense that there are now new categories of volatility. At the recent FEDAI conference at Zurich in March 2025, I had described them as (a) volatility in economic data, (b) volatility in the way the same data is interpreted, (c) volatility in narratives - shifting stories that drive market behaviour, and (d) volatility in market sentiments. Likewise, there is "Great Uncertainty" these days, less of "Risk" - that can be measured, modelled and mitigated - and more of "Uncertainty", and continuous, relentless Uncertainty. Like batting and bowling records in T-20 international cricket, the records in financial markets are also being bettered (or worsened???) quite regularly.

5. Let me illustrate. On August 5, 2024, during a "mini flash crash" that rattled global markets, the S&P 500 dropped 3%. This downturn was fuelled by a mix of unwinding of Yen carry trades and U.S. recession fears. Recently, the S&P 500 index fell almost 13% in the four sessions from April 03 to 08 before rallying by a stupendous 9.5% on April 09, 2025. I will not be surprised if this record is also broken in a few months' time.

6. For decades, diversification - the sacred cow of portfolio theory - as a shield against systemic shock had remained unquestioned until 2022, when both the equity and bond indices tanked at a pace not seen since records began in 1990. I had highlighted about this in the FIMMDA conference at Dubai. Incidentally, markets exhibited similar trend in the week ended April 11, 2025 when S&P 500, DXY and US Treasuries all declined in tandem amid a spike in cross-asset correlation and faltering diversification. Warren Buffet once said, "Diversification is protection against ignorance. It makes little sense if you know what you are doing." Today diversification hardly offers any protection, either to the ignorant investor or to the seasoned.

7. Now that VUCA has become commonplace, a new acronym is doing the rounds; *viz*. **BANI**[4] (Brittle, Anxious, Non-linear and Incomprehensible). Markets are **brittle** when a single tweet - or a rogue algorithm - can trigger collapse; investors are **anxious** and they amplify chaos with fear-driven trades; disruptions are **non-linear** so

[4] The creator of this concept is Jamais Cascio, an American anthropologist, futurist, and author.

that a policy tweak in one corner of the globe unleashes a torrent of sell-offs elsewhere; and there are **incomprehensible** forces, from black-box AI strategies to sudden geopolitical flares that defy even our best models. The series of acronyms create a belief that they are self-fulfilling and markets have no escape from VUCA or BANI or whatever the next acronym that may be coined. This is far from correct.

Why “Great Uncertainty”?

8. Let us briefly recount the Black Swan events over the last five years that have characterised the current era of Great Uncertainty.

(i) Covid (2020 - 21)

(ii) War between Russia and Ukraine (February 2022 - ongoing)

(iii) World-wide inflation and unprecedented, synchronised rate hikes by central banks (September 2021 - July 2023)

(iv) Geo-political tensions (February 2022 - ongoing)

(v) Israel-Hamas war (October 2023 - ongoing), and

(vi) Tariffs and Trade war (November 2024 - ongoing)

9. It is noteworthy that out of these six major sources of uncertainty, as many as four are still ongoing. Before one black-swan event ends, another starts and gets superimposed on the previous ones. The polycrisis that I had mentioned at Dubai becomes more complex and VUCA gets intensified.

The Problem and its Genesis

10. Why are markets becoming more and more volatile with each passing day? It is because traders react to each announcement about tariffs and counter-tariffs. In the last few months, news flow about tariffs and trade wars have become almost continuous and so have been the reaction in markets. We all know that as the days go by, there will be more and more news about tariffs, and that the last word has certainly not been heard on this subject. Yet markets prefer to react to every news as if it is the final one. Market participants fail to keep their cool. This problem is largely behavioural. As algo trading, High Frequency Trading, and fresh news and events move markets every millisecond, behaviour of market participants becomes more

volatile, sometimes bordering on the irrational. And as more and more market participants start reacting in quick time, markets become even more volatile. In other words, volatility is feeding on itself and uncertainty is leading to more uncertainty in what is a vicious cycle.

System 1 thinking

11. The current nature of behaviour of market participants is possibly because of what Daniel Kahneman, Nobel Prize winning psychologist, calls “System 1 thinking”. Richard Thaler and Cass Sunstein explained that the working of the brain can be imagined as consisting of two systems. System 1 is fast and intuitive while System 2 is slow and reflective. Today, in financial markets, System 1 thinking is rampant while System 2 thinking is rare. System 1 thinking results in fast, intuitive reactions without sparing a few minutes, leave alone hours, to deeply think through the issues.

A Possible Solution

12. In such a state of financial markets, those who do not react to every news or market move in a knee-jerk manner but try to visualise where markets will be 1-2 months down the road may be better-off. Those who endeavour to strategize their moves keeping in mind the likely scenarios after 1-2 years may be bigger winners. And those who also factor into their moves long-range predictions, howsoever probabilistic they may be, regarding demographic trajectories, impact of climate change, frontier technologies, such as Artificial Intelligence (AI), Machine Learning (ML), quantum computing to name a few, will be the real winners. Secular forces such as demographic and climatic trends and the progress of technologies will ultimately shape the future of various countries. Today, market participants need to factor in only the extent to which the current news or market movements alter or impact the secular trends. The rest is noise and can be safely ignored.

13. Therefore, it is vital to identify and focus on longer-term secular forces that will last for years, if not decades. These forces have to be studied, and the way they are dynamically evolving has to be analysed. While I admit that this is easier said than done, it is probably the only way that we as market participants can escape from the tyranny of non-stop news, that is increasingly erratic and conflicting, resulting in non-stop and exponentially increasing volatility in markets.

Conclusion

14. Amidst this incessant noise that everything is changing and changing rapidly, it is useful to remember the observations of French writer Jean-Baptiste Alphonse Karr in 1849, and I quote, “the more things change, the more they stay the same.” Interestingly, in the context of financial markets, Carmen Reinhart and Kenneth Rogoff in their book “*This Time Is Different: Eight Centuries of Financial Folly”* remind us that crises often follow familiar patterns. To reiterate, while we can completely ignore the daily news only at our own peril, we should take the same into account only to the extent to which it changes the medium and long-term trajectories.

15. I wish the Conference all success. Thank you and Namaskar.

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