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RESEARCH

BOB ECONOMICS RESEARCH | FED POLICY

Ending the year with another rate cut

SUMMARY

INDIA ECONOMICS: FED POLICY

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Ending the year with another rate cut

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US Federal Reserve in its latest policy went ahead with the 3rd rate cut in a row. The policy remained balanced with weaker labour market conditions being the main rationale for policy decision. There remains less scope for further easing in CY26 with just one rate cut priced in, as per Fed's projections. In 2027, the dot plot signals the last rate cut to bring the rate to 3.0-3.25%.

So, what this policy holds for India? It becomes crucial from the standpoint of interest rate differential between India and US at a time when currency has remained volatile. The policy rate differential between India and US has largely been contained due to sharper pace of rate cut by RBI compared to the US. The yield differential has also mirrored the same trend as policy rate differential. This was supportive of FPI flows in the initial months. However, the volatility of rupee currently has had an impact on flows of late. Going forward, we expect the policy rate differential between India and US to be maintained at the current level.

Easing for 3rd time in a row

US Fed in its latest monetary policy meeting delivered another rate cut for CY25, taking the cumulative rate cut for the year to 75bps. The rate is now 3.50-3.75%. This has been the third consecutive policy that Fed continued to remain on the path of monetary easing. This is notwithstanding the absence of economic data since US government shutdown from 1 Oct 2025 onwards. So, what is the rationale for rate cut since the last policy?

The employment data, as seen from the payroll numbers, have shown downward revision for the past two months. The 4-week moving average claims have also remained elevated. In its policy document as well, it has been reiterated that "unemployment rate has edged up through September". On inflation front, there has not been much data to analyze. However, the policy document highlighted elevated risks to inflation. In fact, Fed highlighted that it is "prepared to adjust the stance of monetary policy as appropriate if risks emerge".

What economic projections of Fed suggest?

1. Growth: For real GDP, the projection for CY26 has been revised upward to 2.3% from 1.8%.

2. Unemployment rate for CY26 has been kept at 4.4%. This leaves less scope for further monetary easing.

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