Press Release

Finally, the Fed pivots and in a grand way!

September 19, 2024

The long awaited Fed rate cut has happened and in a bigger way than what the markets had expected a few weeks back – 50 bps. Fed's rate now ranges between 4.75%-5.00%. Such an action from the US central bank signals a significant shift in global monetary policy and an acknowledgement that the prolonged phase of higher interest rates has helped in guiding the US economy to a sustainable path of disinflation. The bigger cut of 50 bps also highlights Fed's intent to avoid a hard landing and minimise the risks of recession in the US. While the bank has not provided much clues on the next steps, it is likely that the Fed will opt for a moderate path on rate cuts i.e. another 50 bps in two tranches till Dec'24 (100 bps in total) unless there is evidence of a rapid cool down of the labour market.

The direct impact of the Fed rate action for India can come in three ways. One, higher foreign capital (FPI) flows to the domestic debt market which may reduce domestic bond yields. The ten year g-sec has already slipped below 6.8% in anticipation of the Fed rate cuts and may drop further which will not only benefit the government from lower interest payouts on new issuances but also stimulate the corporate bond market. While the domestic bond market had seen a slowdown in the early part of the fiscal, it has seen a significant revival over the last two months on the back of weaker bank lending particularly to NBFCs. Banks and infrastructure sector issuers may explore a larger quantum of longer term issuances to capitalize on the softness in yields. Additionally, external commercial borrowings (ECB) may become more attractive amidst a relatively stable rupee, increasing the fund mobilization options for Indian corporates.

The second potential impact is on the INR due to the expectation of higher capital inflows. The INR has regained strength from a high of 84.0 to 83.7 over the last week and this trend may continue in the near term. However, we believe that RBI's intervention in the forex market will prevent any further appreciation of the INR; by the end of the fiscal, we expect to see an orderly and mild depreciation of the INR to 84.5.

While RBI is likely to take an independent view on any interest rate action in India, the strong rate cut from Fed may have increased the likelihood of a 25 bps cut from the MPC in Dec'24, provided however, there are no fresh surprises on the food inflation front.

In response to the severe post Covid inflation, the Fed had delivered 11 interest rate hikes from historic lows to the current rate of 5.25-5.50%, the highest in over twenty years. From July 2023, the Fed had been monitoring incoming inflation and labour data closely, resisting all pressures for a premature rate cut. From a high of 9.1% in Jun'22, the headline US CPI inflation has steadily declined to 2.5% in Aug'24. While PCE (personal consumption expenditure) index, the Fed's preferred measure as an inflation gauge, has been relatively sticky, it is largely in line with the central bank's expectations at 2.5% in Aug'24. Clearly, the disinflation has been also supported by global factors such as the slowdown in China and declining global commodity prices particularly crude oil.

While interest rates in US had remained elevated over the last two years, the data still doesn't indicate any severe impact on the labour market which is still relatively healthy with unemployment at 4.2% (Aug'24) and positive albeit moderating wage growth. Typically, unemployment spikes to 8% and above during periods of recession. It appears that the Fed action has been driven more by the risks of a rapid deterioration in the labour market and the need to take timely action. Given the current and the expected Fed rate cuts, we believe that the likelihood of a US recession in 2025 has reduced significantly.

About Acuité Ratings & Research Limited:

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