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THE FED ACTION - IMPLICATIONS FOR INDIA

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The Federal Reserve slashed its benchmark interest rate by a bigger-than-expected 50 basis to a range of 4.75% to 5%, after holding it for over a year at its highest level in two decades. This move by an overwhelming majority of 11 to 1 marked an aggressive start to a policy shift aimed at providing an impetus to the US labor market in the wake of softening inflation at 2.5% “*moving sustainably down to 2%*” and the need to ease the cost of borrowing. To place matters in perspective, it may not be unreasonable to recapitulate that the last time the Federal Open Market Committee (FOMC) or the Federal Open Market Committee cut by half a percentage point was way back in 2008, during the global financial crisis, other than of course the devastating Covid-19 pandemic period.

While “*additional adjustments*” to rates based on “*incoming data, the evolving outlook, and the balance of risks*” will be considered, projections showed 10 of 19 officials favor lowering rates by at least an additional half-point over their two remaining 2024 meetings. In view thereof, there is still a fair way to traverse in the rate-cutting cycle.



Global Cues Impacting India - What, How and Why?

This move, which marked an evolving policy from '*inflation is transitory*' to '*higher rates for longer*', is likely to influence global liquidity facilitating flows to emerging market assets such as India with a weaker dollar and lower rates. With the interest rate in India still being higher, the Indian economy is likely to get a boost through capital inflows like Foreign Portfolio Investment (FPI) inflows, Foreign Direct Investments (FDI) and External Commercial Borrowings (ECB). The languishing Chinese economy could also provide some tailwinds to the Indian economy.

While the Indian stock market may get a leg up, aspects like valuation, and earnings also must be factored into the decision-making matrix. Therefore, stock-specific strategies rather than a broad-brush approach would be advisable. Lower interest rates may, however, benefit India's infrastructure and metals sectors. Capital market investors would do well to be careful, keep their eyes and ears open, and explore emerging opportunities but not be oblivious to building up systemic risk, macro and micro risk factors, transforming overarching global and domestic settings, and shifting paradigms.

Higher foreign capital inflows into the Indian debt market would lower domestic bond yields, which are currently below 6.8%. Lower domestic bond yields would benefit both government borrowing and the corporate bond market.

This deep cut may not induce the Reserve Bank of India (RBI) to go in for a rate cut in India in its forthcoming October 2024 Monetary Policy because of an element of decoupling of the Indian economy with the larger global economy and the growth-inflation dynamics in India with the inflation rate at about 4 %, unacceptably high sticky food inflation and the distinct possibility of inflation rising from 4.1 % in Q2 to 5.0 % in Q3FY25 because of waning base-effect. In challenging times, deft macroeconomic steering is needed.