

7. Us Federal Reserve Rate Cut – Economy

The US Federal Reserve cut its benchmark interest rate due to a slowing US job market despite persistent inflation. This decision is expected to boost capital inflows into India and strengthen the rupee, creating a mixed impact on Indian inflation and export competitiveness.

US Federal Reserve's First Rate Cut in Nine Months – The US Federal Reserve (Fed) recently announced its first interest rate cut after nine months of maintaining a steady policy. The benchmark federal funds rate range was lowered by 25 basis points to 4–4.25%.

Understanding the Fed Rate and Rate Cuts – It's the interest rate at which commercial banks in the US lend their excess reserves to each other on an overnight basis. It serves as the primary benchmark for all other borrowing costs in the US economy, influencing everything from credit card rates to home loans. The rate is set by the Federal Open Market Committee (FOMC) of the US Federal Reserve.

Reasons for the Recent Rate Cut – The Fed's decision is a careful balancing act aimed at fulfilling its dual mandate – ensuring price stability (managing inflation) and achieving maximum employment.

Weakening Labour Market – Recent data indicated a slowdown in the US job market. Non-farm payroll employment rose by only 22,000 in August, falling short of expectations. The Fed officially noted that "job gains have slowed" and unemployment is gradually increasing, posing downside risks to the employment outlook.

Inflation Dynamics – While the job market is weakening, inflation remains a concern. The Fed's preferred inflation gauge, the Personal Consumption Expenditures (PCE) Price Index, increased from 2.2% in April to 2.6% in July.

Inflation Forecasts – The Fed expects inflation to remain above its target for the near future. The 2025 forecast is unchanged at 3%. The 2026 forecast has been revised upward to 2.6% (from 2.4%). The Fed projects that its 2% inflation target will only be reached by 2028.

Impact of US Fed Rate Cuts on the Indian Economy

Impact	Positive Effects (Pros)	Negative Effects (Cons)
Capital Flows	Lower US rates make Indian markets more attractive for foreign investors, leading to increased Foreign Portfolio Investment (FPI) inflows into equities and debt. This improves market liquidity and can ease bond yields.	While not explicitly negative, a sudden surge in inflows can increase market volatility if not managed properly.
Rupee & Exchange Rate	A weaker dollar (resulting from lower US rates) and stronger capital inflows can cause the Indian Rupee to appreciate.	A stronger Rupee makes Indian exports more expensive and less competitive on the global market.
Inflation	A softer dollar can reduce imported inflation, as the cost of importing crude oil and other commodities priced in dollars becomes cheaper.	Higher liquidity in the domestic market, driven by strong FPI inflows, can create domestic inflationary pressures.
Exports & IT Sector	Looser US monetary policy may lead to a revival in global trade, potentially increasing demand for Indian goods and services.	An appreciating Rupee directly impacts the revenue of exporters and the IT sector, as their earnings are in dollars, which convert to fewer rupees.
Wider Macro Impact	Lower global credit costs reduce India's external borrowing burden for both the government and corporations. It also encourages Indian companies to raise funds abroad and boosts overall investor confidence in India's growth story.	No direct negative effects are noted, but an over-reliance on external borrowing could pose risks if global conditions change.

Source – <https://www.federalreserve.gov/default.htm>