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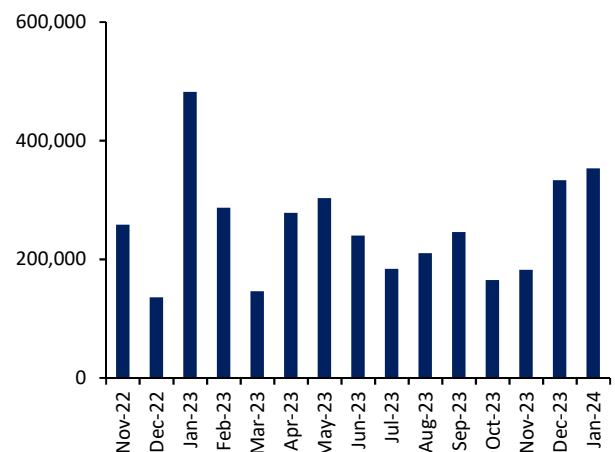
## Rate Cut Timing Still Uncertain

When and What should lead to a rate cut is now a question that remains in ambiguity as jobs market in the US remains robust, inflation is steady and as optimism prevails in the US economy. Since the start of the year, market participants were expecting that the Fed should look for a rate cut and that would be soon as March despite US economy showing any signs resilience. The Fed generally believes in preparing the market about their further course of action and that is the guiding path for investors to take a view on rates. US 10-year yields have witnessed a lot of swings in the market and has been moving and in the last couple of months it has moved from 3.8% to 4.3% suggesting that investors remain cautious on aggressive rate cut announcements by the Fed. But let's see how the jobs market has evolved and how the market is pricing in rate cuts for this year.

### Job Market Remains Robust

Latest jobs report released from the US was quite robust and data showed job addition at 353,000, one of the biggest addition in the last one year. January's number too was revised further bringing suggesting jobs market remains resilient despite the impact of higher interest rates. Unemployment rate remained steady and that has not had much of an impact of the overall jobs number. On the other hand, wage growth ticked higher in January, as average hourly earnings jumped 0.6%, outpacing 0.4% monthly gains reported in November and December.

US NonFarm Payrolls



Source: Reuters

The Fed would not necessarily want the jobs market to slowdown, but would want to see inflation coming down towards its inflation target or at least sustain around the 2% mark. The strong jobs data will not deter the Fed from launching its widely accepted rate cuts this year, but resilience the labour market could weigh on the timing and potential rate cut announcements. Most officials are of the view that the Fed remains on track to cut rates later, on expectation that inflation in the later half could recede even if the US economy continues to adds jobs this year

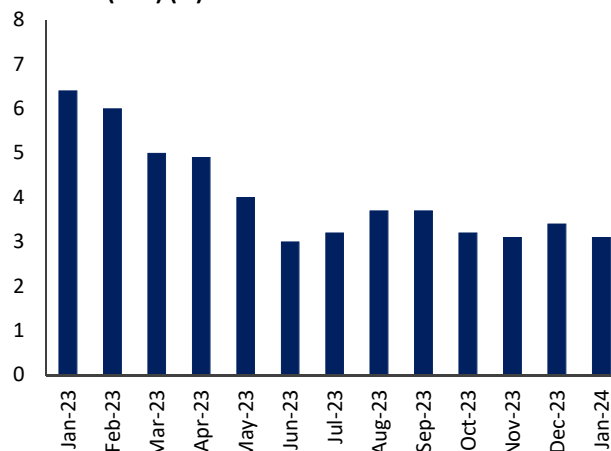
### Inflation above Fed target but remains steady

Controlling inflation remains one of the top most priorities for Fed and the steps taken by the central bank last year have started to take shape as inflation has receded sharply from the highs. From the highs hit in June'22, latest number showed inflation growth for January steadied at 3.1%. The number is just a stone throw away of 2%. But recent rally in global crude oil prices and other contributors to inflation could deter hopes of lower inflation at least for the next couple of months.



The persistent inflation in housing, services and food underscores the challenges facing the economy in achieving the Fed inflation target of 2%. The costs of food at grocery stores have been a particular problem for consumer budgets, which have not moderated to the same extent as other consumer goods. Fed officials in their recent statements suggest that they are no hurry to cut rates as they ascertain risk to restoring price stability. But the question now remains how much and what would be the good data to analyse? Officials now have sufficient of time to analyse data before a rate cut announcement either in May or June. Not necessary that the Fed will align with the inflation and the path towards neutrality could be more quickly than indicated by the Fed in its projection summary. If the Fed continues to be data-dependent, the chance of being behind the curve is nontrivial. In retrospect, the central bank was behind the curve—as Fed officials acknowledge—when it came to predicting inflation during the pandemic.

US CPI (YoY) (%)



Source: Reuters

### Fed rate cut probability

The Fed wants a rate cut but the central bank is taking its time. Odds of the March rate cut are almost zero now following comments from the Fed governor and also inflation in January grew 3.1%. Since the start of the year probability for rate cut for March was as high as 65% but that is now below 10%. The CME Fed watch tool suggest that the first rate cut announcement by the central bank could come in around summer.i.e. as early as June. Amongst the major currencies, India rupee could benefit from the carry trade this year and interest rate differential could widen from here.

Probabilities for Fed Meetings		
Fed Meeting	Rate Cut	Unchanged
March	8.50%	91.50%
May	34.20%	65.80%
June	78.7%	21.20%

Source: CME Fed Watch Tool

### Outlook

We expect that rate cuts could begin in as early as June with inflation concerns still looming around. Cost of rent and food inflation is a concern but steps taken by the Fed is likely to take shape and that could eventually lead the Fed to its 2% target. Everything is quite data dependent on the current job market scenario for the Fed to decide on the quantum of rate cuts. Previously the probability of rate cut used to be more than 100 bps but now investors are discounting rate cuts below 100 bps.

The Federal Reserve's monetary policy path appears to be one of caution, with future adjustments heavily dependent on a lagged drop in housing costs over the course of this year. While the peak inflationary pressures of



2022 have subsided, the journey towards economic stabilization and price stability remains complex and contingent on careful policy navigation.

A greater risk looms in the corporate debt markets as \$3 trillion to \$3.5 trillion in corporate debt will need be refinanced into 2025. This is addition to the stress in the commercial real estate market as building owners grapple with plunging values. It is never going to be an easy task for timing the rate cut announcement. Never the less, we expect that the trend for dollar could be divided during the year, with first half of the year trend little positive and the latter could be negative, considering rate cut announcement would be after summer in the US. Technically, the Dollar index is likely to take resistance in the zone of 105.50 – 105.80 and support lies at 103.30 and break below the support level could take it towards 102.20 level eventually.

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