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EcoScope
The Economy Observer

FOMC Jan'26: A clear pause for some time

- **The Fed kept interest rates unchanged (in line with expectations) at 3.50%–3.75%, signaling a pause after three consecutive cuts, with policy now close to neutral and future moves fully data-dependent. The focus of markets has clearly shifted to the increased likelihood of another US government shutdown and the selection of the next Fed leader—the choice is now between Warsh and Rieder.**
- **With no new projections or dot plot, Powell indicated that the central bank is 'well-positioned' to wait for clearer signals on inflation and employment.**
- **Rate markets still price in about a 60% chance of two 25bp cuts later this year (probably in June/July), but confidence has weakened, leaving investors focused on upcoming jobs and inflation data rather than Fed guidance.**
- **Going ahead, the Fed is likely to remain on hold for longer unless there is a clear slowdown in job growth or faster disinflation. With the GDP nowcast tracking above 5% for 4QCY25, the overall growth outlook appears strong amid contained price pressures.**
- **For India, we expect the RBI to cut rates by 25bp in Feb'26, as growth is likely to moderate in 2HFY26, even if inflation remains broadly contained.**

Rate decision

1. The FOMC voted 10-2 to maintain the current interest rate in the target range of 3.50% to 3.75%, ending a streak of three consecutive quarter-point cuts. Governors Stephen Miran and Christopher Waller dissented, favoring a 25bp cut.
2. Powell indicated the central bank is 'well-positioned' to wait for clearer signals on inflation and employment, emphasizing that the path forward is data-dependent, with no preset course for future rate adjustments.
3. He further added that the current policy stance is appropriate, and the policy rate is now within the plausible range of the estimated neutral interest rate.
4. The Fed is maintaining its balance sheet operations to ensure ample reserves in the banking system after officially ending quantitative tightening (QT) in Dec'25.

Macro outlook

1. **Growth:** The Fed upgraded its assessment of economic activity from 'moderate' to expanding at a 'solid pace' and noted that the unemployment rate has shown signs of stabilization, with job gains remaining low.
2. **Inflation remains 'somewhat elevated',** primarily due to the effects of tariffs. Powell expects tariff-related price pressures to peak and then recede around mid-2026, which could allow for policy easing later in the year.

Market reaction: Muted

1. Markets reacted with little enthusiasm, as the Fed's decision was fully expected. Equities ended largely flat, while bond yields moved in a narrow range, reflecting comfort with the view that policy is now close to neutral.
2. Rate markets still price roughly a 60% probability of two 25bp cuts later this year (June/July), but conviction is fading. Overall, the response was one of indifference rather than relief or concern, with investors waiting for fresh cues from economic data, especially jobs and inflation, rather than the Fed.

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■ **Outlook: Fed unlikely to cut rates in 1HCY26**

1. Going forward, markets are likely to remain range-bound and data-driven. With the Federal Reserve signaling patience and policy rates close to neutral, investors will look to labor market and inflation data to determine the timing and extent of any further easing.
2. Unless there is a clear slowdown in job growth or a sharper disinflation trend, the Fed is likely to stay on pause for an extended period.

■ **Implications for India**

1. The pause in US policy rates signals a shift from active easing to patience, keeping global financial conditions stable but not loose. For India, this reduces the risk of abrupt capital outflows, supports currency stability, and helps contain external financing pressures, even as global yields remain relatively elevated.
2. Domestically, India's macro fundamentals remain supportive. Inflation is within the RBI's comfort zone, while real rates are still restrictive, giving policymakers some flexibility. That said, growth momentum is uneven, and external uncertainties—especially around global trade and demand—continue to cloud the outlook for exports and private investment.
3. With inflation under control and real rates still high, the RBI has room to support growth but is likely to ease policy gradually and cautiously. We expect the RBI to cut rates by 25bp in Feb'26 as growth is likely to moderate in 2HFY26, even if inflation remains broadly contained.

Exhibit 1: Real repo rate at a seven-year high in India

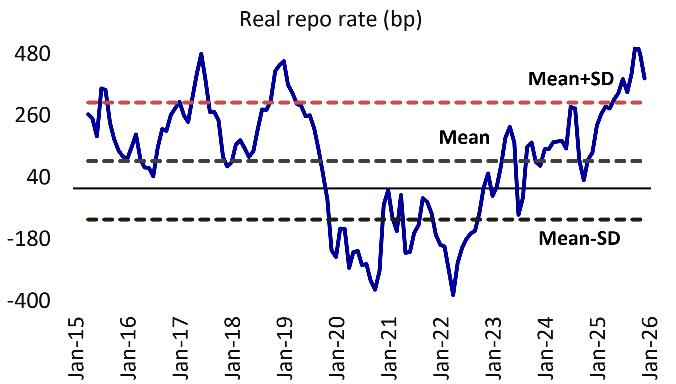
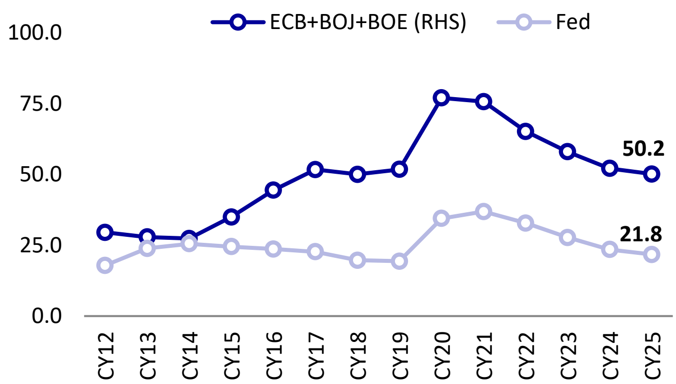


Exhibit 2: Central bank balance sheet (% of GDP)



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