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Powell – we are at ‘neutral’ now

The Fed delivered a widely expected 25bp rate cut, bringing the policy rate to 3.5–3.75%. While the dot plot points to just one more cut in 2026, markets still price in two. Treasury purchases (US$40bn/month) have resumed to stabilize short-term rates after a spike in SOFR, supporting liquidity but not signaling a classic QE. With insurance cuts likely over, the growth outlook has improved, yet inflation remains sticky and above target. The Fed’s next moves will hinge on upcoming data and leadership transition, with policy uncertainty heightened by political pressures and the pending appointment of a new chair.

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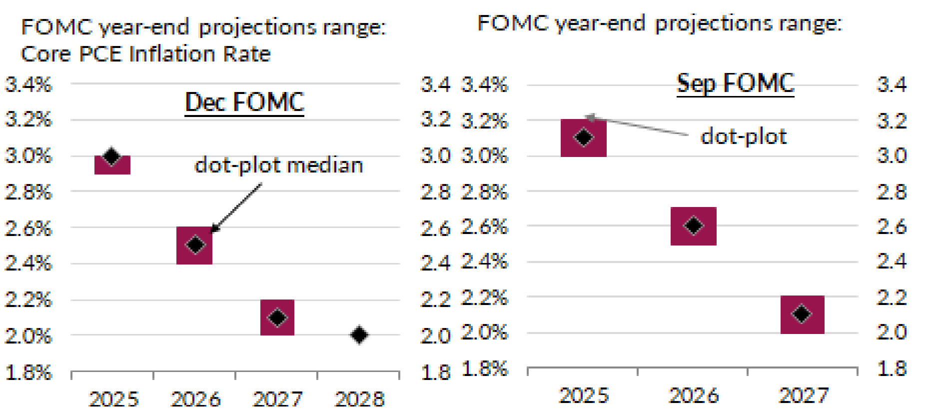
Exhibit 1 - FOMC: US inflation projections lowered for 2026 by 10bps



Source: Bloomberg, Axis Bank Research

Fed cuts as expected but policy at a crossroads

The Fed’s third consecutive 25bp rate cut brings the policy rate to 3.5–3.75% but signals a pause ahead. The FOMC’ dot plot suggests only one more cut in 2026 (Fig 5), but markets are still pricing in two cuts in 2026 (Fig 4). Three formal dissents and several “silent” non-voting objections reveal deepening divisions within the Fed. Some officials fear inflation remains sticky and above target, while others worry about labor market deterioration.

Liquidity support: Treasury purchases resume to maintain ‘ample reserves’

Between 20th Nov and 1st Dec, the SOFR rate jumped 20bps (Fig 6). The Fed’s resumption of Treasury purchases (US$ 40bn p.m.) to maintain ample reserves is a response to this sharp move. This is not classic QE, but it does support market liquidity. This move should help anchor short-term rates and ease funding pressures thus supporting risk sentiment.

Insurance cuts are now over, growth outlook remains strong and inflation sticky

The rate cuts so far were insurance against a potential weakening in the labor market (link). However, the growth outlook has recovered (Fig 7) while inflation remains sticky (Fig 2,3). Inflation expectations (2Y ahead) are now 60bps lower vs. peak (Fig 2) but remain elevated. The Fed’s next steps will hinge on upcoming economic data, with FOMC watching for signs of sticky inflation or further labor market deterioration.

Uncertainty and leadership transition

The Fed faces a challenging environment: inflation remains above target, the labor market is cooling, and political pressures are mounting. President Trump’s criticism of the Fed’s pace of easing has raised concerns about central bank independence. Despite the lack of market reaction (so far) to Fed leadership uncertainty, the choice of the next chair will be crucial for policy direction and credibility.

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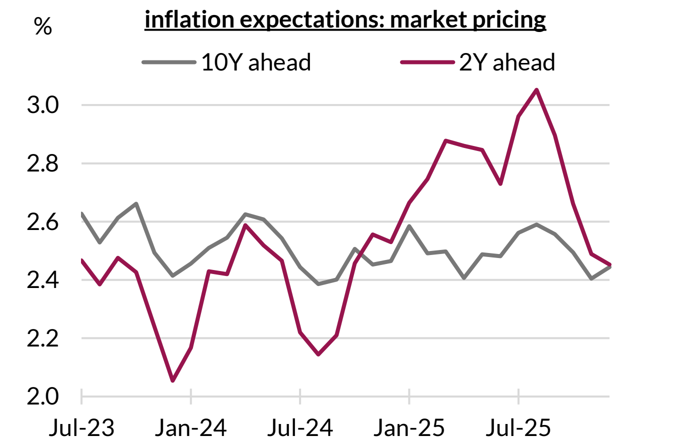
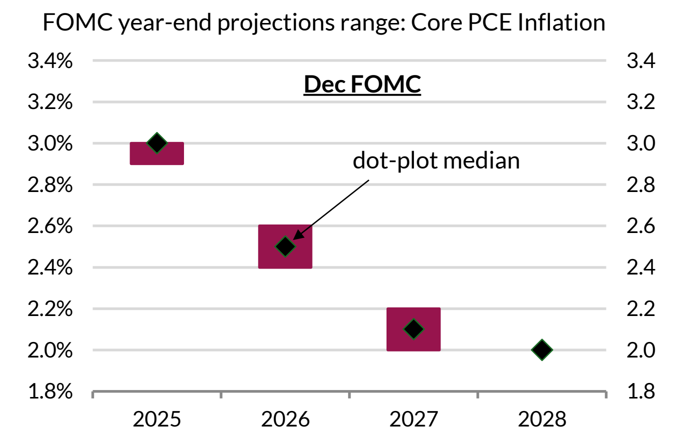
FOMC review

Exhibit 2 - Market inflation expectations (2Y) 60bps lower vs. peak: tariff related inflationary shock expectations have abated



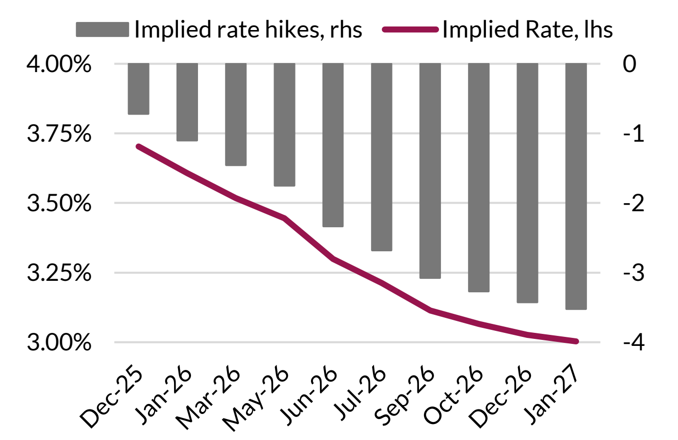
Source: Bloomberg, Axis Bank Research

Exhibit 3 - FOMC agrees: Inflation uncertainty (measured by dispersion, size of the box) is now low



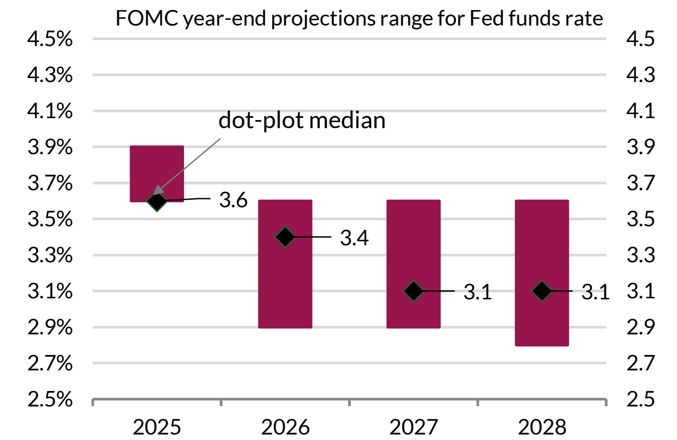
Source: Bloomberg, Axis Bank Research

Exhibit 4 - Markets now pricing another 50bps cut in 2026



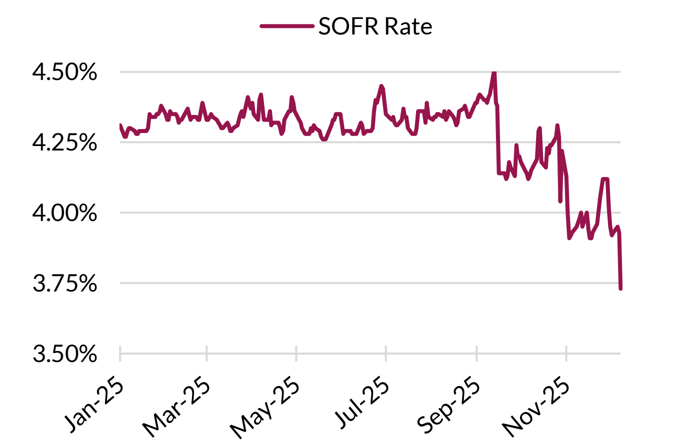
Source: Bloomberg, Axis Bank Research

Exhibit 5 - FOMC 'dot-plot' shows only one cut in 2026



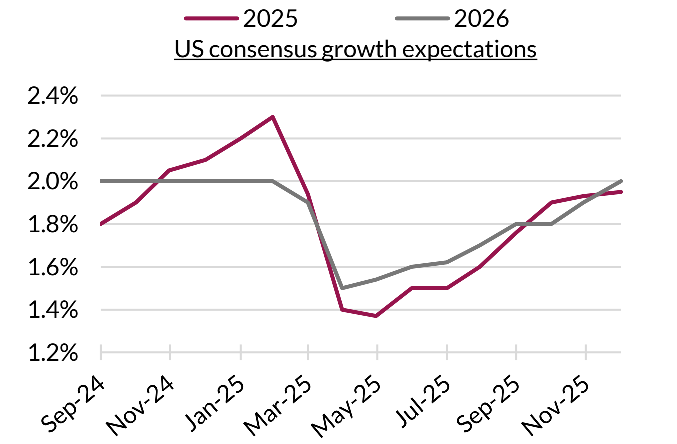
Source: Bloomberg, Axis Bank Research

Exhibit 6 - Sofr rate jumped between 20-Nov and 1-Dec



Source: Bloomberg, Axis Bank Research

Exhibit 7 - 2025 growth expectations inching back to 2%



Source: Bloomberg, Axis Bank Research