

Rate cut cycle resumes after 9-month hiatus

The Fed's 25 bps cut—its first in nine months—marks a pivot amid deteriorating labor market data and persistent inflation overshoot above the target. Powell's messaging and the SEP reveal a growing bias toward risk management, with a narrow majority signaling two more cuts in 2025 (our view: only one more cut in 2025). The removal of "solid" from labor market language underscores rising concern over cyclical fragility. While inflation remains sticky, the Fed appears willing to tolerate modest overshoots to preserve employment stability. Still, market pricing of rate cuts in 2026 seems highly improbable.

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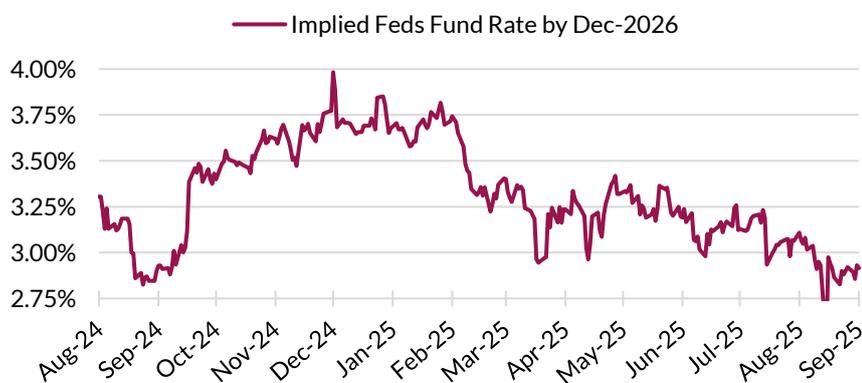
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Exhibit 1 - Markets pricing of rate cuts by end of 2026 appears optimistic



Source: Bloomberg, Axis Bank Research

Fed cut rates by 25bps: members divided on the extent of further rate cuts

The Fed cut policy rate by 25 bps in line with recent expectations (a delay we anticipated since May; [Stagflation fears induce FED paralysis?](#) and our warning in Jul [Keeping options open may come at a cost](#)). In the latest summary of economic projections (SEP), the dot plot median showed three rate cuts in 2025 (Fig 4): in line with market pricing (Fig 5). However, markets are pricing two additional rate cuts by end-CY26 vs. the FOMC median.

Greater weight to labor markets deterioration despite growth upgrades

We argued post May FOMC ([link](#)) that the downside risks to growth must dominate policy focus but stagflation fears have likely induced paralysis and heightened the risk of policy errors. Despite 20 bps growth upgrades (Fig 6-7), growth remains weak and a faster convergence to terminal rate (r -star) alleviates some of the downside risks.

2026 core inflation projections revised higher (+20bps): caution warranted

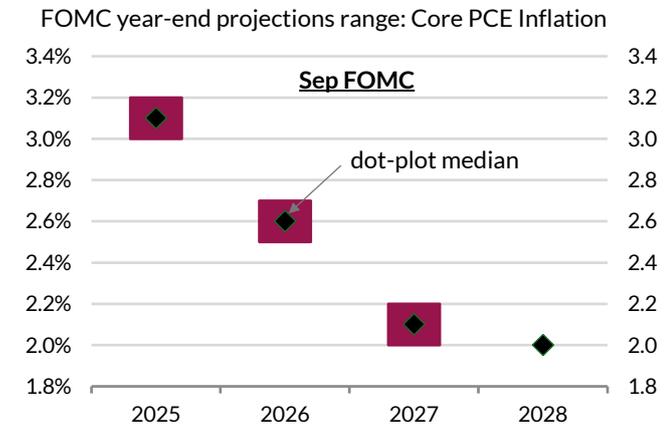
The core PCE inflation projection remained unchanged for CY25. However, price pressures in 2026 are expected to remain higher than the previous projection (2.6% YoY vs. 2.4% earlier; Fig 2-3). While long-term inflation expectations remain stable and tariffs must be treated as a one-period shock, the Fed is right to remain cautious about how quickly it eases policy in such an environment. Optimistic market pricing w.r.t rate cuts likely assumes that the Trump appointees will deliver more/faster cuts than optimal under the current scenario.

1pp rate cut priced in; UST 10Y yields below 4% unlikely to sustain for very long

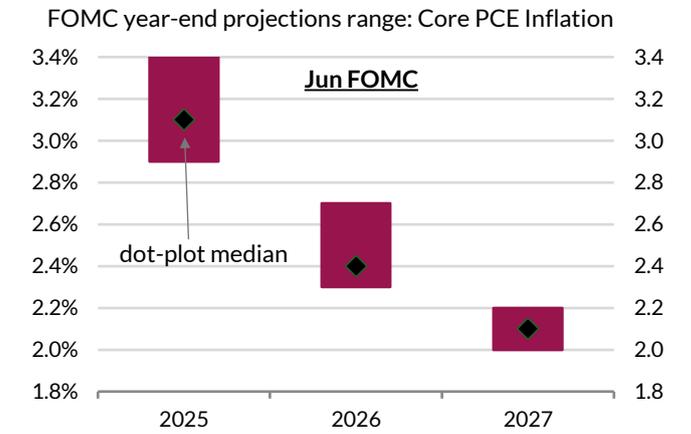
We are now in the era of higher-for-longer rates (Sep-23 report [link](#)). Higher reliance on T-bills (post Mar-25) to finance deficits have kept UST rates under check: share of incremental issuances over 3M via T-Bills was -10% in Mar-25 but rose to 45% in Aug-25. Lower rates on 10Y bonds make long duration borrowing more attractive thus putting upward pressure. Hence, UST rates are unlikely to remain below 4% on a sustainable basis despite rate cuts.

September 18, 2025

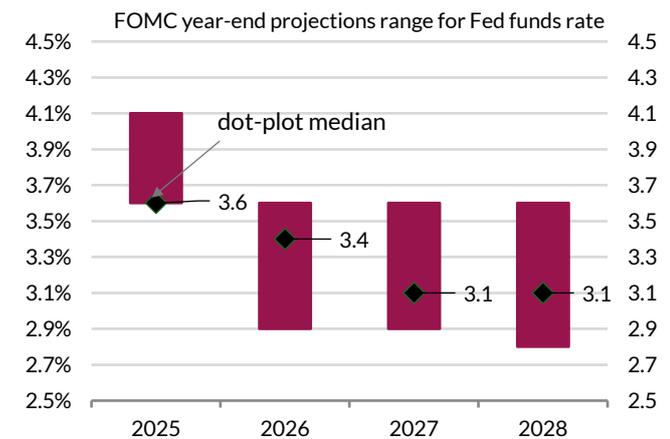
FOMC review

Exhibit 2 - While inflation uncertainty (as measured by dispersion, size of the box) is now lower vs. Jun FOMC...


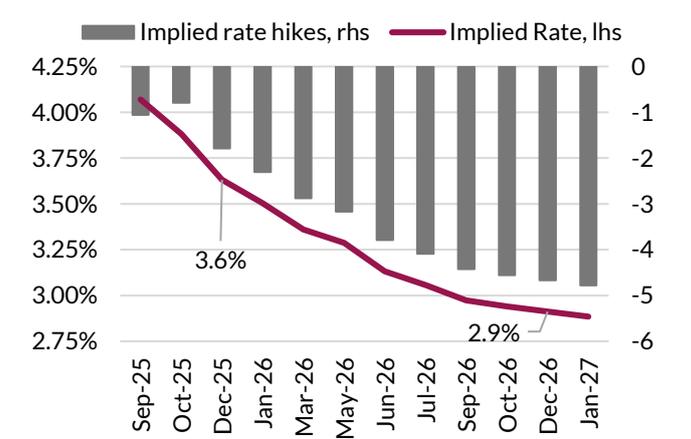
Source: Bloomberg, Axis Bank Research

Exhibit 3 - ... median 2026 inflation expectation rose by 20bps (2.4% earlier, 2.6% now) as tariff passthrough may take longer


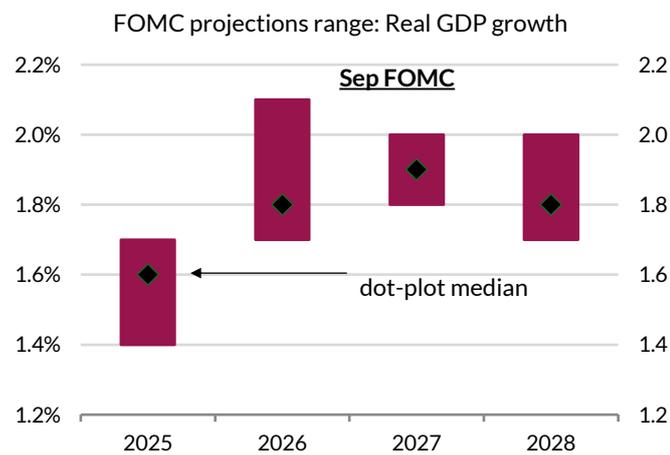
Source: Fed, Axis Bank Research

Exhibit 4 - High dispersion of rate views, median expectations show additional 50 bps cuts in CY25 & CY26 each...


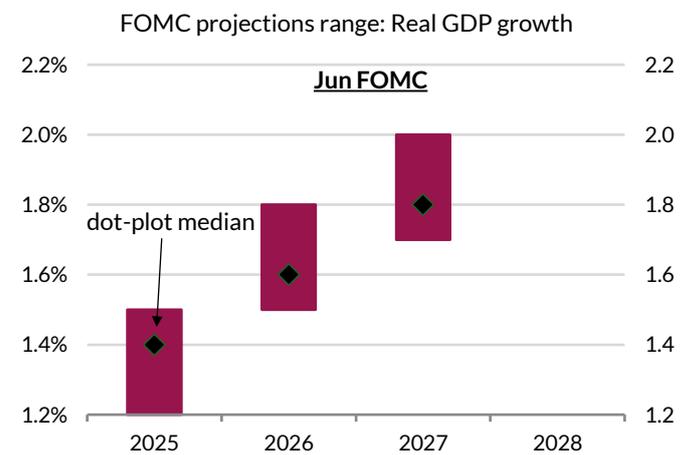
Source: Fed, Axis Bank Research

Exhibit 5 - ...current markets pricing of rate cuts in 2026 highly improbable given the elevated inflation scenario...


Source: Bloomberg, Axis Bank Research

Exhibit 6 - ...especially as 2025/2026 growth projections see...


Source: Fed, Axis Bank Research

Exhibit 7 - ...20bps upgrade vs. Jun FOMC dot-plot


Source: Bloomberg, Axis Bank Research

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