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What does a dovish stance of the Fed mean for us?

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The Federal Reserve has kept rates unchanged in their recent meeting but more importantly indicated that there will be no rate hikes this year. This is a change in stance from the earlier position of having two possible rate hikes in 2019.

GDP growth is to be around 2% and inflation well below the target and unemployment would be around 4%. Excluding fuel and food, inflation remains at less than 2%. Overall inflation is unlikely to cross 2% for the next two years too.

The Fed also affirmed that as of May they would slow their monthly reduction of as much as $50 billion in asset holdings, and halt them altogether in September, ending what amounted to a second lever of monetary tightening that had run in the background since late 2017. The Fed rate has been retained at 2.25-2.5%.

What does this mean?

- The American economy is definitely not getting stronger which is also an indication that overall global growth will remain at best stable and be driven more by other nations especially countries like China and India. The uncertainty on the route to Brexit keeps UK and European Union in a state of flux for the time being.
- While the decision is of a Committee which voted in favour of no change, the voice of President of USA may have also played a role according to some market participants. 9 of the 17 members reduced their outlook for Fed funds rate.
- The fact that GDP growth for 2019 is now kept at 2.1% which is to slow down to 1.9% and 1.8% in the next two years, it does appear that the fiscal stimulus spoken of by the government in the past has not worked out fully to push up overall growth. This may not resonate well with the government as it means that there is a still a lot of work to do on this front.
- The unemployment forecast of the Fed has also increased from 3.5% in December policy for 2019 to 3.7% which is expected to move gradually upwards to 3.9% in 2021.
- The dovish view had lowered treasury yields in the market.

Future implications

- An unchanged stance as of now with possibility of a rate cut means that the dollar would no longer be strengthening against the other currencies. The dollar-euro equation is going to be fragile with the tendency to weaken.

- This is positive news for the rupee which will appreciate on this score. However a lot depends on how the other factors turn out such as current account deficit and capital flows. Movement in oil prices would hold the clue here. Therefore, a rupee appreciation cannot be taken for granted even as the normal pace of depreciation expected of 3.5-4% this year would get reduced. Further the swap of dollars by the RBI from banks to inject liquidity will in a limited manner also restrain appreciation of the rupee.
- An unchanged interest rate regime in the USA is good news for the FPI flows especially in debt and the present wave of positive inflows would continue for some more time. A weak and volatile rupee tending towards depreciation and higher rates in the USA had kept FPI flows negative last year which can get reversed.
- FDI is unlikely to be influenced by this decision as it is driven by other factors such as policy framework, political stability, etc.
- Lower interest rates in USA would be useful for ECBs where companies can continue to leverage this market under a stable forex currency regime. This window can be used more by Indian companies depending on the interest rate spread between foreign and Indian markets. As interest rates in India are poised only downwards, overall cost of funding may be expected to go down.
- Monetary policy action in India is unlikely to be influenced overtly as the target is inflation and while the external sector and the state of the rupee are factors looked at when drafting the statement the decision is driven by inflation and hence should not have an impact.

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