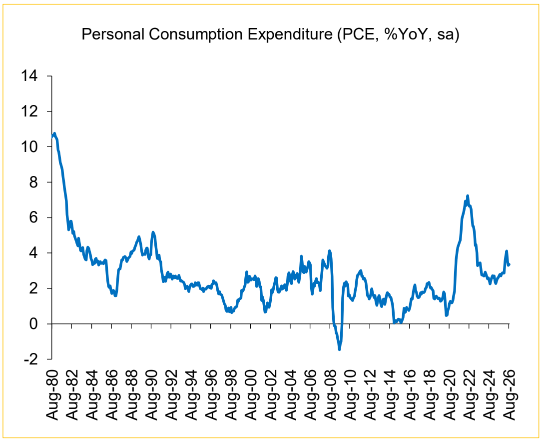
FOMC Meeting KTA - The Energy Squeeze: Fed Blinks, Japan's Next, India Can't Wait

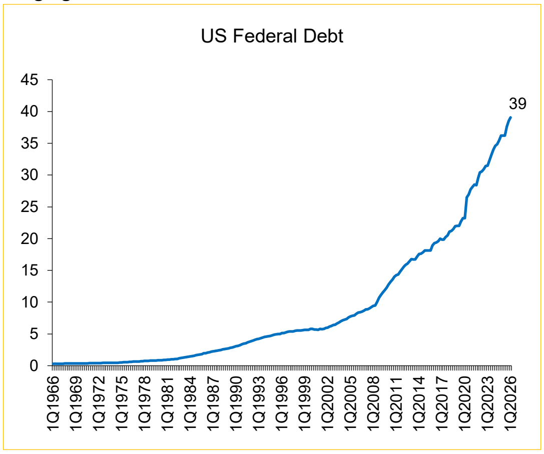
September 17, 2026

PCE inflation is trending higher above the GFC levels



Source: FRED, Choice Institutional Equities

US public debt has surpassed USD 40 Tn recently, amid a surging fiscal deficit



Source: FRED, Choice Institutional Equities

Key Takeaways -

- **The Fed has stopped looking through energy - A 12-0 vote lifted the funds rate 25bps to 3.75-4.00%, the first hike since July 2023, into a supply-driven inflation impulse it would normally ignore. The move is defensive, not confident: a Fed haunted by the 2021-22 "transitory" error is buying credibility insurance, accepting the risk of over-tightening to avoid being late twice.**
- **The dot plot is hawkish up front, split underneath - All 16 submitted dots see at least one more hike in 2026, but 2027 fractures into hikes, holds, and cuts. The signal is a short, sharp, shallow cycle, and a median resting on a few swing dots carries less conviction than the headline suggests.**
- **The SEP quietly concedes lost ground - Headline PCE is nudged to 3.7% for 2026, core to 3.4%, with 2% inflation not expected until 2029. Disinflation is backloaded to 2027 on the assumption that energy normalises; a firmer 4.1% unemployment rate removes the excuse to look through the shock.**
- **This is a synchronised global turn - The BoJ is set to hike to 1.25%, removing the world's last anchor of cheap funding. Central bank tone has shifted from easing to vigilance on the same energy-plus-wages thread, and global yields are the transmission belt, with the US 10-year beyond 5% and Japan's past 3%.**
- **India's MPC now looks sooner and harder - With the Fed and BoJ both hiking narrowing the rate differential, CPI nearing 5% and climbing toward 6%, and negative real rates increasingly untenable, the extended-pause base case is gone. We expect a pivot toward a meaningfully positive real rate, repo nearer 6.5%, with the early-October meeting the first place to watch.**
- **Position for a higher cost of capital - A resetting risk-free rate compresses valuations and keeps FII flows hesitant. The G-sec front end is most exposed, the rupee stays pressured despite hikes serving as currency defence, and long-duration growth equities carry the most downside while energy and commodity names hold up in relative terms. The tail worth hedging: every disinflation path assumes energy behaves, and a persistent West Asia supply shock would make the tightening deeper and longer than priced.**

The decision, and why it deserves scrutiny

The FOMC voted 12-0 to raise the funds rate by 25bps to a 3.75-4.00% target range, its first hike since July 2023. The Fed is hiking into an inflation impulse it would normally look through. The proximate driver is a supply shock, energy costs pushed higher by West Asia conflict, layered on lingering tariff effects. Central banks are trained to see past relative price shocks and target underlying demand pressure. The Committee has chosen not to this time. That choice is the real story, and the rationale is defensive rather than confident: policymakers are haunted by the "transitory" misjudgement of 2021-22, when a supposed supply shock became entrenched 40-year-high inflation. Warsh's Fed is pre-committing to credibility insurance, accepting the risk of over-tightening into a supply shock to avoid the far higher reputational and economic cost of being late twice.

The critical tension: hiking rates does nothing to lower the price of oil. It targets the second-round risk that a durable energy shock lifts inflation expectations and bleeds into wages and core prices. The Committee is effectively betting that anchoring expectations now is worth the growth it may cost later.

Link to the previous note addressing the precarious fiscal scenario persisting globally :

[Fighting the Tide: Why US Intervention Can't Lower the Cost of Money]

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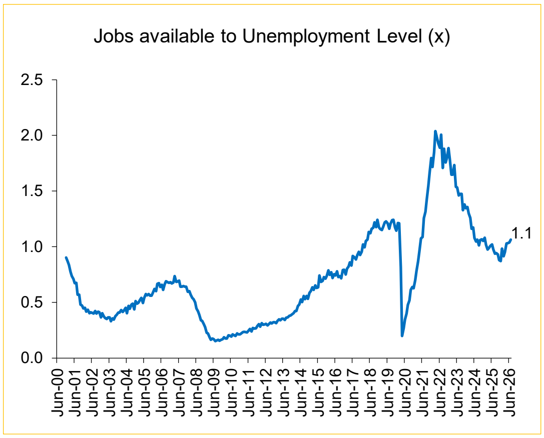
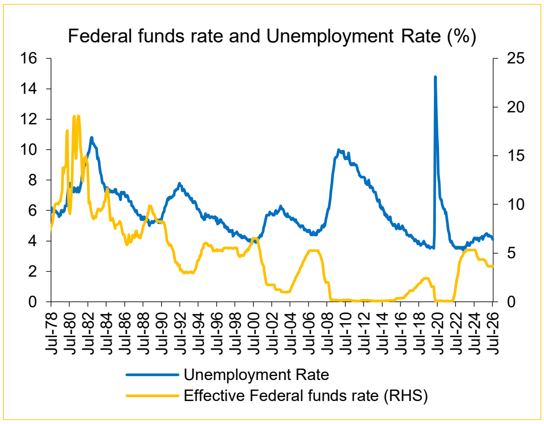
Rising ratio of jobs available to unemployment level indicates that the labour market is pivoting towards tighteness



Source: CMIE, Choice Institutional Equities

Unemployment edged higher while the Fed funds rate moderated recently, reflecting a higher-for-longer policy



Source: CMIE, Choice Institutional Equities

Broader central bank tone has has shifted from easing bias to vigilance. The common thread everywhere is the same energy-driven inflation impulse plus sticky wages, which is why this looks like a synchronised turn rather than isolated national decisions.

Reading the dot plot: hawkish, but with a soft core

The dots point in one direction, but the conviction behind them is uneven, which matters more than the median.

- Of the 18 participants, 16 submitted dots. All 16 see at least one more hike this year. Four of those pencil in two more. Only two expect the Committee to stop after this single move.
- The near-term signal is unambiguous: the bias is to keep going in 2026.
- But 2027 is where the facade cracks. Eight officials see another hike, six see a hold, four see cuts.
- Beyond that, the dots show no further increases, with one cut penciled in for 2028 and at least one for 2029. So the market is being shown a short, sharp, shallow cycle, not a prolonged tightening regime.

The honest interpretation is a Fed confident about the immediate move and genuinely split on everything after it. When a median rests on a handful of swing dots, it conveys less conviction than the headline implies.

The forecast table: an admission on inflation

The Summary of Economic Projections (SEP) quietly concedes the Fed is further from its goal than it was in June.

- Headline PCE is now seen at 3.7% for 2026 and core at 3.4%, each nudged up 0.1pp from June.
- More striking is the timeline: the Fed does not expect inflation back at 2% until 2029. That is a long road for a 2% target, and it implicitly acknowledges the energy shock is not assumed to fade quickly.
- The projected drop-off is backloaded to 2027 (2.3% headline, 2.5% core), which conveniently coincides with the assumption that energy prices normalise. If that assumption is wrong, the entire disinflation path slips.
- On the labour side, unemployment was revised down to 4.1% (from 4.3% in June). A firmer labour market is precisely what removes the Fed's excuse to look through energy inflation, it raises the odds that a supply shock feeds into wages.

There is also a newer, structural inflation worry the Fed is beginning to name: the sheer scale of AI-related capital investment as a demand-side pressure. That is a slow-burn concern, but its appearance in the discussion signals the Committee sees inflation risks as broadening beyond oil.

The global picture: a synchronised turn, not a US story

This is not the Fed acting alone. The world's major central banks are converging on tightening, amplifying the signal and market impact.

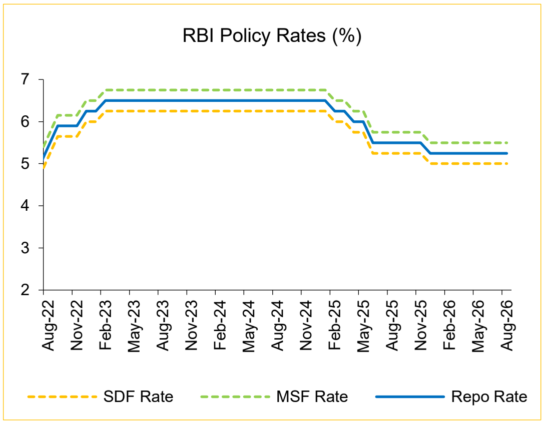
- **Bank of Japan (tomorrow):** The BoJ is expected to raise its policy rate by 25bps to 1.25% at the conclusion of its September 17-18 meeting. The survey consensus is effectively unanimous, with a follow-up move seen by January. Japan's normalisation, underway since 2024, is being forced by a weak yen, imported fuel inflation, and wage growth, with added external pressure from Washington on the currency. A hiking BoJ removes the world's last great anchor of cheap funding, with implications for global carry trades and JGB yields that ripple well beyond Japan. Thus, justifying the Fed’s interest rate hike.
- **Broader central bank tone:** The direction of travel has shifted from easing bias to vigilance. The common thread everywhere is the same energy-driven inflation impulse plus sticky wages, which is why this looks like a synchronised turn rather than isolated national decisions.

Global yields are the transmission belt

Markets front-ran this. Treasury yields have been surging, with the 10-year US Treasury yield moving beyond 5%, with the rate-sensitive 2-year moving even harder. Japan’s 10 year Treasury yield has also breached the 3% level.

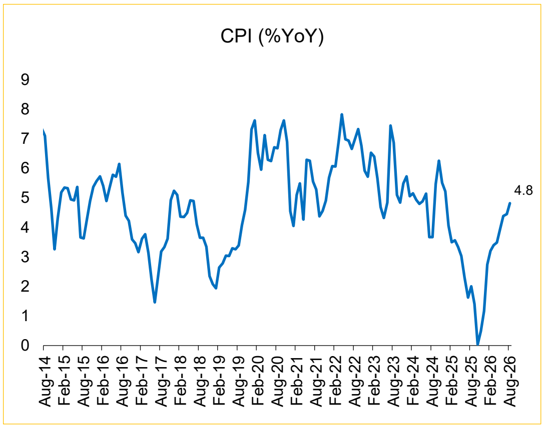
The mechanism to watch: rising energy costs lift headline inflation, central banks respond with tighter policy, and term premia rise as investors demand more compensation for inflation risk. That is a self-reinforcing loop pushing global yields structurally higher, and it tightens financial conditions everywhere regardless of local fundamentals.

RBI holds interest rates steady since its last cut in Dec'25; expected to pivot in the October policy



Source: CMIE, Choice Institutional Equities

CPI inflation has been persistently rising since Oct'25 and has remained above RBI's long-term inflation target of 4%



Source: CMIE, Choice Institutional Equities

India: the MPC meet now looks sooner and harder than expected

The RBI has held the repo rate at 5.25% with a neutral stance, its focus shifted defensively toward currency stability and imported inflation. That calculus is now being overtaken by events.

Street expectations have moved fast. A growing body of sell-side opinion argues the RBI may hike 25bps each at both the October (5-7) and December meetings, taking the repo to 5.75%, with some flagging risk of up to 75bps cumulatively. The cycle is framed as shallow, driven by inflation normalisation rather than broad-based price pressures. The trigger is a CPI trajectory now expected to press against, and possibly breach, the upper end of the tolerance band as global energy transmits into the domestic basket.

The logic for India moving sooner:

- A synchronised global tightening cycle, with the Fed and BoJ both hiking, narrows India's rate differential and pressures the rupee. Rate action is one of the cleaner defence tools.
- Imported energy inflation hits directly through the oil import bill, feeding both CPI and the current account. As a structural energy importer, India absorbs this shock harder than producers do.
- With the Fed no longer looking through energy, the credibility cost of appearing behind the curve is higher for an EM central bank than for the Fed.

The earlier base case of an extended pause has been overtaken. The realistic risk is now a hike, possibly at the very next meeting.

Holding at 5.25% looks increasingly out of step with the trajectory: WPI persistently high, CPI nearing 5%, and a projected climb toward 6% all point to growing discomfort with negative real rates. We expect a shift toward a meaningfully positive real rate, with the repo nearer 6.5%, rather than continued accommodation. Watch the early-October MPC meeting for the first signs of that pivot.

The case for a hike comes down to three points. Start with real rates: in an emerging economy, price stability and financial discipline arguably need a real rate of at least 1%, which pushes the nominal repo toward 6.5%. Then there is the cost of waiting. Keep real rates negative or near zero for too long and you tend to get leveraged consumption, thinner savings, and a central bank with little room left to act once inflation broadens. Finally, the uneven recovery itself argues for moving early.

Market Implications: The combination of sticky inflation and an RBI moving to 6.5% resets the domestic cost of capital upward. A higher risk-free rate compresses valuations just as the Fed's own hiking narrows India's yield cushion, a pairing that keeps foreign flows hesitant and makes FY27's tentative recovery in FII interest look fragile rather than durable. The FCNR(B) forex buffer buys the RBI some room, but a crude bill that refuses to ease can widen the trade gap, draw down reserves, and squeeze corporate margins between costlier inputs and costlier money.

- **Government bonds:** The domestic curve must catch up to a hawkish Fed and a higher global yield backdrop at once. The front end takes the brunt as the market drags forward the odds of an October move.
- **Rupee:** Sustained pressure from a stronger dollar, richer US yields, and a yen no longer anchored at zero leaves the currency exposed. A hike helps, but it works more as a defence of the rupee than a cure for inflation, and it will not neutralise the external pull on its own.
- **Equities:** A steeper discount rate hits hardest where cash flows sit furthest out, so expensive growth and rate-sensitive names carry the most downside. The mirror image is that anything geared to the oil move itself, energy producers and the broader commodity complex, holds up better in relative terms.
- **The tail worth hedging:** Every disinflation forecast in the room, the Fed's included, quietly assumes energy behaves. Let a West Asia supply shock run, and the synchronised tightening runs deeper and longer than either the dot plot or consensus is currently priced for. That is the scenario to insure against.

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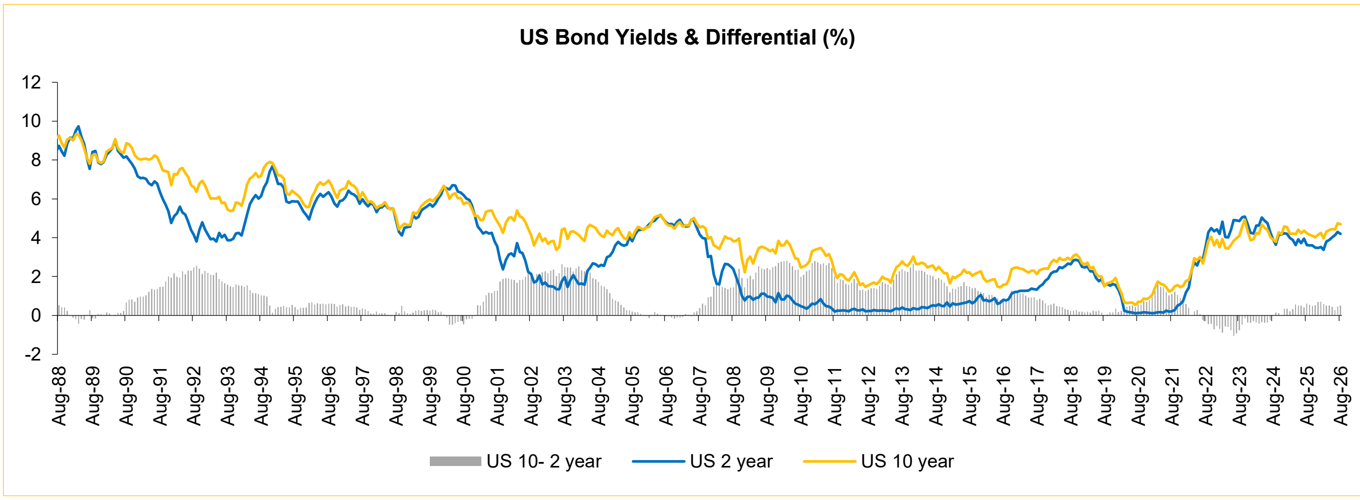
Economic projections of Federal Reserve Board members, September 2026

Percent

Variable	Median[1]					Central Tendency[2]					Range[3]				
	2026	2027	2028	2029	Longer run	2026	2027	2028	2029	Longer run	2026	2027	2028	2029	Longer run
Change in real GDP	2.3	2.4	2.2	2.1	2.0	2.2–2.4	2.2–2.6	2.1–2.3	2.0–2.2	2.0–2.2	2.1–2.6	2.0–2.9	1.8–2.6	1.8–2.4	1.7–2.5
June projection	2.2	2.3	2.2		2.0	2.0–2.3	2.0–2.4	2.0–2.3		1.8–2.0	1.8–2.6	1.9–2.9	1.8–2.6		1.7–2.5
Unemployment rate	4.1	4.1	4.1	4.1	4.2	4.1–4.2	4.0–4.2	4.0–4.2	4.0–4.3	4.0–4.3	4.0–4.3	4.0–4.5	3.9–4.4	3.8–4.4	3.8–4.4
June projection	4.3	4.3	4.2		4.2	4.3–4.4	4.2–4.5	4.1–4.3		4.0–4.3	4.3–4.6	4.0–4.6	4.0–4.4		3.8–4.5
PCE inflation	3.7	2.3	2.1	2.0	2.0	3.5–3.7	2.2–2.5	2.0–2.2	2.0	2.0	2.9–3.8	2.0–2.6	2.0–2.2	2.0	2.0
June projection	3.6	2.3	2.0		2.0	3.5–3.7	2.2–2.5	2.0–2.1		2.0	2.7–4.1	1.9–2.8	2.0–2.3		2.0
Core PCE inflation[4]	3.4	2.5	2.2	2.0		3.3–3.4	2.3–2.6	2.0–2.2	2.0		2.8–3.5	2.1–2.7	2.0–2.3	2.0–2.1	
June projection	3.3	2.5	2.1			3.2–3.5	2.3–2.6	2.0–2.2			2.6–3.5	2.0–3.0	2.0–2.4		
Memo: Projected appropriate policy path															
Federal funds rate	4.1	4.1	3.9	3.6	3.2	4.1–4.4	3.6–4.4	3.1–4.1	3.1–3.6	3.0–3.6	3.9–4.4	3.1–4.4	3.1–4.1	2.9–3.9	2.9–3.9
June projection	3.8	3.6	3.4		3.1	3.6–4.1	3.1–3.9	3.1–3.6		3.0–3.5	3.4–4.4	2.9–4.4	2.9–3.9		2.9–3.9

Source: Fed FOMC, Choice Institutional Equities

US 10-year/2-year yield spread has remained positive since 2025 but remains below historical norms. As 2-year yields have risen more than 10-year yields, the curve has flattened, often associated with a more challenging late-cycle stagflationary environment



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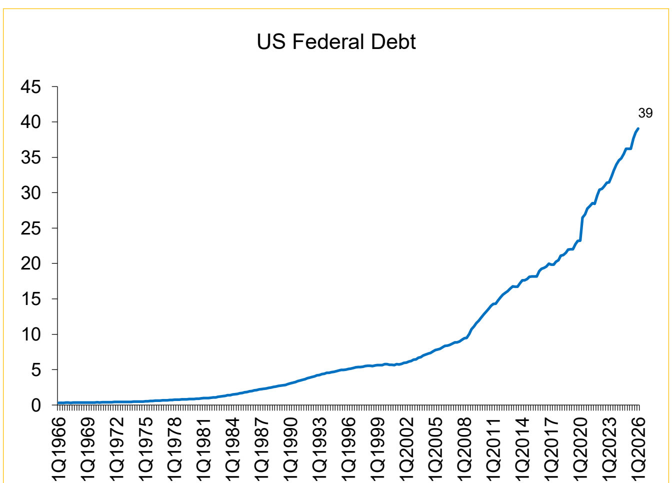
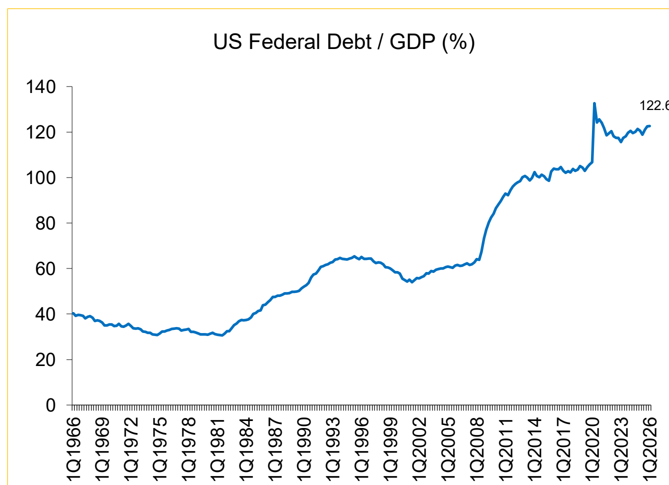
US public debt has surpassed USD 40 Tn recently, amid a surging fiscal deficit



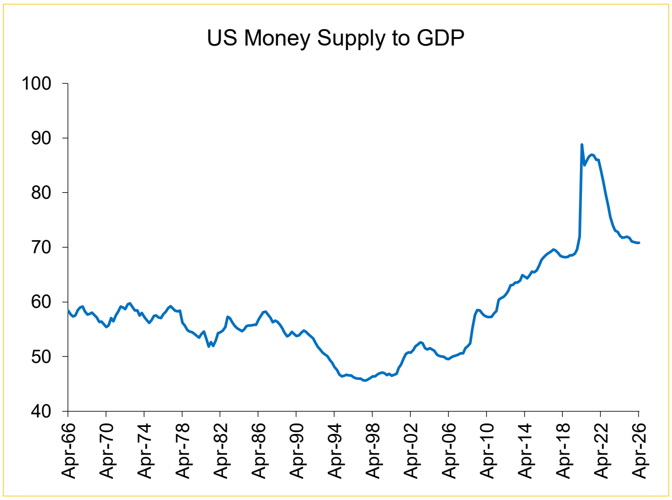
Source: FRED, Choice Institutional Equities

Pushing the debt to 122.6% of GDP, significantly higher than the pre-COVID levels despite the post-COVID correction



Source: FRED, Choice Institutional Equities

US money supply GDP has declined sharply from the COVID peaks but remains higher than the pre-COVID levels



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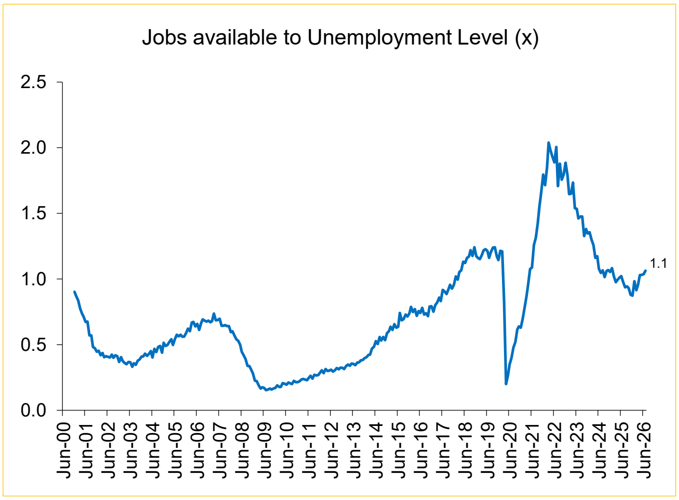
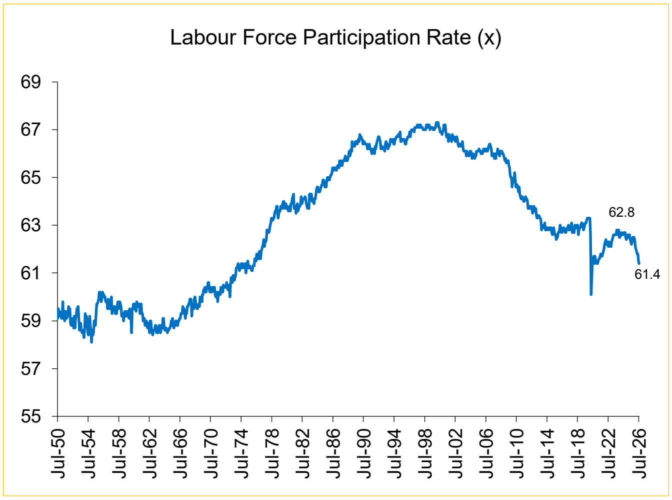
Rising ratio of jobs available to unemployment level indicates that the labour market is pivoting towards tighteness



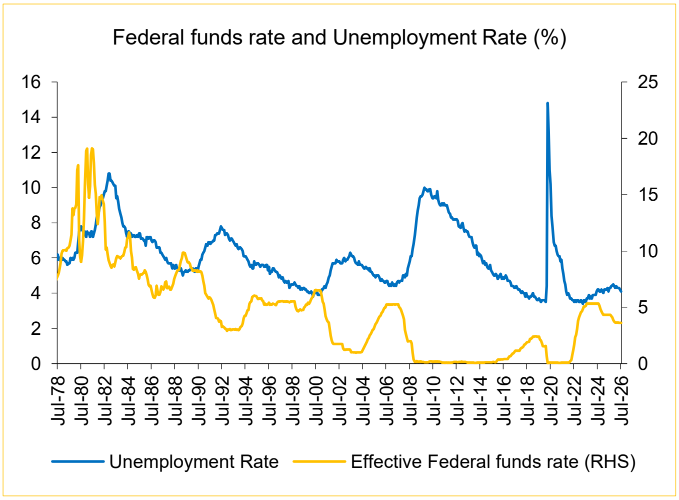
Source: FRED, Choice Institutional Equities

Tightness in the labour market is also due to the falling labour force participation rate in the US



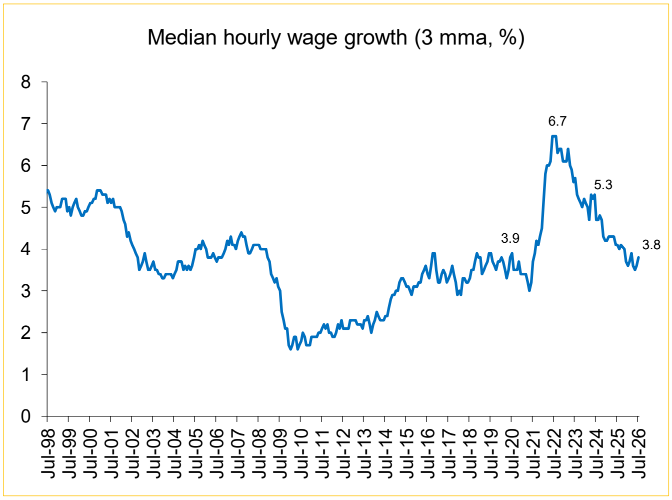
Source: FRED, Choice Institutional Equities

Unemployment edged higher while the Fed funds rate moderated recently, reflecting a higher-for-longer policy



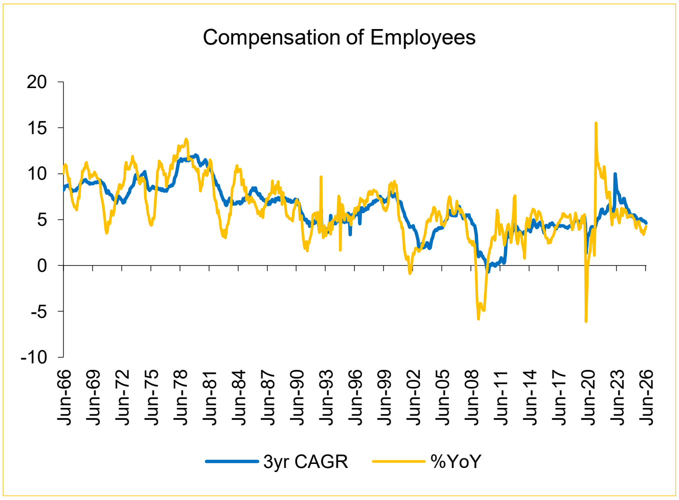
Source: FRED, Choice Institutional Equities

Median hourly wage growth has been consistently declining and is closer to the pre-COVID levels



Source: FRED, Choice Institutional Equities

Compensation of employees grew by 4.3% and has fallen to pre-COVID levels



Source: FRED, Choice Institutional Equities

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Large Cap*	
BUY	The security is expected to generate upside of 15% or more over the next 12 months
ADD	The security is expected to show upside returns from 5% to less than 15% over the next 12 months
REDUCE	The security is expected to show upside or downside returns by 5% to -5% over the next 12 months
SELL	The security is expected to show downside of 5% or more over the next 12 months
Mid & Small Cap*	
BUY	The security is expected to generate upside of 20% or more over the next 12 months
ADD	The security is expected to show upside returns from 5% to less than 20% over the next 12 months
REDUCE	The security is expected to show upside or downside returns by 5% to -10% over the next 12 months
SELL	The security is expected to show downside of 10% or more over the next 12 months
Other Ratings	
NOT RATED (NR)	The stock has no recommendation from the Analyst
UNDER REVIEW (UR)	The stock is under review by the Analyst and rating may change
Sector View	
POSITIVE (P)	Fundamentals of the sector look attractive over the next 12 months
NEUTRAL (N)	Fundamentals of the sector are expected to be in stasis over the next 12 months
CAUTIOUS (C)	Fundamentals of the sector are expected to be challenging over the next 12 months

***Large Cap: More Than INR 20,000 Cr Market Cap**
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