

Quote by Shravan Shetty, Managing Director, Primus Partners

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Fed rate cut or pause: What it can mean for Indian stock markets?

Rate cut decisions by the US Federal Reserve impact the Indian stock market, as it weighs or boosts several rate sensitive stocks.

Authored by Debaroti Adhikari



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Article Content:

How can US Fed's rate cut decision impact Indian stock markets

The US Federal Reserve held its Federal Open Market Committee (FOMC) meeting between December 9-10, and will be announcing the outcome of the meet later tonight around 11:30 p.m. (IST).

Analysts expect the American central bank to cut the key interest rate for the third straight time, driven by weak labour market.

Then how will the domestic markets react? Let's take three scenarios – no rate cut, 25 bps rate cut and 50 bps rate cut. Here's how market experts anticipate Indian stock markets to react in each of these scenarios:

Scenario 1: Fed cuts rates by 25 bps

A 25 basis point rate cut by the American central bank is mostly expected by analysts. Traders are pricing in an approximately 87 percent chance of a 25-basis-point rate cut today, according to CME's FedWatch Too

Shravan Shetty, Managing Director at Primus Partners, expects Fed to cut rates by 25 basis points, while keeping a 'hawkish' stance. Harshal Dasani, Business Head at INVasset PMS, said that a 25 bps cut is the base case and is largely priced in by the markets.

"Markets may attempt an initial relief rally, led by rate-sensitive sectors, but the sustainability of that move will depend on the Fed's tone. A cut without strong confidence in the economic outlook will be interpreted as a precautionary move — not a bullish one. Equities may open higher but fade as investors digest that the Fed is easing into economic weakness. Bond yields would drift lower, and the dollar could soften modestly, supporting gold and silver," he said.

Siddharth Maurya, Founder & Managing Director at Vibhavangal Anukulakara, said that a 25-bps rate cut may rekindle risk-on mood. But this will also be driven by Fed's stance. If the American central bank indicates more easing in the future - worldwide money could flow back to the emerging markets such as India, and sectors that are highly dependent on foreign inflows and liquidity may experience a rapid increase in their value, the analyst said.

Indian equities may open higher led by financials and cyclicals, steady rupee, and stable FII flows as a 25 bps rate cut could mildly boost global risk-on sentiment, said Khushi Mistry, Research Analyst at Bonanza.

Scenario 2: Fed cuts rates by 50 bps

A 50 bps cut would trigger a sharp knee-jerk rally, but for the wrong reasons, cautioned Dasani. "Such an outsized cut in a market already at all-time highs would signal that the Fed sees deeper underlying stress. Risk assets may spike at the open but turn volatile through the session as traders question what the Fed is trying to pre-empt. US yields would fall sharply, the dollar would weaken materially, and precious metals would likely surge as safety flows intensify," he said.

A 50 basis points is highly unlikely since it would indicate a drastic change in stance towards easing, even as inflation remains high, Shetty noted.

Mistry however noted that a 50 bps dovish cut can trigger high-beta rally in banks, IT, and realty amid softer USD boosting INR and inflows, though growth tone matters.

Scenario 3: Fed keeps interest rates unchanged

Markets may react negatively in case the Fed does not cut rates, Shetty said. "In case the Fed surprises by keeping the rates unchanged or being cautious in its tone, markets will probably be uneasy-reacting - volatility will increase greatly, and investors will most likely move their money to safer, domestic-oriented assets rather than global cyclicals," said Maurya.

Dasani said that a pause would surprise the market and likely trigger a risk-off reaction. "Equities may correct as traders unwind bets on immediate easing, and bond yields may push slightly higher. The dollar would likely strengthen in the short term, putting pressure on global equities, especially EMs. Gold and silver may dip initially but remain supported as uncertainty persists around delayed policy support," he added.

How does US Fed's rate cut impact Indian markets?

Rate cut decisions by the US Federal Reserve impact the Indian stock market, as it weighs or boosts several rate sensitive stocks. For example, a rate cut in the US is expected to increase the discretionary spending limit, which in turn benefits IT companies which derive a significant portion of their revenue from the North American market.

It is important to note that this time, analysts will watch out for Powell's narrative more than the size of a rate cut. "A hawkish hold sparks risk-off, India gap-down (defensives resilient), FII selling, and INR weakness," Mistry said.