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Beyond the Headlines

22 JUNE 2026

Impact on Indian Markets of
a Hawkish Reversal by the Fed

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Impact on Indian Markets of a Hawkish Reversal by the Fed

How a regime shift to “higher-for-longer” reshapes Indian policy, the value-versus-growth divide in equities, and the yield curve

The June 2026 FOMC meeting — the first under newly appointed Fed Chair Kevin Warsh — delivered a definitive macro shockwave. The Committee held the benchmark funds rate steady at 3.50%–3.75%, but the underlying signal turned aggressively restrictive. The Summary of Economic Projections revised headline PCE inflation sharply higher to **3.6% (from 2.7% in March)**, and **9 of 18 officials now project rate hikes later this year**. By dropping “maximum employment” from the key text and declaring that it “will deliver price stability,” the Fed has initiated a structural hawkish reversal. As the global cost of capital resets to remain higher-for-longer, the transmission to Indian policy, equities and fixed income is already playing out.

Macro Snapshot

Indicator	Reading	Read-through
US Fed funds rate	3.50–3.75% (held)	Restrictive; higher-for-longer
2026 PCE projection	3.6% (was 2.7% in Mar)	Inflation fight re-prioritised
FOMC “dots”	9 of 18 see hikes in 2026	Hawkish reversal confirmed
US 2Y / 10Y Treasury	4.22% / >4.50%	Narrower EM risk premium
RBI repo rate	5.25% (held)	Policy flexibility constrained
India CPI (May)	3.9% — 16-month high	Limited room to cut
India 10Y G-Sec	6.85–6.90%	Structurally decoupled, anchored
USD (DXY) / INR	DXY firm / INR pressured	Imported-inflation risk

1. The RBI’s Defensive Corner: Pushing Back the Pivot

Just a week earlier, the Reserve Bank of India concluded its June MPC under Governor Sanjay Malhotra with a hold at 5.25%. India’s domestic picture is complicated by sticky May CPI, which spiked to a 16-month high of 3.9% on supply disruptions and West Asia energy shocks. The Fed’s hawkish turn now severely restricts the RBI’s room to manoeuvre.

- **FX transmission.** As US yields march higher and the Dollar Index strengthens, the rupee faces fresh structural depreciation pressure — feeding imported inflation across crude and the commodity complex.
- **A delayed rate-cut cycle.** The RBI’s neutral stance will be heavily tested. Any lingering expectation of domestic cuts has effectively been pushed into deep 2027; if global capital keeps leaving, the RBI could even be forced to contemplate a tactical, defensive hike to preserve stability.
- **Capital-protection tactics.** The RBI anticipated this. Scrapping FPI taxes on select government bonds, subsidising hedging costs on FCNR(B) deposits, and easing External Commercial Borrowing rules are an active structural defence to lock in foreign capital and stabilise the Balance of Payments.

2. Indian Equities: A Two-Speed Market — and a Decisive Tilt to Value

For equities, the Fed's reversal changes both the valuation math and the flow picture. The cleanest lens is growth versus value. When the discount rate resets higher, the long-dated cash flows of "growth" compounders are repriced hardest, while businesses backed by real, near-term, cash-generative assets hold their ground. Historically, rate-hike regimes coincide with a rotation into firms that offer genuine valuation comfort — and a liquidity crunch punishes high-multiple, high-beta names. That divide now maps cleanly onto the Indian market.

The hiding place — real-asset value plays

The strongest shelter sits in capital-intensive, domestically anchored sectors with real assets and visible order books: power, infrastructure, capital goods, defence, railways and infrastructure finance. Their cash flows are tied to a domestic capex cycle and government-backed demand rather than the US cost of capital, and they still trade at undemanding multiples. In a higher-for-longer world, these value plays are the market's most reliable hiding place.

Growth and rate-sensitive cyclicals at risk

- **IT and exporters.** Domestic IT majors derive close to two-thirds of revenue from corporate America, so an elevated US cost of capital directly dampens discretionary tech spend and squeezes deal pipelines — a classic high-duration, export-heavy profile facing multiple compression, on top of ongoing AI-related headwinds.
- **But much is already priced.** Crucially, large-cap IT has already absorbed a roughly 40% valuation de-rating through 2026 on AI-replacement fears. A good deal of the rate-hike impact may therefore already be baked into multiples — leaving incremental downside more limited for quality large-caps than for richly valued mid- and small-cap IT, and arguably turning the best large-caps into a contrarian, de-rated value candidate.
- **Rate-sensitive cyclicals.** Autos, housing and real estate, hotels and airlines sit squarely in the liquidity-crunch firing line: both end-demand and funding costs move the wrong way as system liquidity tightens and EMIs rise.
- **Financials — a nuanced split.** Not all financials are equal here. Large, well-capitalised private and PSU banks should prove relatively resilient — net interest margins are supported in a higher-for-longer regime, domestic credit demand remains strong, and steady DII/SIP flows provide a cushion. The pressure point is NBFCs, housing finance and auto financiers, whose wholesale funding models are most exposed to higher rates and tighter liquidity.

Flows: FII outflows versus DII resilience

With the US 2-year Treasury yield at 4.22%, the emerging-market risk premium has narrowed, and liquid, foreign-heavy large caps will likely face persistent FII selling. The domestic engine, however, remains remarkably resilient: consistent DII flows via mutual-fund SIPs act as a formidable systemic backstop against outright capitulation — supporting precisely the domestic, real-asset names the value rotation favours.

Sector Positioning Map

Stance	Where	Why
Overweight — value / real assets	Power, infrastructure, capital goods, defence, railways, infra finance	Real assets, domestic capex, government-backed order books; valuation comfort; insulated from US cost of capital.
Selective — quality banks	Large private & PSU banks	NIM support in a higher-for-longer regime; strong domestic credit demand; DII/SIP cushion.
Special case — large-cap IT	Top-tier IT services	~40% 2026 de-rating means much of the rate impact is already priced; downside more limited than mid/small IT.
Underweight — growth / rate-sensitive	Mid/small IT, NBFCs, housing finance, autos, real estate, hotels, airlines	High-duration or funding-dependent models compressed by a higher discount rate and a liquidity crunch.

3. Fixed Income: Navigating a Flatter Curve

In fixed income, investors must sharply distinguish the short end from the long end of the Indian curve.

The short end (under 1–3 years) — bearish on price, attractive on accrual

T-bills, commercial paper and certificates of deposit are highly reactive to system liquidity and currency volatility. To blunt the Fed's pressure on the rupee, the RBI will keep banking-system liquidity tightly managed. Short-term yields should therefore stay elevated, flattening the curve and offering attractive accrual rather than capital gains.

The long end (10-year G-Sec) — structural decoupling

India's long bonds are showing a striking decoupling. While the US 10-year has surged past 4.50%, the Indian 10-year G-Sec has held near 6.85%–6.90%, anchored by two internal pillars:

- **Global index inclusion.** The phased entry of Indian sovereign debt into global benchmarks such as JPMorgan's GBI-EM guarantees a structural, non-cyclical pipeline of foreign inflows.
- **Fiscal prudence.** Strict adherence to fiscal-deficit reduction targets has kept a lid on excess supply at the long end.

Tactical Asset-Allocation Takeaway

The macro playbook has shifted. The traditional "duration catch" — buying long bonds to ride a rapid global rate-cut cycle — is off the table for 2026. The optimal fixed-income stance is high-quality accrual at the short-to-medium end of the curve. In equities, lean into domestic-facing value: real-asset sectors (capital goods, infrastructure, power, defence, railways, infrastructure finance) over high-duration growth; be selective within financials, preferring well-capitalised banks to wholesale-funded NBFCs; and treat de-rated large-cap IT as a value candidate where much of the bad news is already in the price. In a higher-for-longer world, valuation comfort — not growth at any price — is the edge.

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