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Last week the Fed delivered its third consecutive rate cut of the year, even as internal dissent intensified and policymakers signalled greater unease about the inflation outlook. Fed Chair Powell framed the decision as a dual-mandate trade-off, noting that risks around both unemployment and inflation remain two-sided but elevated. Crucially, the Fed stressed that further easing is not pre-committed. ***Markets are trading the Fed's cuts as a green light but the Fed is signalling caution. The key tension is widening as investors are pricing fast easing, while policymakers are preparing to pause. That gap is now driving rates, FX, and risk sentiment into 2026.***

Financial markets remain notably misaligned with the Fed's own projections. *While Fed funds futures price a sharper and earlier easing cycle, the dot plot implies a far more gradual path. This divergence has lifted longer-dated Treasury yields even as front-end rates fall, reflecting investor scepticism on inflation persistence and the durability of a sustained cutting cycle.* ***The net result is a steeper yield curve. While U.S. equities have pushed to record highs as markets interpret the outcome as dovish****, but that optimism rests on a narrow foundation: confidence that the Fed will respond quickly if labour conditions deteriorate.*

Market-Implied Path (Fed-Funds Futures snapshot)

Meeting	Implied Rate	Cumulative Change
28 Jan 2026	3.58%	-06 bp
18 Mar 2026	3.51%	-13 bp
29 Apr 2026	3.45 %	–20 bp
28 Oct 2026	3.12 %	–52 bp
09 Dec 2026	3.08%	-55 bp

Next meeting probabilities: **No change 75 %, 25 bps cut 25 %**

The U.S. dollar also looks increasingly vulnerable*. Fed visibly more sensitive to labour-market downside, and markets pricing faster easing than the Fed is signalling, the dollar appears structurally exposed. Strong growth and still-favourable yield differentials can offer near-term support, but the dollar's upside now hinges on either inflation re-accelerating or the labour market stabilising two outcomes the Fed does not appear fully confident about. Further softening in employment would likely compress front-end differentials, reinforce expectations of earlier cuts, and renew downward pressure on the dollar, especially versus currencies backed by improving growth dynamics or more credible fiscal anchors.*

This week's U.S. data calendar will shape expectations across inflation, labour, and growth. *Headline CPI on Thursday is expected at 0.3% m/m for November, lifting annual inflation to 3.1%, while core CPI is seen at 0.2% m/m and 3.0% y/y. On Friday, PCE inflation data will be in focus after September's 0.3% monthly gain and 2.8% y/y print. Meanwhile, Tuesday's non-farm payrolls report is expected to show job growth slowing to 45,000 in November from 119,000 previously.*

Japan is also in focus ahead of the BoJ decision, ***markets expect the BoJ to raise rates (95% probability), lifting the policy rate by 25 bps to 0.75% from 0.50%****. If delivered on 19 December, this would take Japan's policy rate to its highest level in roughly three decades.* ***Investors are watching for spillovers via the yen carry trade****. The July 31, 2024 hike to 0.5% offers a reminder when the yen rallied, risk appetite deteriorated in early August while on 05th August was black Monday. With JGB yields already at multi-decade highs across the curve, the move would also represent policy catching up with market pricing.* ***As U.S. easing is colliding with Japan tightening that policy divergence plus a large Fed/market pricing gap raises the risk of abrupt reversals in yields, FX, and carry-driven risk positions which needs to be closely watched.***

Global Markets Enter a Divergence-Driven Volatility Regime

The Fed is trying to cut without capitulating. But markets are already running ahead, forcing a steepening curve, a more fragile dollar setup.

Global markets are entering a **divergence regime,** policy paths are splitting, disinflation is uneven, and heavy sovereign bond supply is keeping yields volatile. The Fed is edging toward gradual easing, while other G10 central banks are nearing the end of their easing cycles; in contrast, the Bank of Japan is expected to hike rates this week. Against that backdrop, **trade fragmentation and geopolitics** are adding a structural risk premium, while US growth remains resilient but increasingly **late-cycle and data-dependent**. The result is a market that can still rally, but one where **rates, FX and risk sentiment will be driven by surprises not consensus**.

While the two main contenders most consistently cited for the next Fed Chair are Kevin Hassett (currently Director of the White House National Economic Council), who is widely viewed as the market favourite and seen as more aligned with faster easing, and Kevin Warsh (former Fed Governor), the principal rival who is perceived as more orthodox and institutionally grounded; President Trump is expected to announce the nominee in early 2026, ahead of Chair Powell's term ending in May 2026.

U.S. policy decision: A cut that signals a pause, not confidence

The U.S. dollar weakened (-0.6%) following last week's FOMC, reflecting a reassessment of the Fed's policy trajectory rather than a clean dovish pivot. Markets now turn to the October–November nonfarm payrolls report as the key determinant of whether this downside momentum persists into year-end. The week is also heavy on global central bank risk, with the BoE, ECB and BoJ all set to meet.

The Fed delivered a 25bp rate cut, but Powell made clear that policy is now at or near neutral. While the Committee stopped short of declaring a formal pause, Powell signalled that the base case for January is to hold, retaining flexibility should labour market conditions deteriorate. Three dissents the highlight a divided FOMC navigating conflicting signals from growth, inflation and employment.

The Fed's reaction function is now labour-led and asymmetric: a pause holds if the labour market stays intact, but a clear deterioration would reopen easing even as above-target inflation and tariff-related pressures keep the policy trade-off unresolved

Powell Pushes Back on Fast-Easing Expectations

▫ **Policy now near neutral:** Powell said the fed funds rate is "within a broad range" of neutral and the Fed is **well** positioned **to wait and see**.

▫ **No preset path:** He stressed policy is **not on a pre-committed course** and decisions will be **meeting-by-meeting**, guided by incoming data.

▫ **Pause is the emerging base case:** The thrust of the message was that after this cut, the debate is increasingly about **whether to pause** rather than keep cutting automatically.

▫ **Two-sided risks still elevated:** Powell framed the outlook as a **dual-mandate trade-off**, with risks around both inflation and employment still meaningful.

▫ **Productivity as the "escape hatch":** He highlighted productivity gains as a potential way to ease the inflation–jobs tension, but acknowledged uncertainty

Labour Market Now the Binding Constraint.

Despite solid headline growth, the Fed's focus has shifted decisively to the labour market. Powell acknowledged measurement issues in payroll data, suggesting recent job gains may be overstated. Markets now interpret an implicit reaction function: unemployment at 4.5% or lower supports a pause, 4.6% is a knife-edge outcome, and 4.7% or higher would likely trigger renewed easing.

Growth–Inflation Trade-Off Remains Unresolved.

Nominal GDP growth remains strong near 5%, supported by fiscal tailwinds and productivity gains, allowing the economy to expand even as hiring slows. Inflation, however, remains above target, with tariff-related pressures complicating the outlook. Powell's message was explicit: there is no risk-free policy path, and labour deterioration may ultimately outweigh inflation concerns at the margin.

The dollar's performance reflected a growing disconnect between market pricing of an extended easing cycle and the Fed's more cautious signalling, leaving the greenback vulnerable

Policy Cuts, Yield Pushback: Markets Reprice the Fed

The U.S. dollar weakened over the week, marking its third consecutive weekly decline, as markets looked through the Fed's widely anticipated rate cut and focused instead on the broader easing trajectory implied by softer labour data and rising internal policy dissent. Post-FOMC, the Dollar Index slid toward the 98–99 range as Treasury yields fell and expectations of further accommodation hardened, particularly at the front end. While the dollar saw brief stabilisation late in the week amid profit-taking and selective hawkish remarks from Fed officials, these moves proved corrective rather than trend-reversing. **Overall, the dollar's performance reflected a growing disconnect between market pricing of an extended easing cycle and the Fed's more cautious signalling, leaving the greenback vulnerable.**

US Treasury yields were volatile but directionally mixed over the week, shaped by Fed easing and inflation uncertainty. Early in the week, yields pushed higher particularly at the long end as investors questioned the sustainability of rate cuts amid resilient activity and sticky price pressures. Following the FOMC decision, front-end yields fell sharply, with the 2-year declining by more than 7 bps, while longer maturities eased more modestly, resulting in a steeper yield curve. By week's end, yields partially retraced lower amid softer jobless claims and easing financial conditions, but remained elevated relative to post-cut norms signalling that markets continue to price a higher terminal risk premium and remain unconvinced about a smooth disinflation path.

Rupee slips amid FPI selling & trade woes, Nov'25 Trade Deficit offers silver lining

Rupee slipped ~0.47% last week on persistent FPI outflows and US-India trade uncertainty, Nov'25's narrower trade deficit offering some relief.

The Indian Rupee weakened modestly by *~0.47%* last week, pressured by persistent FPI outflows, ongoing US-India trade uncertainties, and broader risk sentiment. Foreign investors continued to sell Indian equities, bringing total 2025 outflows to around ₹1.6 lakh crore (~$18.4bln), driven by high valuations and global portfolio adjustments, while domestic debt markets also saw continued foreign selling.

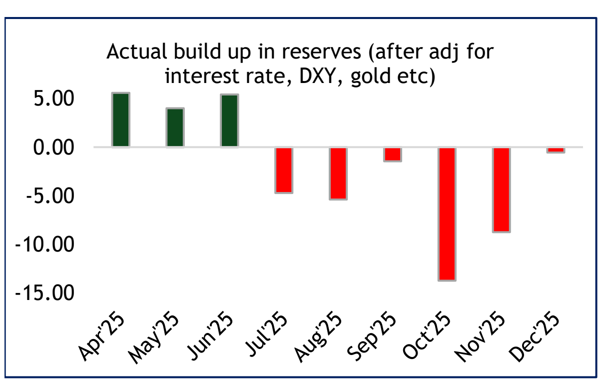
On the macro side, India's merchandise trade deficit narrowed to ***$24.53bln in Nov'25, a five-month low***, supported by a rebound in exports, particularly to the US and lower imports of Gold & NONG components providing a silver lining amid currency pressures. Commerce Secretary Rajesh Agrawal said India is assessing the impact of Mexico's higher MFN tariffs, which could affect ~$2bln of exports, though authorities have been told the move is not aimed at India. India is currently in talks with several other countries and trade blocs — including ***Canada, Peru, the EU, Chile, Qatar, Israel, SACU, and New Zealand***. The India-Oman trade agreement has been completed and is expected to be signed soon. Looking ahead, market attention will focus on key US macro data and any positive domestic developments, which will be crucial in determining the near-term trajectory of the rupee. (Last Friday's close: ₹90.0000/$) [O: ₹90.0725/$, H: ₹90.5700/$, L: ₹89.8425/$ & C: ₹90.4250/$]. (Refer report: FX weekly: Fed Messaging vs Market Pricing: A Potential Reality Check for the U.S. Dollar)

India - US Trade talks

India-US trade talks gained steady momentum through Nov-Dec, with six rounds completed.

Date	Event	Details
Nov-05	Piyush Goyal Update on Talks	Commerce Minister Piyush Goyal states negotiations are "going on very well" with 5 rounds completed since March; emphasizes addressing "sensitive, serious issues" like tariffs, while protecting farmers & MSMEs. First tranche of agreement by November.
Nov-14	Positive Developments in Tariff Talks	Senior US official notes "positive developments" on resolving tariffs and Russian oil imports; deal eyed by year-end to normalize trade.
Nov-17	LPG Import Deal Signed	Indian PSU oil firms conclude 1-year contract for 2.2 MTPA LPG imports from US Gulf Coast (2026 delivery), aimed at balancing trade; not directly tied to BTA but signals goodwill amid tariff pressures.
Nov-17	First Tranche "Nearing Closure"	Commerce Secretary Rajesh Agarwal announces six rounds of talks completed; BTA phase 1 focuses on reciprocal tariffs (25% broad levy + 25% oil surcharge) and US market access in dairy, EVs, and agro-products. India seeks relief for textiles, gems, and shrimp.
Nov-18	Goyal Signals "Good News Soon"	Piyush Goyal indicates pact nearing completion if "fair and equitable"; prioritizes safeguards for farmers, fisherfolk, and small industries against US demands in agriculture and autos.
Nov-20	Tariff-Cut Plan Preparation	India readies concessions on US industrial equipment, chemicals, and engineering goods; US pushes for access in autos, dairy, and high-tech manufacturing.
Nov-24	Russia Oil Import Cuts	Major Indian refiners halt new December orders for Russian crude, aligning with US pressure; expected to boost BTA momentum by easing tariff justifications.
Nov-28	Optimism for Year-End Seal	Commerce Secretary Agarwal: "Only a matter of time" for first tranche closure before Dec 31; two parallel tracks—full BTA and immediate framework for tariffs. Most issues resolved; political-level fixes for sticking points like agriculture.
Dec-10	Advancing work on the first phase of the BTA	Deputy USTR Rick Switzer and supported by chief negotiator Brendan Lynch visiting India. US Under Secretary of State Allison Hooker is also in India this week to deepen strategic ties.
Dec-11	Diplomatic engagement	PM Modi held his third call with US President Trump, reviewing bilateral relations (including trade). Chief Economic Adviser predicts deal; Most issues resolved; surprised if not signed by March; parallel discussions on tariff framework and comprehensive pact.
Dec-12	Negotiation feedback	A senior US negotiator **praised India's "best-ever" market-access offer**, though sticking points remain (agriculture, dairy).
Dec-15	Following six rounds of bilateral trade talks	India and the United States are on the brink of finalising an initial framework agreement, Commerce Secretary Rajesh Agrawal said.

Month	Change in total FX reserves	Build-up in reserves (after adj for interest rate, DXY, gold etc)
Apr'25	22.73	5.58
May'25	3.36	4.00
Jun'25	11.3	5.41
Jul'25	-4.59	-4.73
Aug'25	-3.96	-5.4
Sep'25	6.01	-1.46
Oct'25	-10.5	-13.76
Nov'25	-3.51	-8.76
Dec'25	1.03	-0.56



FPIs continue selling Indian equities and debt, with $18.39 bn YTD equity outflows and $7.22 bn in FAR flows.

Foreign Portfolio Investors (FPIs) have pulled out ***$18.39bln (YTD)*** from Indian equity markets as of 12th Dec'25. Even though, we saw the trend reversed in Oct'25 with positive inflows but turned negative again in Nov'25 and continues in Dec'25. FPIs continue to be net sellers ***in equities ~$681mln*** vis-à-vis ***outflows of ~$1315mln*** on a WoW basis. Debt markets also saw continued outflows to ***~$783mln vis-a-vis ~$57mln*** outflows a week ago. FAR flows, at ***$7.22bln YTD***, including a ~$745mln outflow so far last week.

FX reserves rose $1.03bln to $687.26bln for the week ending 5th Dec'25, supported by gold gains despite FCA decline and valuation losses

FX reserves increased by $1.03bln to ***$687.26bln*** for the week ending 05th Dec'25 (*covering ~11 months of imports*), driven mainly by a ***$0.15bln*** fall in **FCA** to $556.88bln and ***$1.19bln*** gain in **Gold**. This gain puts FX reserves $17.6bln short of the all-time peak of $704.86bln reached on 27th Sep'24. A valuation loss of $0.56bln was also noted in this week, with a cumulative of ***~$25bln** since **Sep'25*** highlighting the central bank's ongoing efforts to stabilize the FX market. Our analysis suggests a BoP deficit of ~$20bln for FYTD26, with FX reserves (excluding valuation effects) continuing to align closely with BoP trends.

Brent crude fell ~2% last week to the low-$61s, pressured by oversupply fears despite geopolitical jitters, markets eye 2026 supply and OPEC+/EIA/IEA updates.

Brent crude oil prices traded volatile last week, weighed by oversupply concerns, though intermittent geopolitical risks, including US-Venezuela tensions, provided temporary support. Prices hovered in the low-$61s per barrel, as markets balanced short-term supply disruptions against expectations of a widening surplus in 2026. In the US, crude inventories fell by ~1.8mb, offering brief support, while larger builds in refined products signaled softer demand. Looking ahead, OPEC+ production decisions, upcoming EIA/IEA reports, and geopolitical developments will be key in shaping near-term Brent price direction. On a WoW basis, prices fell by **~2%**, and they reflect a sharp **YTD decline of ~18%**.

DXY softened ~0.73% last week, weighed by hawkish-leaning FOMC guidance, weak labor signals, and muted risk sentiment, as markets await key US data

Dollar Index (DXY) softened last week, as markets balanced the FOMC 25bps rate cut with its relatively hawkish commentary and limited projected future easing. Weak US labor market signals, including the surge in weekly jobless claims, reinforced expectations of slowing growth and contributed to the dollar's modest decline. Broader risk sentiment and global flows also influenced the index, as safe-haven demand remained muted. Looking ahead, key upcoming US macro data delayed Nonfarm Payrolls for Oct/Nov, CPI, and retail sales will be closely watched, as they are likely to shape the near-term direction of the dollar. On a WoW basis, fell by ~0.73%, and they still reflect a YTD decline of ~9%.

Outlook (INR - ₹ view):

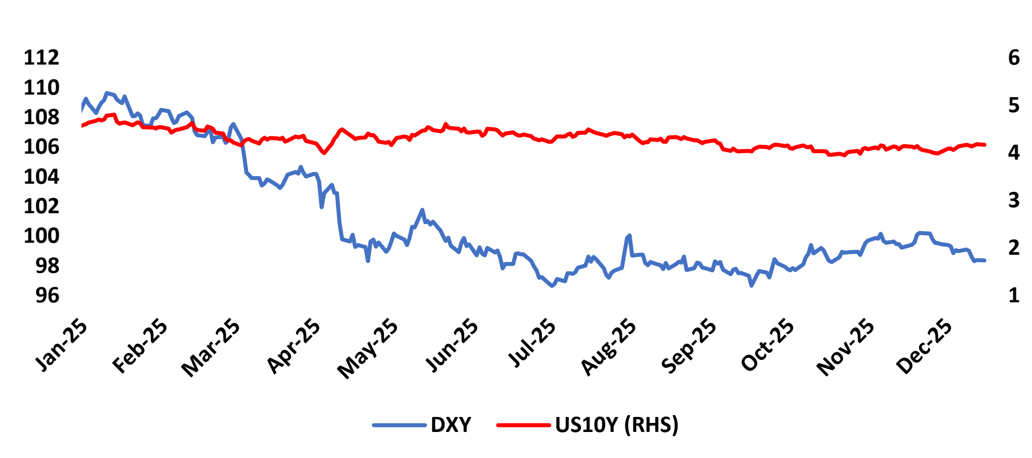
Rupee is likely to remain range-bound but fragile near ₹90.30–₹91.20/$, with near-term direction driven by FPI flows, India-US trade clarity, IPO inflows, and global risk sentiment, while technical levels and fundamental undervaluation suggest limited scope for sharp depreciation.

The rupee is expected to remain range-bound but fragile, with downside risks persisting as long as FPI outflows continue and trade negotiations remain unresolved. Positive catalysts include, IPO-related inflows, could provide temporary support to INR liquidity in the near term. Markets will also closely track upcoming US macro data (inflation, retail sales, labor) and Indian domestic indicators, which will influence dollar strength, rate expectations, and capital flows. Overall, while structural positives remain intact, the rupee's near-term trajectory will be dictated by capital flows, trade-deal visibility, and global risk sentiment, with stability likely only if foreign inflows return or trade clarity improves meaningfully.

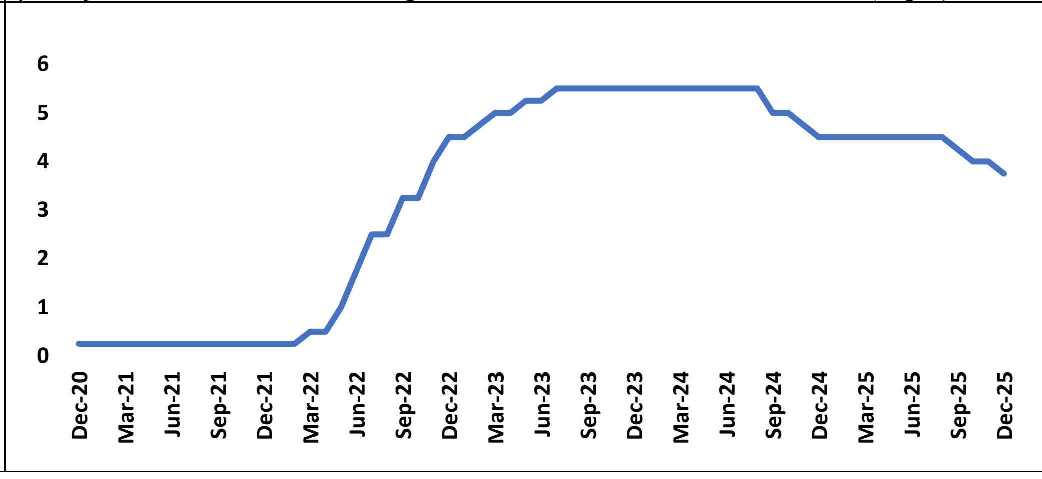
From a technical standpoint, the rupee is expected to remain range-bound between ₹90.30 and ₹91.20 through end-December. Sustained domestic equity inflows or tangible progress in India-US trade negotiations could strengthen the INR toward ₹89.90/$, with ₹89.50/$ acting as a key interim support. If an India–US BTA is finalized; the appreciation threshold for the rupee could shift meaningfully. Conversely, any bearish catalysts such as delays in resolving US–India tariff issues are likely to face strong resistance near ₹90.90/$, where exports are likely to intensify selling. A break above this zone could trigger a move toward ₹91.20/$. Overall, geopolitical and tariff developments will remain central drivers of market sentiment.

Our fundamental view on the Rupee: The currency appears undervalued at current levels based on the REER by about 2.5%. Our analysis suggests that over a three-year horizon, the currency typically adjusts through an average annual depreciation of about 3–4%, broadly in line with the India–US inflation and interest rate differentials. Given that the rupee has already weakened by ~5% this fiscal year to date, we do not see significant and runaway depreciation pressures to persist.

The dollar has weakened marking its third consecutive weekly decline, as markets looked through the Fed's widely anticipated rate cut. (Fig 1)

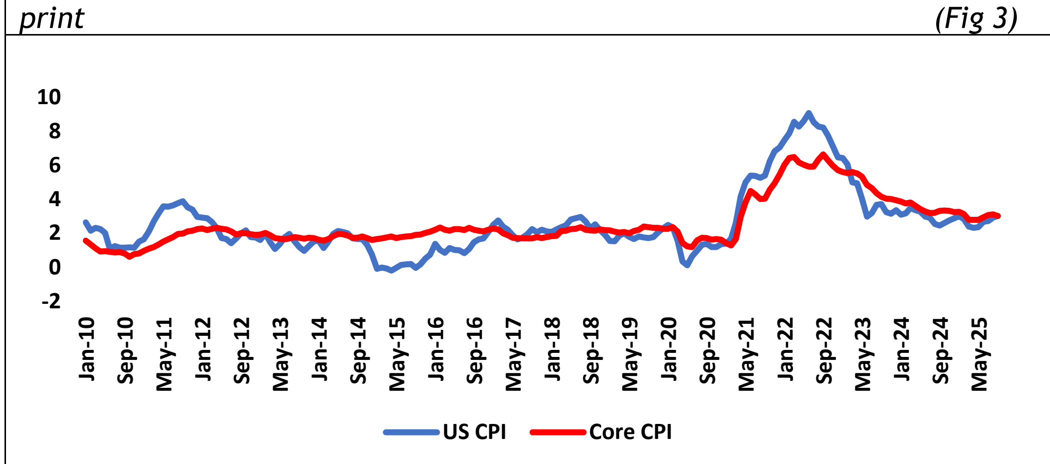


The Fed delivered its third consecutive rate cut of the year bringing the policy rate at 3.5%-3.75% range (Fig 2)

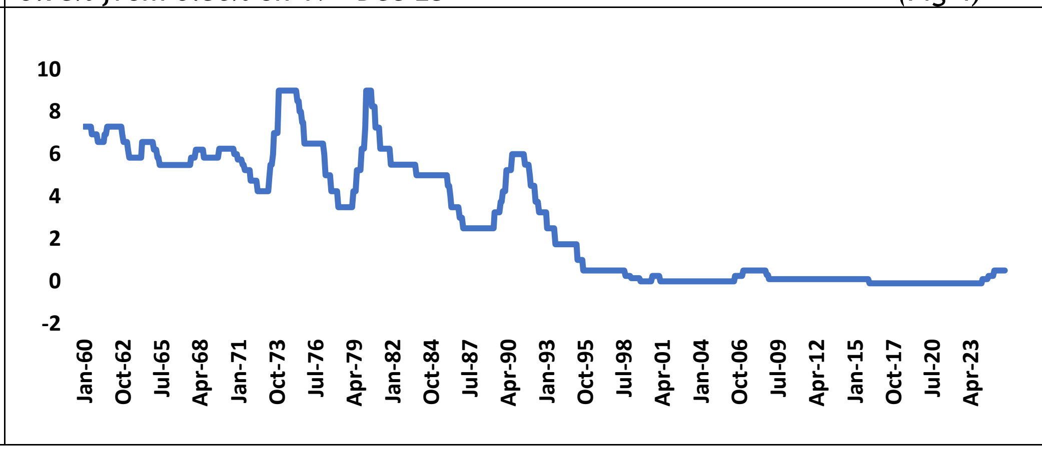


Source: LSEG, UBI research

U.S. inflation has remain sticky all eyes will be on this week Nov'25 CPI print (Fig 3)

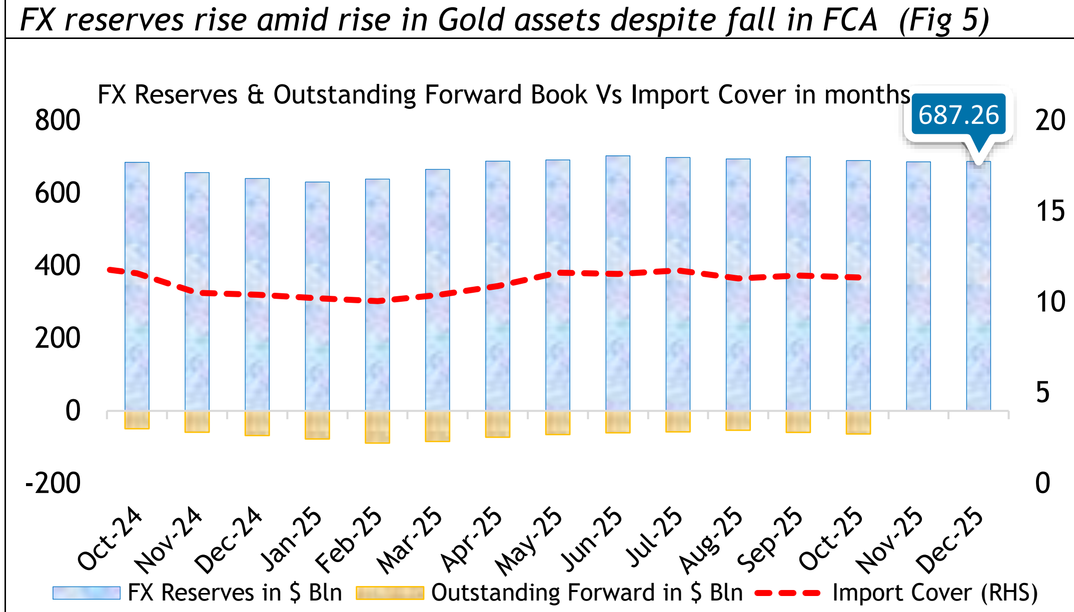


Markets expect the BoJ to raise rates, lifting the policy rate by 25 bps to 0.75% from 0.50% on 19th Dec'25 (Fig 4)

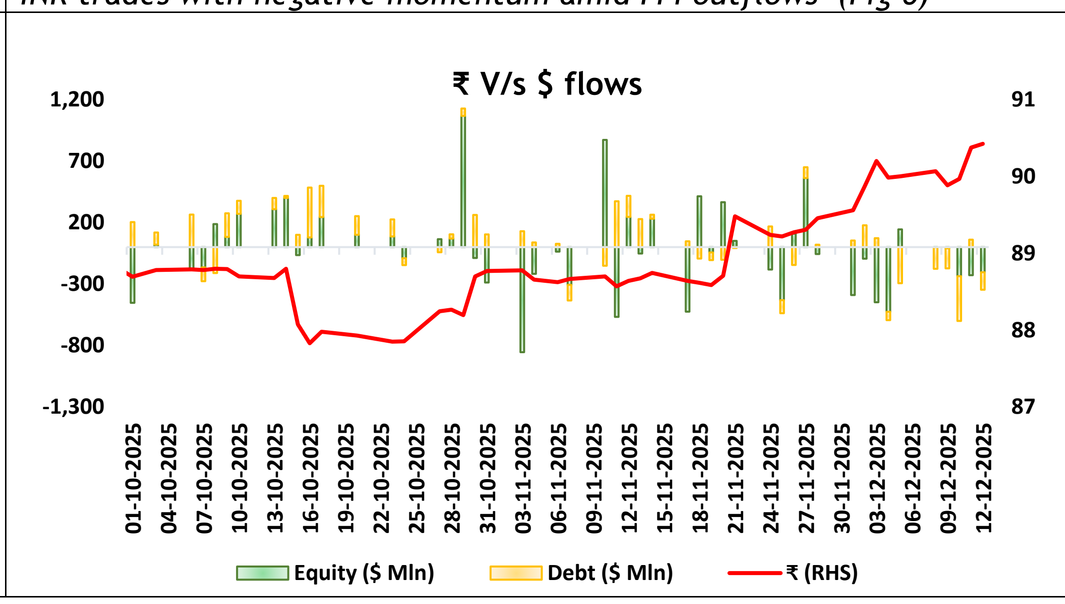


Source: LSEG, UBI research

FX reserves rise amid rise in Gold assets despite fall in FCA (Fig 5)



INR trades with negative momentum amid FPI outflows (Fig 6)



Source: Bloomberg, LSEG Workspace & UBI Research

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