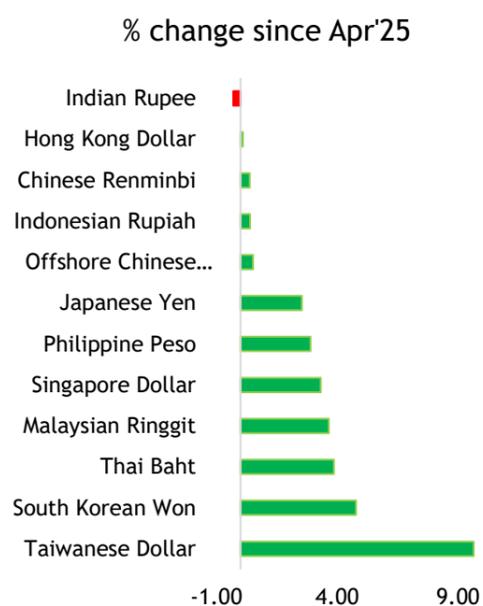


US trade developments remain the single biggest driver for the dollar

The recent trajectory of key US economic indicators suggests a mixed but stabilizing outlook as of early 2025.

Taiwanese Dollar clocks sharpest spike since 1988



Source: Bloomberg & UBI Research

Trump and Treasury Secretary Bessent may likely continue pressuring the Fed to cut interest rates but the rise in the effective tariff rate relative may cause inflation to move higher and the unemployment rate to increase in coming months. On one hand, the FOMC would want to ease policy as the jobless rate rises. On the other hand, however, rising inflation would induce Fed policymakers to refrain from easing policy.

The rate cut hinges on two factors, clarity on tariffs and how they translate into hard data. The best course of action for the FOMC may simply be to wait for more clarity about trade policy and its implications for the US economy. Indeed, Chair Powell reiterated during his press conference that "we don't think we need to be in a hurry to adjust rates."

As per market expectations the probability of rate cuts is being paired backed specially after then release of NFP data and FOMC outcome. In the start of 2025, 4 rate cuts of 25bps each in 2025 was factored but the pricing has now come down to 3 rate cut of 25bps each, while as per CME Fed-Watch tool the probability of Fed holding rates has increased to 30%.

Mixed but stabilizing outlook

The recent trajectory of key U.S. economic indicators suggests a mixed but stabilizing outlook as of early 2025. The ISM Services index remains in expansion territory, rebounding to 51.6 in April 2025 after dipping slightly in March, indicating resilience in the services sector. Conversely, the ISM Manufacturing index has remained below the critical 50 mark for several months, standing at 48.7 in April, signalling ongoing contraction in manufacturing. Industrial Production has shown signs of recovery with year-over-year growth turning positive in early 2025, though gains are still modest. Meanwhile, the NFIB Small Business Optimism Index has risen consistently, peaking at 105.1 in December 2024 before moderating slightly, reflecting improved sentiment among small business owners. Overall, the indicators reflect a slow but steady economic adjustment, with services leading the recovery while manufacturing and production lag, underscoring a sectoral divergence in post-tightening economic normalization.

Recent US inflation trends show a gradual deceleration, reflecting the delayed effects of Federal Reserve rate hikes and easing supply chain pressures. While core inflation remains above the Fed's 2% target, headline rates have moderated significantly from their 2022 peaks. The housing market has displayed resilience despite higher mortgage rates, with home prices stabilizing and housing starts showing signs of recovery, though affordability remains a concern. Consumer sentiment, as typically captured by indices like the University of Michigan's, has improved modestly in recent months but remains below long-term averages, reflecting persistent cost-of-living concerns. Taken together, these indicators suggest a slowing but not contracting economy. The data does not yet confirm a recession, but caution is warranted especially if inflation proves sticky or if consumer demand weakens further.

Taiwanese Dollar clocks sharpest spike since 1988: Will it spillover into broader Asian FX?

FX move led by Dollar weakness and prospects of trade deal with US

The precise trigger behind the move remains unclear. However, the rally closely followed the conclusion of US-Taiwan trade talks in Washington, fuelling speculation that a behind-the-scenes agreement may involve a weaker US dollar in exchange for trade concessions. Although Taiwan's central bank has consistently denied any such arrangement, market participants remain unconvinced. The magnitude of the rally suggests a possible tacit approval by Taiwanese authorities, and the outcome is likely welcomed by the US, given broader geopolitical and trade interests.

Taiwan's USD exposure remains elevated at ~USD 1 trillion

Taiwan (Pvt Sector + Reserves)	\$ Billion
Unhedged Overseas Invst by Life Insurers	160
Foreign Currency Deposit	300
Bond ETF's	100
USD Position in FX Reserves	460
Total	1,020

Source: media reports, UBI research

Exporters and life insurers running to hedge USD exposures

Market dynamics further indicate that a substantial unwinding of long-held USD positions is underway. Years of persistent trade surpluses have left Taiwan with large dollar holdings—particularly among exporters and life insurers. The abrupt move has exposed the fragility of this positioning, prompting both defensive hedging and strategic reallocation by local investors. In addition to speculative pressure, the central bank has cited recent foreign fund inflows and growing corporate expectations for a stronger TWD as contributing to the recent volatility.

Beyond the short-term drivers, the rally reflects deeper shifts in global FX flows. The broader weakening of the US dollar has prompted Taiwanese institutions to reconsider their heavy USD exposure. This is fuelling both increased hedging demand and early-stage diversification away from US denominated assets.

US-Taiwan Trade Dependence:

- o In 2024, Taiwan's exports to the U.S. totalled USD 111.4 billion (+46.1% YoY).
- o The US accounted for 20% of Taiwan's total exports—second only to Mainland China and Hong Kong (27%).

US has been naming Taiwan as a currency manipulator in its FX report

In US Treasury's Nov'24 report stated that China, Japan, South Korea, Taiwan, Singapore, Vietnam and Germany were on its "monitoring list" for extra foreign exchange scrutiny.

If the move sticks only with TWD and other Asian crosses ex CNY/CNH, we are unlikely to be significantly affected

1. While the sharp move in TWD may not have direct impact on INR given limited trade linkages and lack of similarity in export basket, yet we need to watch if:
 - a. Exporters across Asia who hold so much USD would have a rethink now after seeing the shock in Taiwan. So that may mean we may see more USD selling than before
 - b. Whether Taiwanese central bank admits it or not, there is a sense in market that maybe the US had a role to play. And if that is true, what does it mean for the other central banks in Asia. Will they buy less USD than before?
2. If the above two risks are realised, we may see scope for appreciation in INR as well
3. That said, we continue to believe that the US-China trade deal discussions and its implications for CNY will be a bigger driver for INR
 - a. Scope for markets to be disappointed remains yet outcome on close watch
 - b. However, if say, tariffs on China move down from 145% to say 60%, it is likely to be +ve from sentiment perspective. (Fig 3)

Rupee weakened on cross-border tensions & Dollar strength, possibility of trade deal with US soon.

FPI flows into the equity markets have continued to be positive in May'25, also FAR related flows are positive now.

FX reserves at 7-month high; dipping after 8th consecutive week

Low Brent crude oil prices continue to support Rupee sentiment

Kargil war did not see much impact on INR yet we are operating in a different world today

Rupee volatility to continue amid global uncertainty and escalating border tensions

Rupee's fragility on escalation of cross-border tensions

The rupee sank steeply more than 1.71% this week, falling the most in over 2 years, the most among all the Asian currencies and surged past 85/\$ handle (85.8525/\$ on 09th May'25) levels last seen in Apr'25; broadly on account of the escalating cross-border tensions with the neighbouring country and Dollar's strength. The return of FPI flows in the equity segment post mid-Apr'25 supported the local currency and the inflows continued in May'25 on possibility of striking a trade deal with US soon. (Refer our report: [FX weekly: Rising optimism of US-China de-escalation helps curb market volatility](#))

FPIs flows in the equity segment, continue to be negative this year to the tune of \$11.52bln but have turned positive in the month of Apr'25 & May'25 (-\$9.04bln in Jan'25, -\$3.98bln in Feb'25, -\$0.41bln in Mar'25, \$0.51bln in Apr'25 and \$1.39bln in May'25). The flows in the equities turned positive in the 2nd half to \$4.46bln vis-à-vis outflows of \$2.42bln in the 1st half, which mainly boosted the Rupee sentiment. Even the inflows continue to pour in equities in this month but it has not given respite to the local currency's weakness. While, the FAR related flows are strong this year to the tune of \$5.42bln; however, turned positive in May'25 to \$0.09bln vis-à-vis outflow of \$0.63bln in Mar'25.

India's foreign exchange reserves rose dipped after 8 weeks by \$2.07bln, steady at 7-month high to \$686.06bln for the week ended 02nd May'25, likely owing to revaluation gains, though it is still down by \$18.80bln from all-time highs of \$704.86 (\$2.09bln rise was adjusted after valuation effects). This shows central bank has persisted with its efforts to curb FX volatility.

The fall in global Brent crude oil prices boosted the Rupee sentiment till now (touched lows of \$58.50/bbl on 05th May'25 to highs of \$63.65/bbl on 09th May'25; current levels: \$63.56/bbl). However, the oil prices are heading north, supported by hopeful developments from the US-China trade talks but still levels are comfortable in terms of the Indian economy.

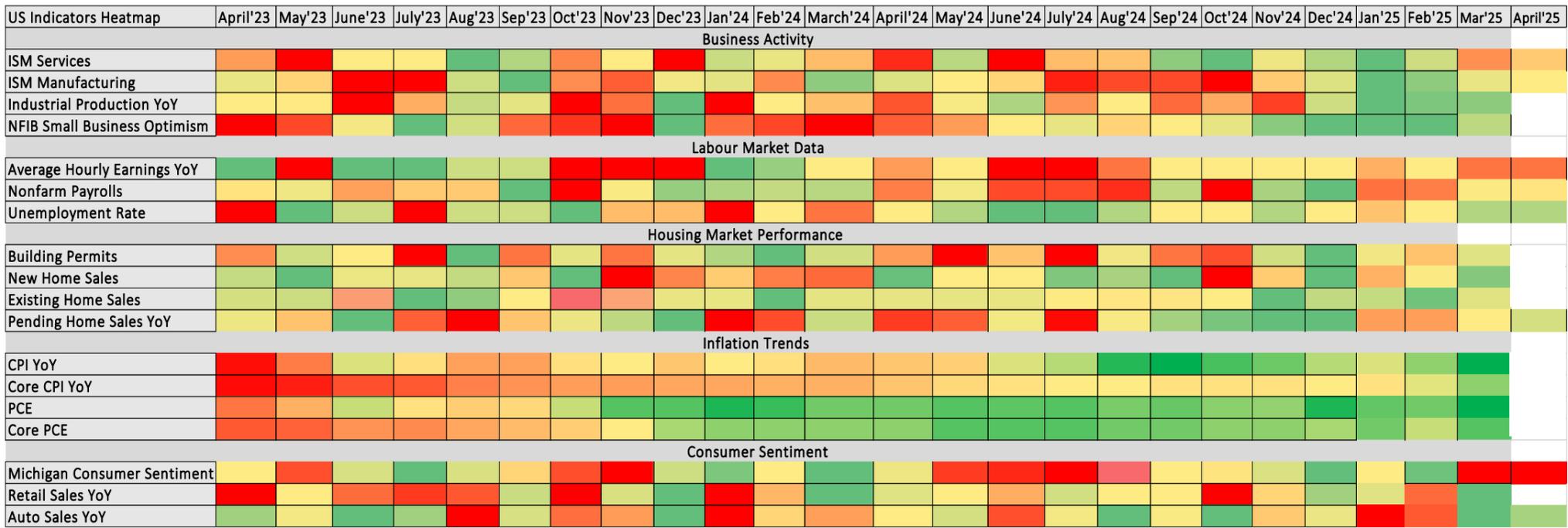
India faced last such significant warfare with Pakistan was in Kargil [3 May 1999 - 26 July 1999], which had a noticeable but limited impact on the INR. The local currency witnessed initial depreciation due to uncertainty amid investor concerns over geopolitical stability. The uncertainty led to temporary outflows in the FPI segment, which added downward pressure on the rupee, however the overall inflows in the year turned out to be \$2.47bln (1999-00) vis-à-vis \$8.9bln (1998-99). While there was a dip in the rupee from 42.64/\$ to 43.60/\$ levels, it quickly stabilized after the war ended and consolidated thereafter till May'2000. India's foreign exchange reserves of \$38.036bln were sufficient with an import cover of 8.20 months to prevent a major currency crisis at that period of time. However, in the Kargil war period there was not limited move in the INR but this time the volatility will not be only due to domestic issues but also due to the international trade wars.

India Macro & market performance during past war periods:

War year (marked in red)	GDP (% YoY)	Inflation* (% YoY)	Central govt fiscal deficit (% GDP)	FX reserves (\$ bln)	BoP (\$ bln)	Import cover (months)	USDINR	10yr bond yield (%)	Sensex (% change)
Kargil war (3 May 1999 – 26 July 1999)									
1998-99	6.18%	13.11%	6.29%	31.586	-47.5	6.88	42.44	12.1%	-3.9%
1999-00	8.85%	3.38%	5.18%	38.036	-55.4	8.20	43.61	10.8%	33.7%
2000-01	3.84%	3.74%	5.46%	42.256	-57.9	8.24	46.64	10.1%	-27.9%
Indo Pakistani war (3 Dec 1971 -- 16 Dec 1971)									
1970-71	5.16%	-	2.96%	9.75	-2.4	-	7.50	-	-
1971-72	1.64%	3.20%	3.39%	11.94	-2.8	-	7.28	-	-
1972-73	-0.55%	7.80%	3.88%	12.19	-2.8	-	7.66	-	-
Indo-Pakistani War (5 Aug 1965 -- 23 Sep 1965)									
1964-65	7.45%	-	-	5.24	-3.0	-	-	-	-
1965-66	-2.64%	-	-	6.26	-2.9	-	-	-	-
1966-67	-0.06%	-	-	6.38	-2.8	-	-	-	-

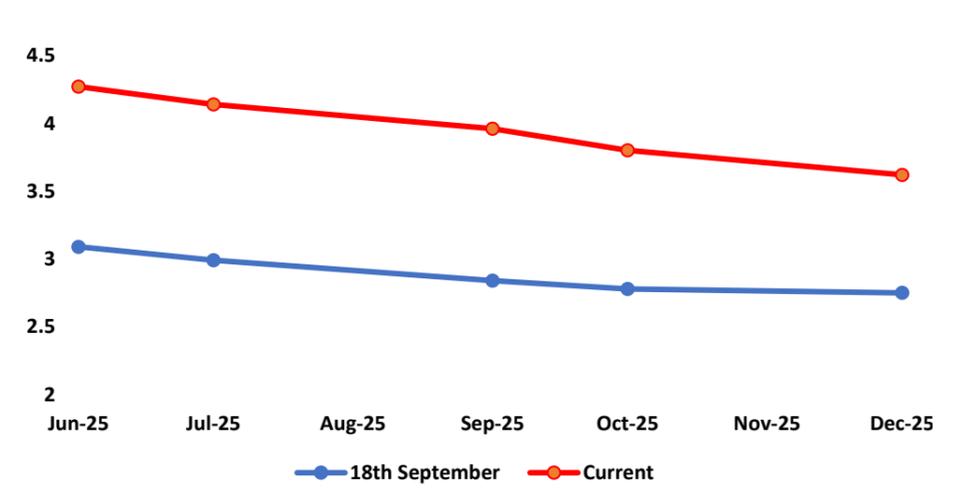
*proxied using WPI, Source: CEIC, UBI Research

Based on the current global scenario, volatility to reign on uncertainties and we expect Rupee to consolidate at current levels. The Dollar Rupee pair has respected our previous technical levels and took support at 84.45 on 30th Apr'25 and now went past 85/\$ handle to touch 85.8525 as major stop losses were triggered. However, major importers & oil companies continue to panic buy dollars. Rupee was more of a Dollar play in recent weeks thereby receiving support amid weakness in the greenback and return of FPI flows in equities. However, it has come under sharp pressure due to cross border political tensions even as there are talks of the central bank making efforts to contain FX volatility. That said, we believe that Rupee is likely to stay under pressure until diplomatic solution is achieved in the cross-border tensions. Meanwhile, another factor on watch is the prospects of de-escalation of US-China trade talks and its impact on CNY (a bigger driver for Rupee) along with broader Dollar index.

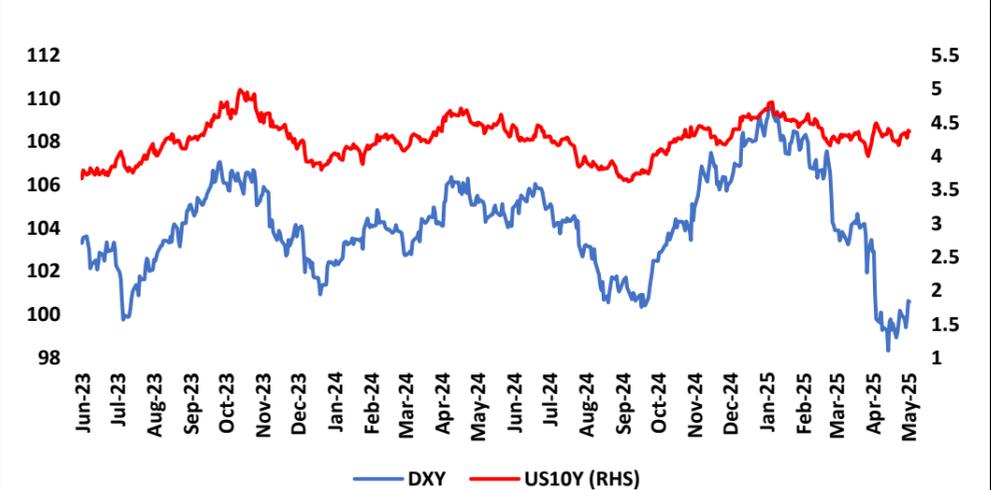


Central bank Policy Rates			
	Current	End of 2024	YTD Change 2025 in BPS
Advanced Economies			
Australia	4.10%	4.35%	-0.25
Canada	2.75%	3.25%	-0.5
Euro-zone	2.40%	3.15%	-0.75
Japan	0.50%	0.25%	0.25
New Zealand	3.50%	4.25%	-0.75
United Kingdom	4.25%	4.75%	-0.5
US	4.50%	4.50%	0
Developing Economies			
Brazil	14.75%	12.25%	125
China (1Y LPR)	3.10%	3.10%	0
India	6.00%	6.50%	-0.5
Indonesia	5.75%	6.00%	-0.25
Philippines	5.50%	5.75%	-0.25
South Korea	2.75%	3.00%	-0.25
Taiwan	2.00%	2.00%	0

The recent NFP data and FOCM meet has led to market pare back its rate cut expectations by total of 60bps as against 100bps on 18th Sep'24 Jumbo rate cut (Fig 1)

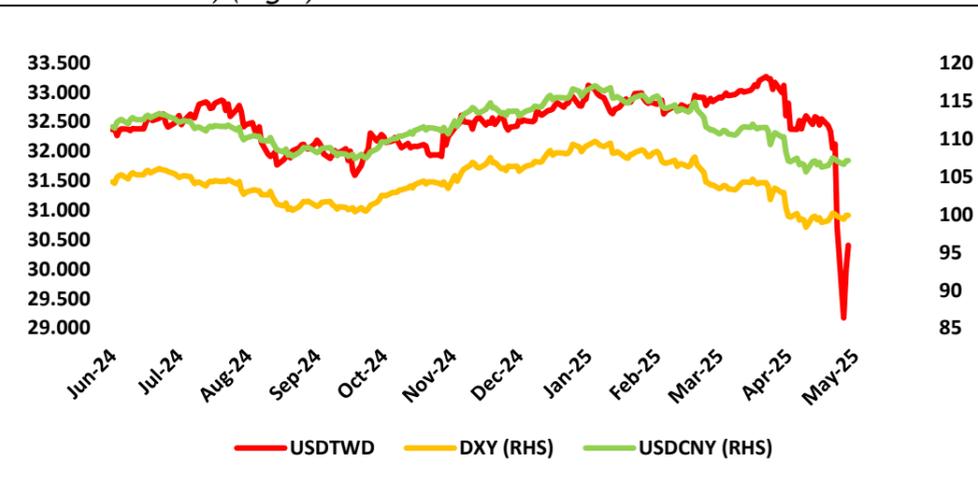


US dollar showing signs of recovery and trading comfortable above the crucial 100 level (Fig 2)

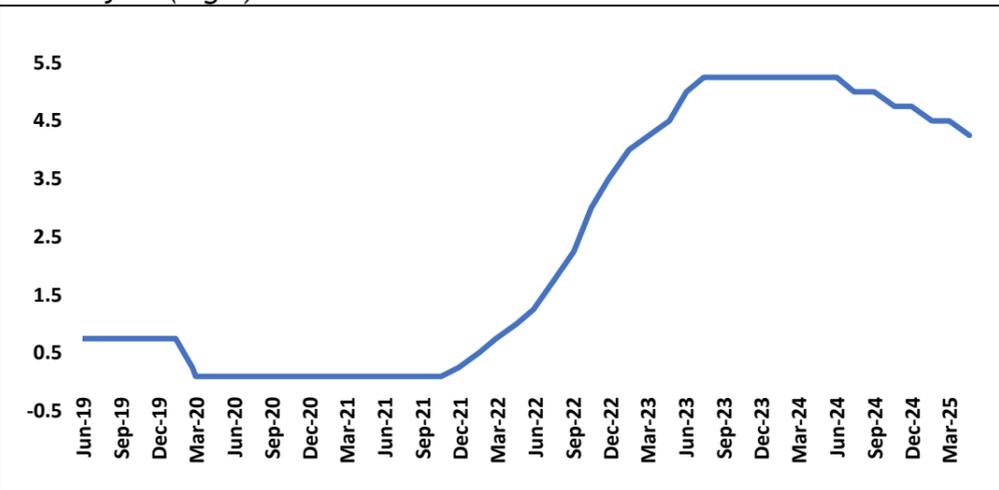


Source: Bloomberg, Reuters, UBI research

TWD gained ~10% since early April, of which 5% came in on 5th May (sharpest move since 1988) (Fig 3)

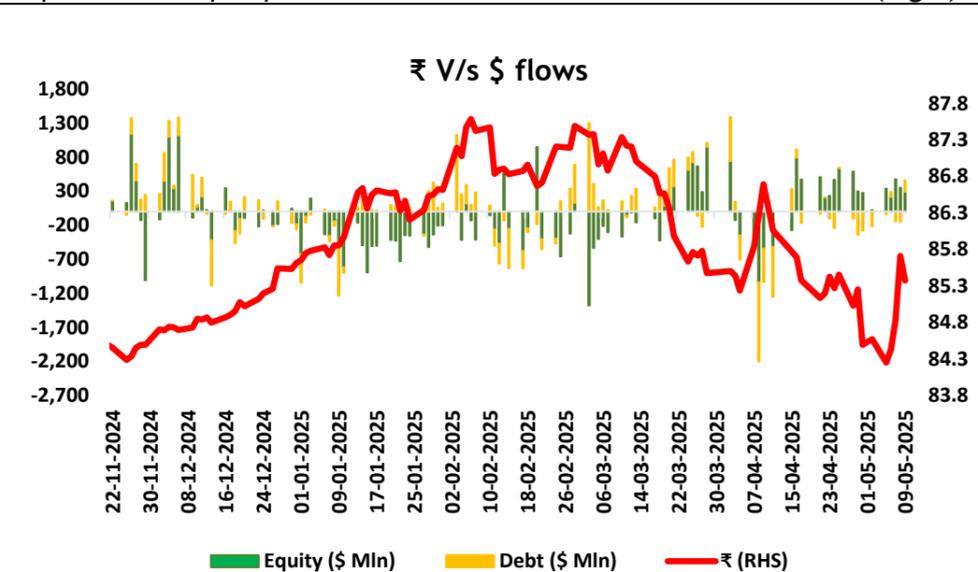


BoE continues with its rate cut cycle while US-UK trade deal is +ve for the economy (Fig 4)

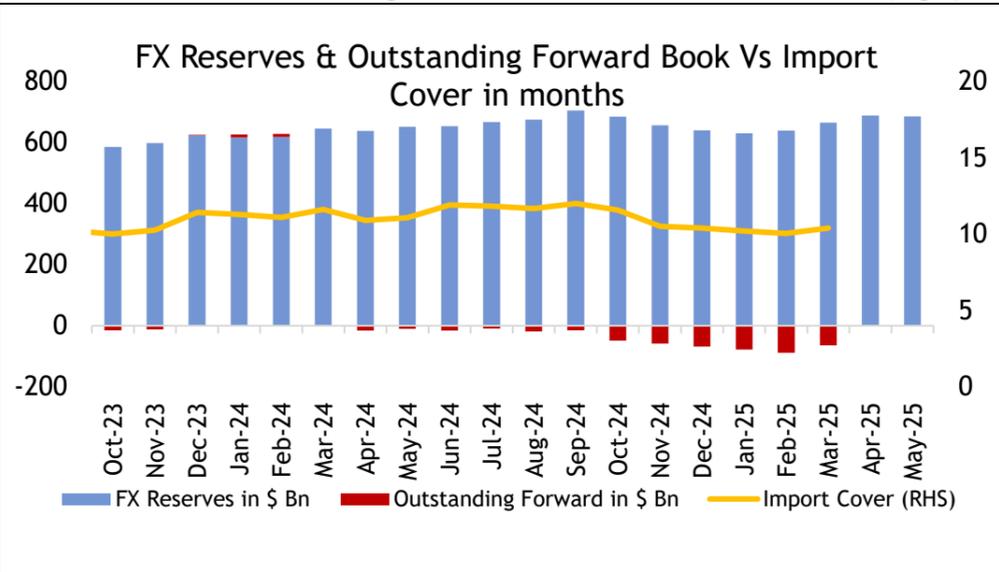


Source: Bloomberg, Reuters, UBI Research

Rupee seen sharp depreciation amid cross-border tensions (Fig 5)



FX reserves still at 7-month high (Fig 6)



Source: Bloomberg, Reuters, UBI Research

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