

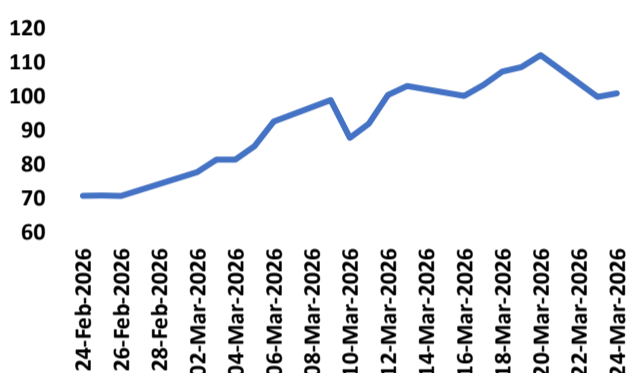
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Oil experienced the most extreme intraday volatility (Fig 01)



Source: Refinitiv

Market-Implied Meeting	Path Implied Rate	(Fed-Funds Futures Cumulative Change (Table 1))
29 Apr 2026	3.66 %	+03 bp
17 June 2026	3.69%	+06 bp
29 July 2026	3.68%	+05 bp
16 Sept 2026	3.69%	+06 bp
28 Oct 2026	3.70 %	+07 bp
09 Dec 2026	3.71%	-08 bp

Next meeting probabilities: No change 86 %, 25 bps hike 13 %

**Middle East Refining Capacity Disruption** (Table 2)

Country	Pre-war capacity (early 2026)	Capacity affected by war	Remaining operable (Mar 2026)
Iran	-2,300-2,400 kbd	600-800 kbd damaged or offline	-1,600-1,700 kbd
Saudi Arabia	-3,400-3,500 kbd	400-700 kbd temporarily offline	-2,800-3,000 kbd
Kuwait	-1,450 kbd	200-300 kbd damaged (Mina complex)	-1,150-1,250 kbd
UAE	-1,250-1,300 kbd	150-250 kbd disrupted (Habshan/Fujairah)	-1,000-1,100 kbd
Qatar	-350 kbd	Minimal refinery damage (mainly LNG hit)	-330-350 kbd
Bahrain	-270-300 kbd	~100 kbd offline (Sitra refinery)	-170-200 kbd
Oman	-500-520 kbd	No confirmed refinery strikes	-500+ kbd

Markets remain suspended in a state of cautious volatility as U.S President Trump's decision to postpone strikes on Iran's power grid offers only temporary relief rather than a real solution. The five-day extension on the 48-hour Strait of Hormuz ultimatum, justified by supposedly "productive" negotiations that Tehran flatly denies even happened, shows the fundamental disconnect plaguing this crisis. As the ancient Greek playwright Aeschylus warned, in war the first casualty is truth and investors are learning this lesson in real time as contradictory stories from Washington and Tehran leave markets navigating in the dark.

The underlying situation remains unstable. With roughly one-fifth of global oil and liquefied natural gas flows still blocked at the Strait of Hormuz and Iranian factions appearing divided on whether to even negotiate, the crisis shows no easy path to resolution regardless of U.S. Presidential statements. This fragility showed up immediately in today's trading, where initial overnight relief quickly gave way to renewed worry. Brent crude reversed sharply higher, climbing 3.6% to \$103.58 after the previous session's 10% drop, while WTI rose 4.12% to \$91.76. The message from markets is clear: traders believe the energy shock continues and the risk of further escalation remains high despite diplomatic talk.

**The Long Road to Recovery Even After Peace**

Even if diplomatic efforts somehow succeed in ending the conflict, the damage already inflicted is severe enough that recovery will take years, not months. Critical infrastructure in the region has been compromised, global supply chains have been disrupted, and the network of shipping, insurance, and logistics that keeps energy flowing has been fundamentally shaken. Oil refineries, storage facilities, and port infrastructure don't repair overnight, and the insurance premiums for shipping through previously contested waters will remain elevated long after any ceasefire. More importantly, global supply chains have already begun adjusting away from Middle Eastern routes, a shift that once made becomes sticky and difficult to reverse. Companies are now actively seeking alternative suppliers and routes, meaning that even when Hormuz fully reopens, trade patterns won't simply snap back to their pre-war state. This structural shift virtually guarantees that average crude oil prices for the year may remain significantly higher than pre-conflict levels, regardless of how quickly diplomacy might resolve the immediate standoff.

**Interest Rates and Currency Markets Signal Inflation Worries**

Treasury markets are repricing sharply as the energy crisis forces a complete rethinking of where global interest rates are headed. U.S. two-year yields jumped 7bps to 3.90%, while the benchmark 10-year climbed over 4 basis points to 4.38%, giving back much of Monday's safe-haven rally. The inflationary pressure from sustained high oil prices has killed off any remaining hopes for further interest rate cuts globally. Instead, futures markets now expect aggressive rate hikes across developed economies the European Central Bank, Bank of England, and Reserve Bank of Australia are each projected to deliver three rate increases this year, a dramatic turnaround from pre-war expectations.

The Fed's outlook has shifted just as dramatically. Before the conflict started, markets were pricing in 60 bps worth of rate cuts for 2025. Now, futures markets assign real probability to rate hikes instead, even though the Fed's own projections still technically show one cut for the year. The Reserve Bank of Australia has already broken away from the pack among major central banks with a 25bps hike, signaling that inflation fears are now trumping growth concerns in policy decisions. Currency speculators have flipped their positions accordingly CFTC latest data shows dollar long positions reaching \$6.79 billion in the week ending March 17, a massive swing from the \$4.85 billion short position held just one week earlier, ending a bearish stance maintained since mid-December.

**Global Fund Flow**

(Table 3)

Asset Class	Flow Trend	Intensity	Flow (\$ bn)
US Treasuries	Inflows	Strong	+12.0
US Equities	Inflows	Strong	+47.1
Japan Equities	Neutral+	Mild	+1.5
Europe Equities	Flat	Weak	+0.04
EM Equities	Outflows	Moderate	-4.8
EM Debt	Outflows	Moderate	-3.3
Gold	Outflows	Moderate	-4.5
Commodities	Outflows	Moderate	Negative

Source: Bofa

Fed messaging reflects heightened uncertainty policy remains data-dependent, with inflation risks still outweighing growth concerns. With energy shocks persisting and rate expectations shifting hawkish, markets remain caught between delayed escalation and no resolution keeping volatility elevated.

**The Key Yield Limit on Trump's War Strategy**

The U.S. 10-year Treasury yield represents the critical point on how long the administration can keep up military pressure on Iran. Yields have already climbed roughly 45 basis points since February 28, following the same pattern seen in April 2025 when a move above 4.50-4.60% forced a policy reversal through the tariff pause. With yields now near 4.40%, that same 4.50-4.60% zone is shaping up as the danger level beyond which market stress will likely force a strategic shift.

The US economy can handle temporary spikes in yields, but yields toward 5% is worrisome. Such a jump would seriously tighten mortgage rates, credit availability, and government borrowing costs. Higher yields also make the government's debt problem worse, with net interest payments projected to climb from about 3.3% of GDP in 2026 to 4.6% by 2036 as the debt burden keeps growing. This creates a hard ceiling on how long markets will tolerate continued escalation without some resolution.

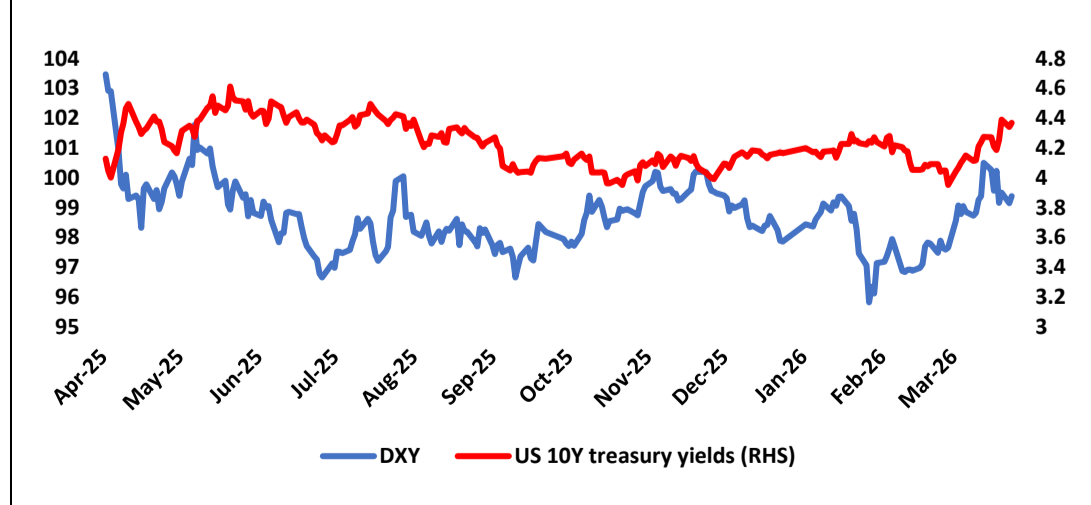
**Fed Officials Navigate Uncertainty with Mixed Views**

Fed officials' comments reflect the genuine uncertainty around policy decisions right now. Fed's Mary Daly emphasized that when uncertainty is this high, thinking through different scenarios is more useful than debating what's most likely to happen. She explicitly pushed back against calls for the Fed to give more specific guidance about future rate moves, arguing that overly precise signals create a false sense of certainty in what is genuinely an uncertain environment. The Fed's right approach, she argued, is to acknowledge the uncertainty, think through multiple possible outcomes, and stay focused on controlling inflation and supporting employment no matter how things develop.

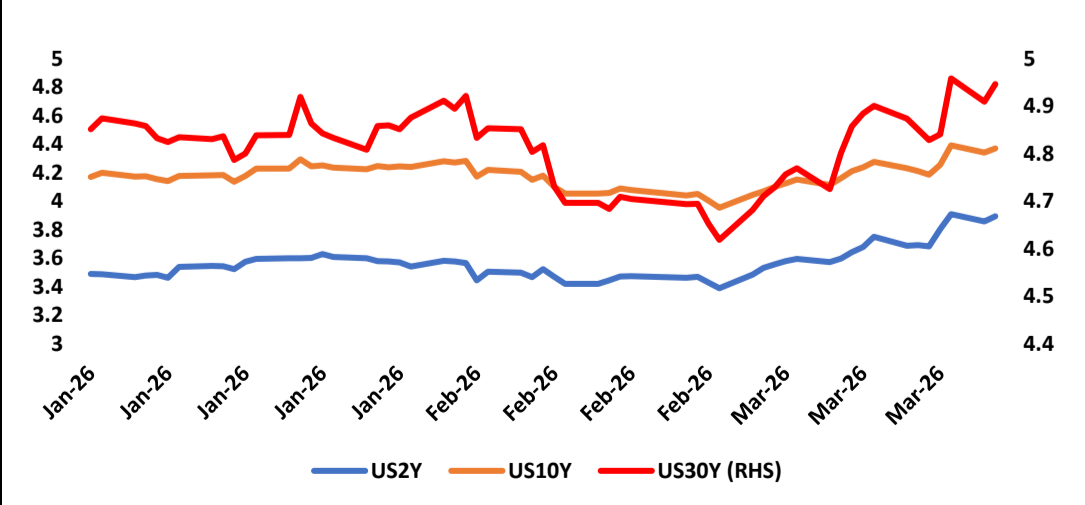
Fed Governor Stephen Miran took a calmer view, suggesting that oil price swings from the Iran conflict haven't yet reached levels that would change baseline expectations for four rate cuts during the year. He advised patience, saying the Fed should wait for clearer trends before adjusting its policy outlook. Meanwhile Austan Goolsbee acknowledged the widest range of possibilities, saying he could see scenarios requiring either rate hikes or resumed cuts depending on how the Middle East situation plays out. Notably, he pointed out that most economic data suggest we're closer to full employment while inflation remains too high, meaning that fighting inflation has to take priority over employment concerns in the Fed's decision-making right now.

Markets are currently stuck between competing forces relief that immediate escalation was delayed versus recognition that the underlying problems haven't gone away. The energy shock continues with Hormuz partially closed, inflation expectations are rising, and central banks worldwide are shifting toward raising rates. The dollar's comeback and rising Treasury yields signal that safe-haven buying is giving way to inflation hedging and bets on tighter policy. What's particularly concerning is that even if peace comes tomorrow, the damage to infrastructure and supply chains means recovery will be measured in years, and average oil prices for 2025 will remain elevated regardless of how quickly diplomacy might work. The critical question now is whether negotiations can produce real de-escalation. Until there's clarity on reopening Hormuz and Iranian unity on negotiations, markets will stay choppy and investors will maintain defensive positions across all asset classes.

The dollar is being whipsawed by Middle East headlines, with focus on any credible ceasefire signals from Iran. (Fig 2)



The Treasury yield across the curve rose today, as oil market volatility and persistent Middle East tensions kept investors on edge. (Fig 3)



Source: LSEG, UBI research

Fig.1: Sensitivity of India's macros to Indian Crude Basket (ICB) prices

Economic Variable	Impact of Every \$10/bbl. Increase in Crude Oil Prices
GDP Growth <sup>^</sup>	-15 bps
CPI Inflation <sup>^</sup>	+30 bps <sup>^^</sup>
Combined Fiscal Deficit <sup>*</sup>	Worsens by ~0.3–0.4% of GDP
Current Account Deficit (C/A) <sup>*</sup>	Widens by ~0.4% of GDP
Indian Rupee (INR)	Depreciation / Weaker Bias

<sup>^</sup> as per the Monetary Policy Report April 2025 and based on a 10% deviation from baseline crude oil assumptions;

<sup>^^</sup> assumes no cut in excise duty;

<sup>\*</sup>negative sign indicates widening deficit;

Source: RBI & UBI research

High oil sensitivity: Brent above \$100/bbl. keeps volatility elevated, with every \$10/bbl. rise widening India's CAD by ~\$15bln.

Safe-haven demand lifts DXY: Rising US yields, \$100+ oil, and global risk-off sentiment push the index toward 100.

RBI's FX cushion remains strong: Reserves at \$709.76bln despite drawdown, with ~\$4bln liquidity drag deployed to manage volatility.

INR undervaluation persists: REER dips to 94.05 in Feb'26, as RBI manages volatility with \$2.53bln net FX purchases in Jan'26.

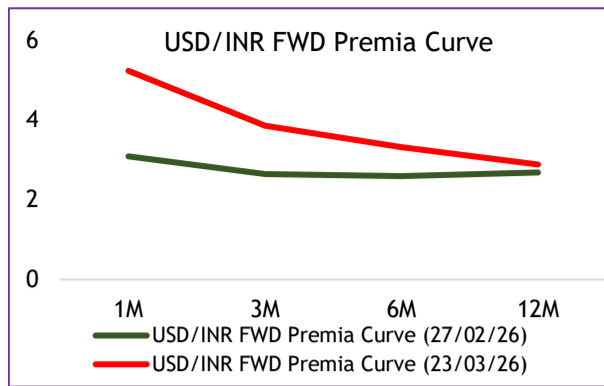
## War pushes ₹ to record lows: Escalating West Asia conflict, \$100+ oil, strong DXY, and FPI exodus

The Indian Rupee remained under intense pressure throughout the reporting week, hitting a fresh record low of ₹93.98/\$ on 23<sup>rd</sup> Mar'26. While the currency flirted with the psychological ₹94/\$ barrier, it has not yet breached that mark in the spot market. This weakness is primarily a "war premium" driven by the escalating US-Israeli conflict with Iran, which has seen direct strikes on critical energy infrastructure, including the Bapco refinery in Bahrain and natural gas fields in the Persian Gulf. These hostilities have effectively throttled global supply chains, with the Strait of Hormuz - a chokepoint for 20% of the world's oil—facing severe disruptions.

The impact on India's economy is twofold. **First**, Brent crude prices have surged into a volatile \$100-\$120/bbl., far exceeding the fiscal baseline and threatening to balloon the trade deficit. **Second**, the "risk-off" sentiment triggered by the war has led to a massive exodus of capital; Foreign Portfolio Investors (FPIs) pulled over \$11.82bln monthly outflow out of domestic markets. With the U.S. Dollar Index (DXY) surging toward 100 as investors seek safety, the Rupee continues to face a perfect storm of high energy costs and sustained capital outflows. (Last Friday's close: ₹92.4625/\$) [O: ₹92.4300/\$, H: ₹93.9800/\$, L: ₹92.3025/\$ & C: ₹93.9800/\$]. [[Refer report: "Strait Under Fire: Global and Indian Macros & Markets at the Crossroads"\(Part II\)](#)]

### Rupee at record low amid Oil shock amid West Asia crisis: Key Risks for India's Macros & Markets

- 1) **High oil price sensitivity:** The Brent crude market experienced extreme volatility last week, characterized by a massive "war premium" as prices surged into the \$100-\$113/bbl. range. This bullish momentum was fueled by the direct strikes on critical energy infrastructure and the effective blockade of the Strait of Hormuz. Market anxiety shifted from simple shipping delays to fears of permanent capacity loss. Although a late-week diplomatic "strike pause" caused a brief retreat from the weekly high of \$119.50/bbl., the underlying physical market remains in a severe deficit. This supply shock has been compounded by a "risk-off" sentiment in global markets, forcing a record release of 400 million barrels from the IEA to stem a rally that threatens to push prices toward the \$130 mark if the geopolitical standoff remains unresolved. **Brent crude is expected to remain highly volatile with an upward bias**, as geopolitical developments in West Asia and potential disruptions to Gulf energy infrastructure remain the dominant drivers. On a **WoW basis, prices dipped by ~2%, and reflect a rise of ~40% YoY**. Sensitivity of C/A deficit to oil prices stays high with every \$10/bbl. move in oil price affecting annual C/A balance by close to \$15bln.
- 2) **Dollar strength and FPI exodus:** The DXY exhibited robust bullish momentum last week, surging toward the critical 100 level as global financial markets retreated into "safe-haven" assets. With Brent crude prices oscillating above \$100/bbl., inflationary fears have resurfaced in the US, leading traders to price in a "higher-for-longer" interest rate environment by the Federal Reserve. The index was further bolstered by a spike in US 10-year Treasury yields, as investors pivoted away from volatile equities and toward the security of dollar-denominated debt. Despite a brief late-week softening following a temporary diplomatic "strike pause" in the Middle East, the DXY maintained its upward trajectory, closing near its weekly highs. During this month, FPIs turned net sellers, withdrawing ~\$11.82bln from Indian markets, amid heightened global uncertainty. FPIs continue to be net sellers in equities to the tune of ~\$3.8bln vis-à-vis outflows of ~\$3.4bln on a WoW basis. Debt markets also remained in negative to the tune of ~\$798mln vis-a-vis ~\$779mln outflows a week ago. FAR flows, at \$1.82bln (FY26), including a ~(\$686mln) outflow so far last week.
- 3) **Strong policy cushion from RBI:** On the on-going external headwinds, India's foreign exchange reserves slip away from record highs at \$709.76bln (as of 13<sup>th</sup> Mar'26) covering ~11 months of imports, driven mainly by a \$7.68bln fall in FCA and \$0.66bln rise in Gold; providing the central bank with substantial cushion to smooth volatility. As per our analysis, the FX drag in liquidity to possibly curb the FX volatility has been ~(\$4bln) (excluding valuation effects) in the week ended 13<sup>th</sup> Mar'26.
- 4) **REER:** (2015-16=100) fell further to 94.05 in Feb'26 from 94.82 in Jan'26. Despite the currency being undervalued (REER <100), the recent weakness has been driven more by sentiment than by fundamentals. The RBI contained severe volatility, recording **net FX purchase of \$2.53bln** in Jan'26, compared with \$10.02bln in Dec'25.



Source: Cogencis & UBI Research

Foreign Investment Inflows				
(US \$ Million)				
Item	2024-25	Apr-Feb	Mar'26	2025-26
FDI	959	-	-	1655 <sup>^</sup>
FPI	3564	(2991)	(11822)	(14813)*
Total flows	4523		-	(13158)

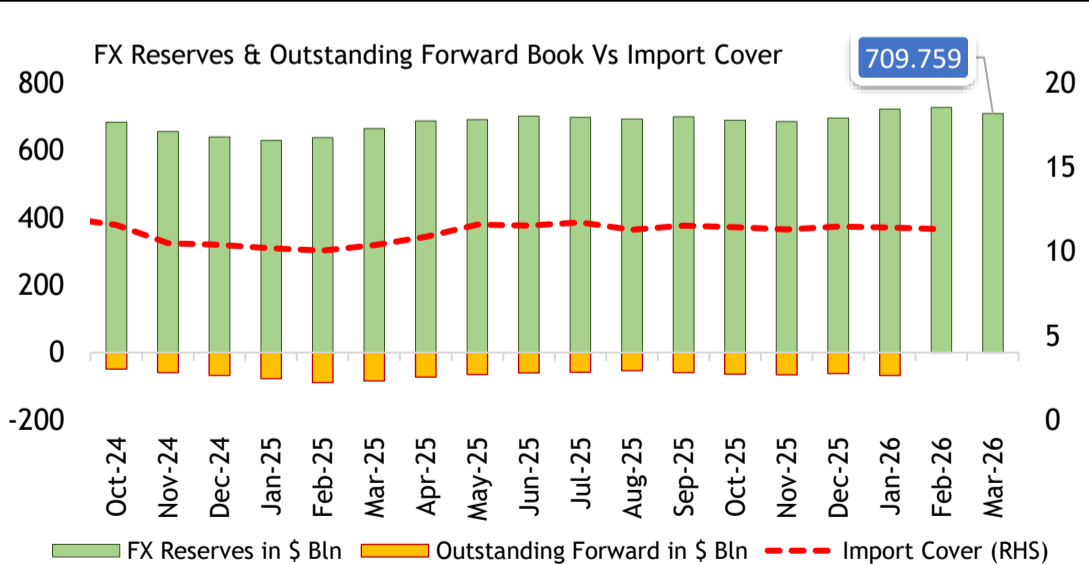
<sup>^</sup>data till Jan'26; \*data till 23<sup>th</sup> Mar'26  
Source: RBI, NSDL & UBI research

**5) The USDINR forward curve:** The INR forward curve witnessed a notable "bearish flattening" last week as the domestic currency hit a fresh record low. This downward pressure on forward premiums was largely driven by a massive weekly outflow from FPIs, which forced aggressive "sell-buy" swap activity in the market. With Brent crude surging into the \$100-\$113 range due to the escalating conflict in West Asia and the blockade of the Strait of Hormuz, oil marketing companies (OMCs) faced intense dollar demand, tightening systemic Rupee liquidity and keeping near-term premiums volatile. Consequently, the 1-year annualized premium hovered between 2.10% and 2.25%, reflecting a narrowing yield differential as markets began pricing in a "hawkish hold" from the RBI to combat imported inflation. The forward curve is expected to remain soft with a downward bias as the spot rate tests the psychological 94.00 barrier.

**Outlook (INR - ₹ view):**

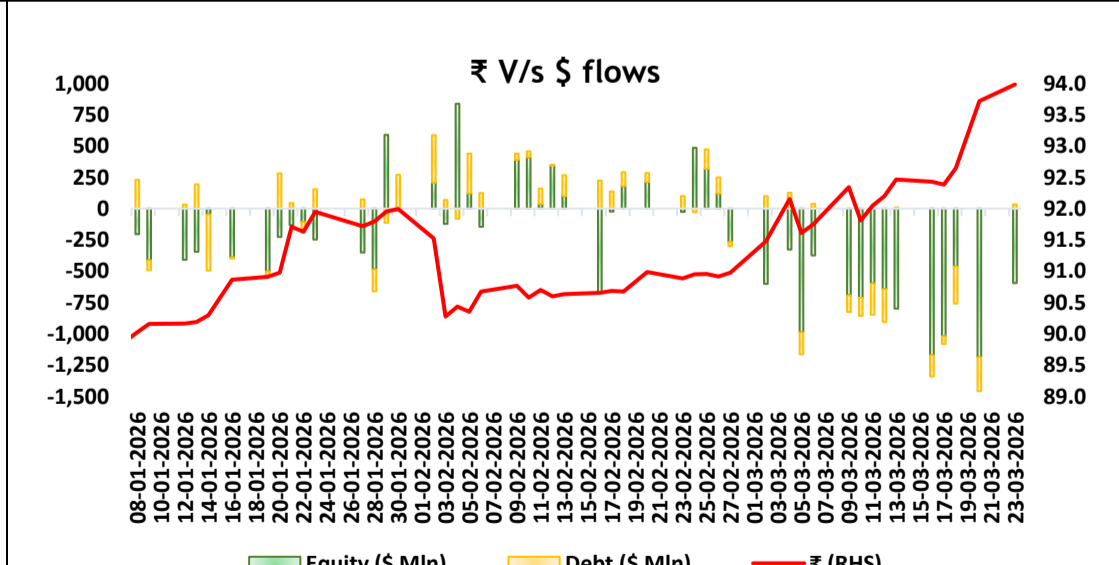
The Indian Rupee enters the week under intense pressure on a uncharted territory after hitting a fresh record low of ₹93.98/\$ on 23rd Mar'26, with the currency hovering just below the key ₹94/\$ psychological mark. The outlook remains fragile as escalating geopolitical tensions in West Asia continue to inject a strong "war premium" into global markets. Given the confluence of elevated crude prices, strong dollar dynamics, and sustained FPI outflows, the rupee is likely to remain volatile with a depreciation bias. However, strong FX reserves, and exporter dollar sales at higher levels may help prevent disorderly depreciation. A critical point of concern is the Balance of Payments (BoP), which is now projected to remain negative for the second consecutive year—a fiscal strain not witnessed since the 1991 crisis. This twin deficit pressure has sparked fears of a "currency overshoot," where the exchange rate moves beyond its fundamental value due to panic-driven momentum. Given these systemic vulnerabilities, the market is bracing for a significant hit to FX reserves; the prevailing view is that policymakers may be forced to prioritize the preservation of the "war chest" over defending specific price handles.

**FX reserves fall amid major dip in FCA despite minor rise in Gold (Fig 4)**



Source: Bloomberg, LSEG Workspace, CEIC & UBI Research

**₹ hits record lows amid West-Asia tensions (Fig 5)**



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