18th May 2026

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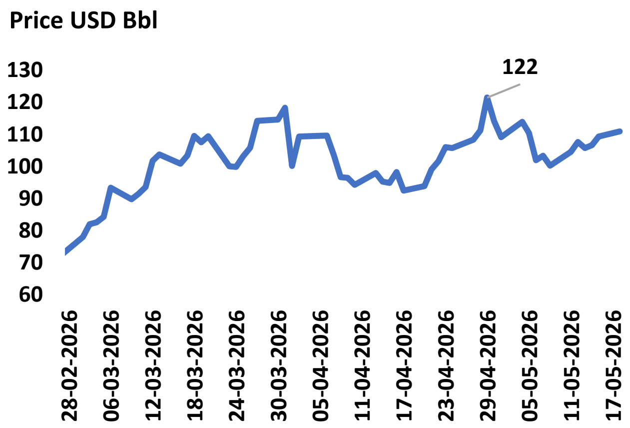
Oil has experienced extreme volatility (Brent Crude) (Fig 01)



Source: Refinitiv

KEY METRICS SNAPSHOT — 18 MAY 2026 (Table 1)

Indicator	Level	Change
US 10Y Yield	4.63%	▲ +25bps WoW
US 30Y Yield	5.16%	▲ +20bps WoW
DXY Index	99.28	▲ +1.4% WoW
Brent Crude	$110.26/bbl	▲ +10% WoW
Gold (COMEX)	$4,540/oz	▼ -3.7% WoW
US CPI Apr	3.8% y/y	↑ Rising
US PPI Apr	6.0% y/y	▲ Sharpest since 2022
Fed Hike Prob.	>50% by Dec	Repriced sharply

Cross Asset Fund Flow Monitor
(Table 2)

Category	4 wk avg ($bn)	2025 avg ($bn)
All Equities	11.6	8.1
All Bonds	13.0	11.3
US Equities	8.3	3.5
US Bonds	4.7	4.3
EM Equities	0.5	0.9
EM Bonds	1.54	0.50
Japan Equities	0.4	-0.1
China Equities	-0.19	-0.15
Europe Equities	-2.0	0.9
Europe Bonds	4.0	4.3

As of 06nd May,' 26 *Source: JP Morgan*

The current market narrative is being shaped by four key themes: a global bond selloff, oil-led inflation risk, renewed central bank tightening concerns and a stronger dollar. Together, these signals show that markets are moving away from a soft-landing narrative toward a more difficult backdrop of sticky inflation, tighter financial conditions and higher geopolitical risk. The move in US yields has been particularly striking. The 10-year US Treasury yield broke above 4.60%, its highest level since February 2025, while the 30-year touched 5.15% and the 30-year JGB hit a record 4.20%. ***More importantly, the rise in yields is already tightening financial conditions, which does not bode well for risk assets, especially emerging markets, where a stronger dollar, higher funding costs and weaker capital flows can quickly become self-reinforcing.***

Eleven weeks into the US-Iran war, the Strait of Hormuz remains effectively closed to normal tanker traffic. The Trump-Xi summit in Beijing produced constructive diplomatic optics and a limited trade framework, but no breakthrough on the waterway that carries approximately 20% of global oil supply. Iran has made its position explicit: transit will resume only when hostilities with the US and Israel cease. With the US blockade of Iranian ports still in place, and drone strikes having reached a nuclear installation in the UAE, the risk of further escalation is real.

Back-to-back US inflation prints last week constituted a genuine data shock. The April PPI reading of 6.0% year-on-year the sharpest monthly gain since 2022, with core at 5.2% signals that pipeline pressures are building. The only mitigating factor is that companies appear to be absorbing some upstream cost pressure rather than passing it fully to consumers at this stage. However, US CPI at 3.8% y/y in April, combined with the Philadelphia Fed's survey-based forecast of 6% for Q2 2026 headline CPI, has made the Fed's rate-cut path increasingly difficult.

The main question now is where oil will settle if the war ends tomorrow. Brent has averaged around $102/bbl since the war began, and a return to the $80-85/bbl zone is possible only under a clean full reopening scenario, where pre-war flows through the Strait of Hormuz are restored and geopolitical risk premia fade meaningfully. That is now a low-probability outcome in the near term. ***Our base case has shifted to around $90/bbl****, as the war has persisted longer than initially expected and any normalisation in tanker flows is likely to be gradual rather than immediate. The main upside risk remains full-scale escalation, including mining, blockade risk or military clearance operations, which could push Brent toward $120-140/bbl.*

The confirmation of Kevin Warsh as the next Fed Chair by the narrowest margin in the institution's history — 54-45 — highlights how polarised the current policy debate has become. His first major test will come at the G7 meeting this week, where investors will watch closely to see whether he still favours the rate cuts sought by President Trump. For now, however, inflation risk is feeding directly into Fed pricing. Markets are increasingly concerned that central banks may need to tighten policy to prevent a broader inflation spiral, with the probability of a Fed rate hike this year now seen as roughly a 50-50 call.

The DXY has turned firmer, around 99.10, as higher US yields, safe-haven demand and rate-hike repricing support the dollar. The near-term bias remains upward while yields stay elevated and oil keeps inflation risk alive. However, we would not treat this as a clean structural dollar breakout yet. Above the 100-101 zone, the dollar may face resistance because the same forces supporting it higher yields, fiscal concerns and oil-led inflation can also weaken US growth expectations and raise questions around Treasury market stability. In short, the dollar remains tactically bid, but the rally becomes less comfortable if it is driven more by stress than by genuine US exceptionalism.

This week, the market needs to watch five signals closely: Brent crude around $110/bbl, the US 10-year yield in the 4.60-4.75% zone, DXY near the 100-101 resistance area, Fed communication around inflation and rate-hike pricing, and intervention-sensitive FX levels such as USD/JPY near 160 and USD/INR near 96. Above all, markets will remain focused on the US-Iran war and whether there is any credible breakthrough on de-escalation or reopening of the Strait of Hormuz. If oil cools and yields stabilise, risk assets can digest the shock. If oil rises further and yields break higher, the current repricing could shift from a controlled adjustment into a broader tightening shock.

The broader message is that we are operating in unprecedented conditions, where market pricing is distorted by war risk, policy uncertainty and highly volatile cross-asset moves. The benign "soft landing with delayed cuts" narrative has now given way to a more uncomfortable "stagflation-risk with tightening bias" environment.

Rupee plunged to a record low of ₹96.1500/$ on 15th May'26 as soaring US Treasury yields, a surging Dollar Index, Brent above $111/bbl. and aggressive global risk aversion triggered sharp capital outflows and intensified external sector pressures.

Rupee hits record low amid triple shock of rising US yields, surging dollar & oil spike: The Indian Rupee is currently weathering a "*perfect storm*" of global headwinds, primarily driven by a sharp spike in the ***US 10-year Treasury yield to 4.63%*** and a ***surging US Dollar Index (DXY) to 99.35***. This risk-averse sentiment is exacerbated by the diplomatic stalemate between Washington and Beijing, where recent high-level meetings failed to yield a breakthrough. Amidst this turmoil, the Rupee easily breached the key psychological level of ₹96/$, hitting a record low of ***₹96.1500/$*** on 15th May'26.

Compounding these pressures is an equity market bloodbath that saw the BSE Sensex and Nifty crash as global funds fled emerging markets in a massive flight to safety. This sell-off was mirrored globally, with Japan's markets reeling from a significant yield spike where the ***Japanese 10-year yield advanced to 2.76%;*** levels not seen in nearly three decades. These factors, alongside fresh, aggressive rhetoric from President Trump toward Iran, have sent ***Brent crude climbing above $111/bbl***. Caught between a widening trade deficit and a relentless exodus of foreign capital, the Rupee remains under severe pressure as global liquidity continues to tighten. (Previous close: ₹94.4800/$) [O: ₹94.8900/$, H: ₹96.1500/$, L: ₹94.8750/$ & C: ₹95.9750/$].

RBI unveiled a multi-pronged INR defence shield through tighter forex exposure caps, temporary NDF restrictions, special dollar liquidity support for refiners, export credit relief and sharp gold import curbs to contain Rupee volatility.

Emergency Measures by RBI for INR defence shield:

Key Measure 1: New Forex Exposure Caps → The Directive (March 2026): Banks must cap their Net Open Position (NOP) in foreign currencies. Limit: A strict quantitative cap of $100 million per day. Comparison: A massive reduction from the previous limit of 25% of total capital. Impact: Forces banks to unwind speculative dollar positions, increasing dollar supply in the domestic market.

Key Measure 2: Cracking Down on Derivatives & NDFs → NDF Restriction (April 1, 2026): Banks are now prohibited from offering Non-Deliverable Forward (NDF) contracts involving the Rupee to both resident and non-resident clients. Cancellation and rollover of existing contracts; and transactions undertaken with non-related non-resident users on a back-to-back basis. (Withdrawn by RBI on 20th Apr'26)

Key Measure 3: Liquidity & Trade Support → Export Realization Extension: Permissible period for repatriation of export proceeds extended from 9 months to 15 months. Export Credit Relief: Enhanced credit period of 450 days extended for disbursals until June 30, 2026. Purpose: Provides liquidity to exporters facing shipping delays and payment cycle disruptions in West Asia.

Key Measure 4: Special dollar credit window for state-run refiners → Special foreign-exchange credit window / dollar line (April 16, 2026): RBI has asked state-run oil refiners to reduce spot market dollar purchases and instead meet their FX requirements through special credit line.

Key Measure 5: Gold Import Curbs → Raised effective gold import duty from 6% to 15% effective 13 May 2026. DGFT capped duty-free gold imports under the Advance Authorisation (AA) scheme at 100 kilograms per licence effective 15 May 2026. Fresh gold import licences will only be issued after fulfilling at least 50% of export obligations under previous licences.

Key take-aways for India's Macros & Markets:

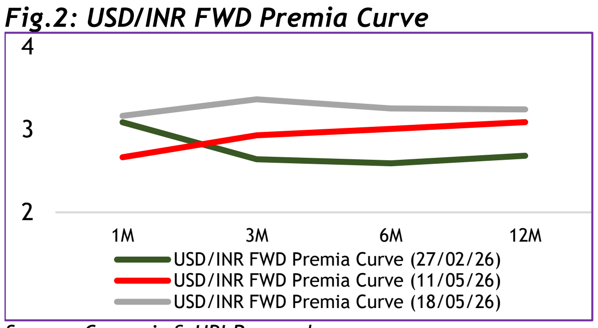
Brent crude surged above $111/bbl. amid deepening supply tightness, escalating West Asia tensions and a 1.74mbpd drop in OPEC+ output, intensifying pressure on India's external balances.

A. **Oil price sensitivity→** Brent crude has entered a phase of extreme structural tightness, surging past the ***$111/bbl***. mark as the market grapples with a massive supply-demand gap. Tensions reached a fever pitch following President Trump's recent ultimatum that the "*clock is ticking*" for Tehran, a sentiment left unchecked after the Beijing-Washington summit concluded without a diplomatic breakthrough. While a surging DXY (99.35) and high treasury yields would typically dampen commodity prices, the severity of the physical supply shock—evidenced by a 1.74 mb/d collapse in OPEC+ output—has decoupled crude from traditional macro headwinds. Consequently, Brent remains aggressively bullish, driven by a "*scarcity mindset*" as global inventories dwindle and the threat of further infrastructure attacks looms over West Asia. With crude oil averaging around $100/bbl. in FY26 YTD versus $70/bbl. last fiscal, India's current account deficit is projected to widen sharply from ~$35bln last year to nearly ~$80bln, equivalent to around 2% of GDP On a ***WoW basis, prices rose by ~6%,*** *The US Dollar's safe-haven dominance intensified as the DXY surged to 99.35 and US 10Y yields climbed to 4.63%, driven by resilient US growth, escalating geopolitical tensions and a global flight to safety amid collapsing risk appetite.*

Heightened FPI outflows, with overseas investors pulling out nearly $9bln this FY27.

India's FX reserves rebounded to $696.99bln as of 08 May'26, providing a strong buffer against external shocks.

Fig.2: USD/INR FWD Premia Curve



Source: Cogencis & UBI Research

Merchandise trade deficit widened sharply to $28.38bln in Apr'26, exceeding market expectations as a surge in gold, oil and NONG imports.

Fig.3: 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^	**-15 bps**
CPI Inflation^	**+30 bps^^**
Combined Fiscal Deficit*	**Worsens by ~0.3–0.4% of GDP**
Current Account Deficit (C/A)*	**Widens by ~0.4% of GDP**
Indian Rupee (INR)	**Depreciation / Weaker Bias**

^ as per the Monetary Policy Report April 2025 and based on a 10% deviation from baseline crude oil assumptions;
^^ assumes no cut in excise duty;
**negative sign indicates widening deficit;*
Source: RBI & UBI research

and reflect a rise of ~69% 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.

B. **Dollar strength→** The DXY & US 10Y Treasury yields are currently locked in a parabolic uptrend, with the 10-year yield hitting 4.63% and the DXY surging to 99.35. This "*double-barreled*" rally is being sustained by a resilient US economy and a total breakdown in global risk appetite following the inconclusive Trump-Xi summit in Beijing. As President Trump's rhetoric toward Iran shifts from diplomatic pressure to a ultimatum, the Dollar has decoupled from traditional valuation metrics, serving instead as a global lifeboat. With Japan's yields hitting 2.76% (a 29-year high) sparking a worldwide equity bloodbath, the US Dollar remains the premier destination for capital seeking both yield and security in a rapidly destabilizing geopolitical landscape. On a ***WoW basis, DXY inch-up by ~1%, and reflect a fall of ~1% YoY***.

C. **FPI exodus→** During this FY, FPIs turned net sellers, ***withdrawing ~$9bln from Indian markets*** amid heightened global uncertainty. FPIs continue to be net sellers in equities to the tune of ~$1346mln vis-à-vis outflows of ~$1493mln on a WoW basis. Debt markets also turn negative to the tune of ~$204mln vis-a-vis ~$461mln inflows a week ago. FAR inflows, at $296mln (FY26), including a ~$81mln outflow in last week.

D. **Strong policy cushion from RBI→** On the on-going external headwinds, India's foreign exchange reserves turned positive after 3 weeks and inched closer to record highs of ***$728.49bln*** (as of 27th Feb'26) to ***$696.99bln*** (as on 08th May'26) *covering ~11 months of imports*, driven mainly by a ***$5.64bln*** surge in **Gold** and ***$0.56bln*** rise in **FCA;** providing the central bank with substantial cushion to smooth volatility. However, if we consider the FX forward & future position of ***$104bln*** then the import cover can be little lower at ~9 months. As per our analysis, the FX lift in liquidity to possibly curb the FX volatility has been ~($0.09bln) (excluding valuation effects) in the week.

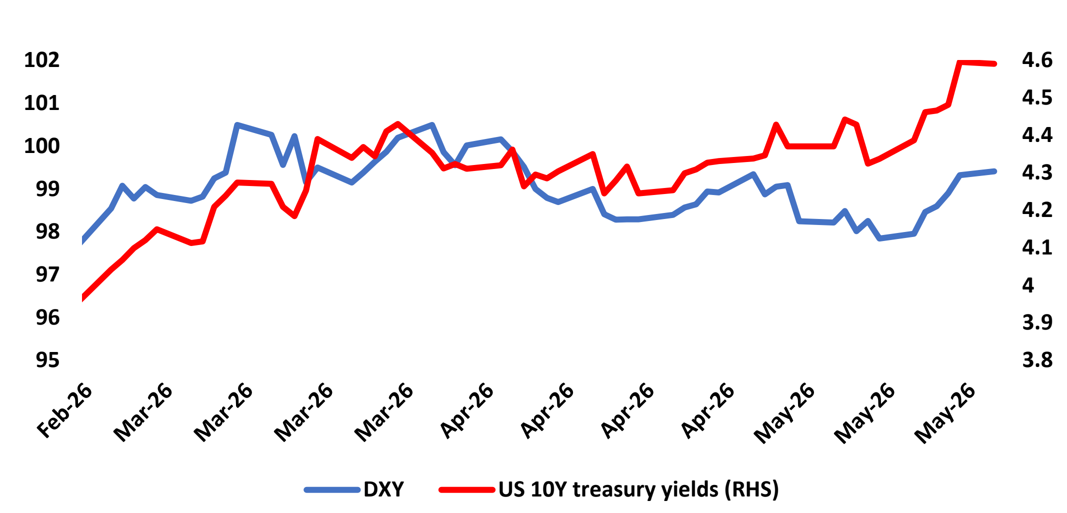
E. **The USDINR forward curve→** The USD/INR forward curve is navigating a period of intense structural distortion, with the 1-year forward premium compressed to the 1.55%-1.70% range, while the shorter-term 3-month and 6-month premiums have softened to approximately 1.42% and 1.53% annualized, respectively. This downward pressure is primarily a mechanical reaction to the narrowing interest rate differential, as the US 10-year yield's surge to 4.63% aggressively closes the gap with domestic G-Sec yields. Consequently, the outlook for the week remains bearish for premiums, offering a strategic, low-cost window for importers to hedge long-term exposures while leaving exporters side-lined by unattractive carry returns.

F. **Merchandise Trade Deficit→** Merchandise trade deficit widened to ***$28.38bln in Apr'26 vis-à-vis $20.67bln in Mar'26***. That said, the data stayed way above the market's expectations of $27bln and above our estimates of $25.7bln, marking a resilient & surging exports and in imports as well. Meanwhile, imports spiked significantly, resulting in widening in the merchandise trade deficit, led by Gold (~47% Up MoM), Oil (~29% Up) and NONG (~40% Up). In terms of sectoral drivers of trade dynamics, oil deficit went up significantly widening, with the latest number at $9.03bln compared to $7.00bln the previous month, gold deficit to $5.12bln vis-a-vis $3.49bln in Mar'26. Notably, non-oil non-gold deficit widened to record highs, levels last seen in Aug'24 to $14.23bln vis-a-vis $10.18bln on the back of volatile sub-segments like Chemicals, Machinery, electronics, etc.

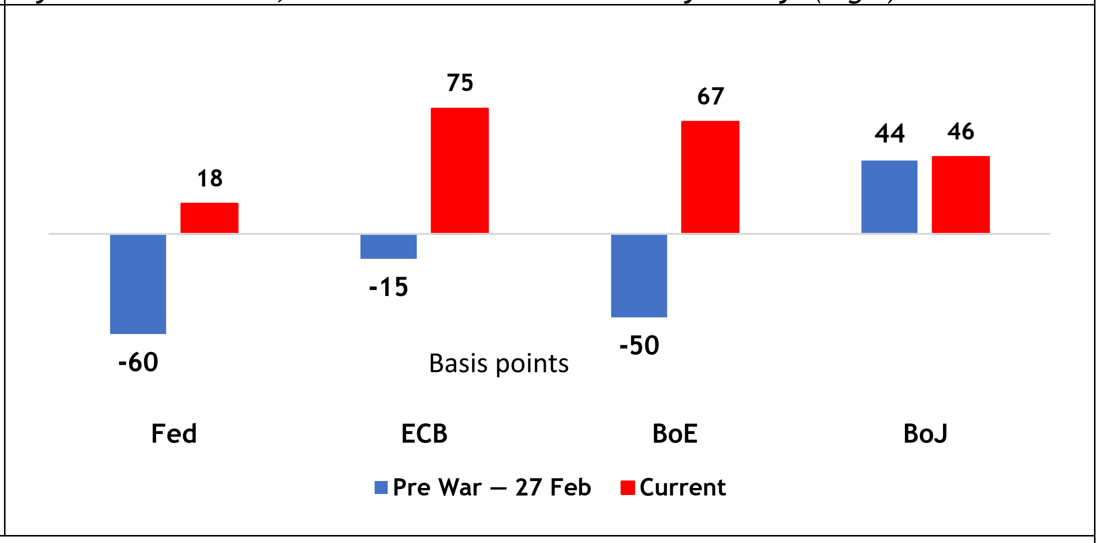
Outlook (INR - ₹ view):

The INR remains decidedly bearish for the week as the currency grapples with geopolitical and macroeconomic headwinds. After breaching the psychological ₹96/$ mark, the Rupee is expected to test the 96.50-96.80 levels as the relentless surge in US 10-year yields and DXY. Amid these pressures, market discussions have increasingly shifted toward measures to attract durable Dollar inflows and stabilize the Rupee. Participants are debating the possibility of reviving special FCNR(B)-type deposit schemes, easing overseas borrowing norms, incentivizing NRI deposits, and encouraging sovereign or quasi-sovereign foreign currency fundraising. There is also growing market speculation that maintaining relatively higher short-term INR interest rates and tighter domestic liquidity conditions may be necessary to improve carry attractiveness, discourage speculative Dollar demand, and support capital inflows. Therefore, policymakers are likely to prefer a calibrated mix of targeted FX liquidity measures and liquidity tightening rather than aggressive rate actions alone, especially as Brent crude hovering near $111/bbl. continues to strain India's trade deficit. That said, markets remain in an unprecedented and highly distorted phase, with participants divided over whether this is the appropriate time to launch FCNR(B)/Dollar bond measures or wait for more favorable near-term conditions and improved market stability.

The DXY has turned firmer (~99.10) as higher US yields, safe-haven demand and rate-hike repricing support the dollar. (Fig 4)

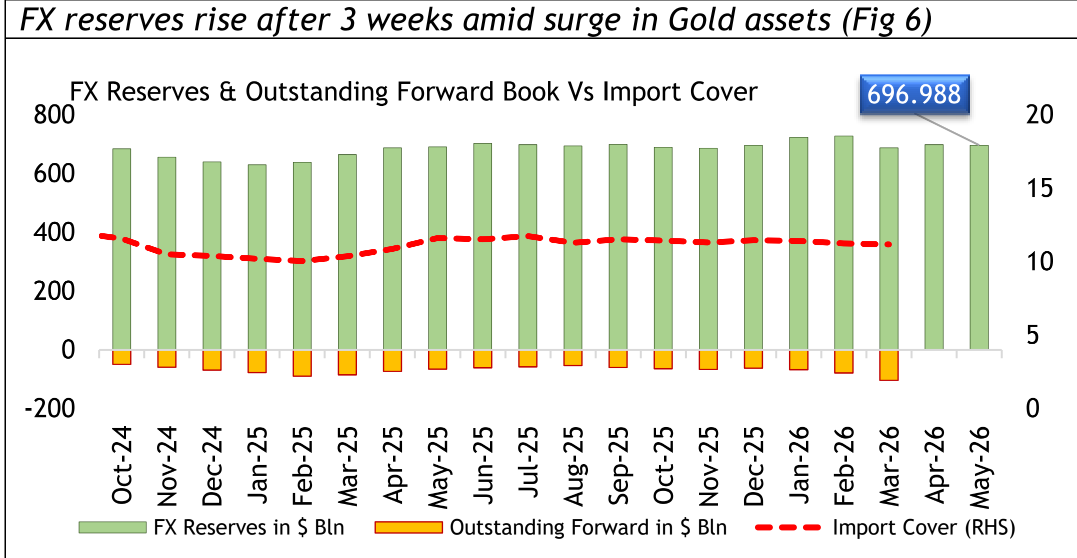


Markets have sharply repriced from rate cuts to renewed tightening risk, led by the ECB and BoE, while the BoJ remains broadly steady. (Fig 5)

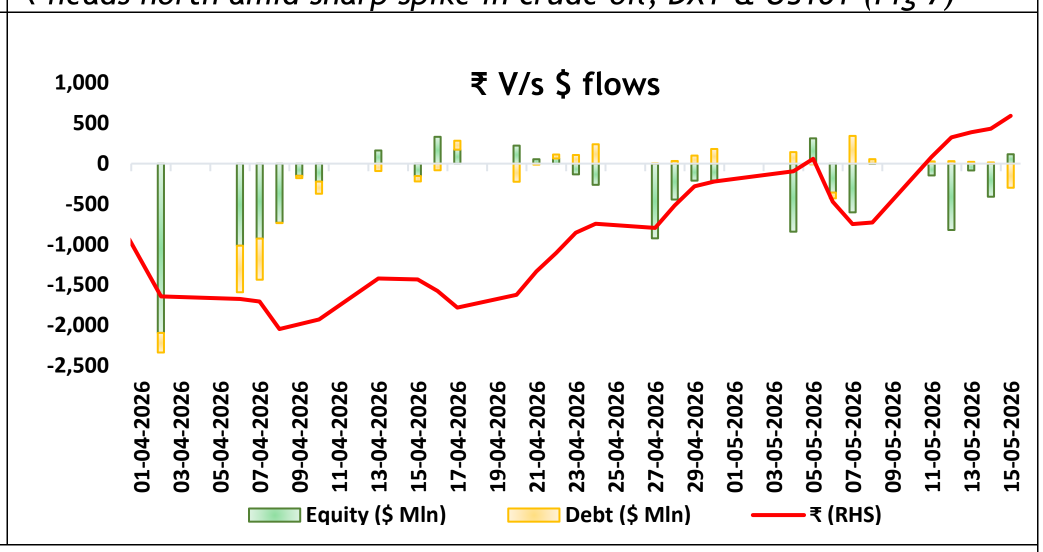


Source: LSEG, UBI research

FX reserves rise after 3 weeks amid surge in Gold assets (Fig 6)



₹ heads north amid sharp spike in crude oil, DXY & US10Y (Fig 7)



Source: Bloomberg, LSEG Workspace, CEIC & UBI Research

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