

By:

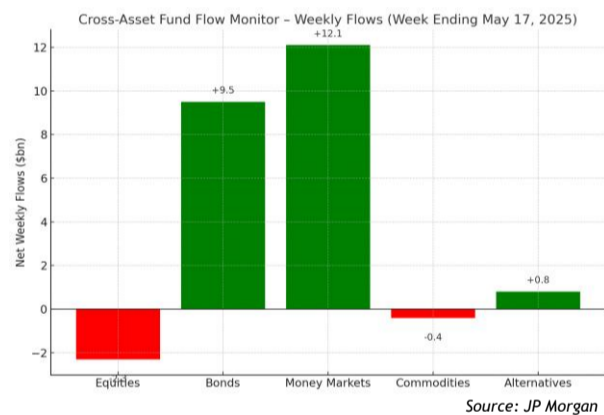
Kanika Pasricha
kanika.pasricha@unionbankofindia.bank

Akash Deb
akash510@unionbankofindia.bank

Shreyas Bidarkar
shreyas.bidarkar@unionbankofindia.bank

Category	Estimated Fiscal Impact (2025–2035)
Tax Cuts & Revenue Losses	-\$3.8 trillion
Social Program Cuts	-\$1.7 trillion
Defence & Border Spending	-\$350 billion
Net Debt Increase	-\$3.3-\$3.8 trillion
Debt-to-GDP Projection	Up to 125% by 2035

Source: CBO



Source: JP Morgan

Positive flows into **bonds and money markets** highlight a defensive allocation trend, while **equities and commodities** saw mild outflows.

The highlight of last week was Trump's "Big, Beautiful Bill" represents a sweeping fiscal package that significantly expands tax cuts, social spending reforms, and defence outlays—adding substantial pressure to the US fiscal outlook. The fiscal impact is already being felt in markets as long-term US Treasury yields have surged, reflecting investor concern over debt sustainability and bond oversupply. The bill has also drawn renewed attention from rating agencies, reinforcing Moody's recent credit rating downgrade of US debt. Overall, while the bill may deliver economic stimulus, it raises significant questions about fiscal discipline and debt trajectory, increasing the risk premium embedded in US assets.

Also, there are notable and evolving global macro shifts currently taking shape. The growing focus on rising debt and fiscal deficits, led by the US is increasingly evident across other major economies as well. As Japan's 30-year government bond yields have also surged to approximately 3.18%, marking their highest level since the bond's inception in 1999 but currently has pared back to 3.05% levels. This significant rise is attributed to a combination of **domestic fiscal concerns, shifting monetary policies, and broader global financial dynamics. This is likely to impact the global flows and may encourage further divestments from the US along with the unwinding of the yen carry trade.**

In FX space the dollar couldn't find a bid despite the yield surge and is trading ~99 level. In Asia there are speculation that FX discussions between the US and South Korea are underway this has led to strength in KRW with spill-over effects seen in TWD and JPY. While yuan has hit 6-month high and currently trade at 7.20 level. Going ahead all eyes will be on **Trump, Tariff and Trade** as after China and UK there has not been any significant breakthrough in trade talks. While Trump's flip flop continues as after announcing straight 50% tariff on the EU on 23rd May'25, but on 25th May'25 Trump agreed to delay this 50% EU tariff till 9 July. The data from the US will consists of prelim. GDP and PCE data will give us more ideas about the current state of US economy.

Key Themes:

- ♣ **Trump's Tax Bill Fuels Bond Market Jitters, while his Trade flip flop continues**
- ♣ **Rupee's FPI-Driven Breakout Reverses; easing DXY & RBI Dividend Offer Support**

Trump's Tax Bill Fuels Bond Market Jitters, while his Trade flip flop continues

The US Dollar has resumed its downward trend last week, pushing the dollar index -99.00 mark and ending the tentative recovery of the past month. Treasury Secretary Bessent's comments last Friday didn't help either; he refused to categorize the dollar as weak, giving dollar bears the green light to push further downside. With already bearish positioning on the dollar, his apparent indifference towards the greenback's recent decline is fuelling more pessimism.

This broad-based USD sell-off saw the European currencies NOK (+2.7%), SEK (+2.6%), and EUR (+1.8%) outperforming within the G10 group, while the KRW (+2.5%) led gains among emerging markets. There may be some reprieve for the US dollar this week as after announcing 50% tariff on EU Trump flip flopped and delayed it till 9th July after announcing the tariffs on EU there were hardly any movement in EUR/USD pair as if markets were expecting the same.

While Between May 19 and May 23, 2025, US Treasury yields experienced significant increases, reflecting investor concerns over US fiscal policy and inflation. The 10-year Treasury yield rose from 4.46% on May 19 to a peak of 4.62% on May 22, marking its highest level since October 2023. Similarly, the 30-year yield climbed to 5.15% on May 22, also reaching its highest point since October 2023. These movements were driven by factors such as the advancement of Trump's tax bill, which is projected to add over \$3 trillion to the federal deficit, the recent downgrade of the US credit rating by Moody's, and persistent inflation concerns. The combination of these elements has led to increased borrowing costs and heightened market volatility.

FX Views

Currency / Index	1–3 Week View	Key Drivers
EUR/USD	Cautious bullish bias; potential to test 1.1450, but upside may be capped by US tariffs on EU goods.	Strong momentum above 1.1250; US tariff threat could dampen sentiment.
USD/JPY	Consolidation with downside bias; support around 142.00.	Oversold conditions may slow declines; divergence in Fed and BoJ policies.
USD/CNH	Range-bound between 7.1750 and 7.2250.	Stabilization after recent volatility; focus on US-China trade developments.
DXY (US Dollar Index)	Consolidation within a range of 98.50–100.50.	Could weighed down by trade policy uncertainties and fiscal concerns, though safe haven flows may lend support near 98.50.

“Trump’s Put”:

Scenario	Trump’s Action	Market Impact
Stock market falls on trade tensions	Hints at progress in US-China trade talks or delays tariffs	Stocks rebound
Growth concerns rise	Floats the idea of tax cuts or infrastructure spending	Risk sentiment improves
Corporate earnings under pressure	Pushes for deregulation or pressures the Fed to cut rates	Equities get a boost
Trade tensions with EU escalate	Threatens a 50% tariff on EU goods, then delays implementation	Calms markets temporarily, mitigates risk-off tone

Recent FX movements in the Japanese yen (JPY) have been shaped by renewed trade discussions with the US

Central Bank Outlook: Currently markets are expecting two rate cut by fed this year of 25bps each for policy rate to reach at 3.88% by end of this year as compared to four rate cuts at starting of the year. Last week’s central bank views are shown in below table.

Central Bank Statement	Stance (Current Trend)
Fed Bostic expects the US economy to slow this year but not fall into recession, sees one interest-rate cut in 2025. He also stated that he expects just one Fed rate cut this year, citing concerns over inflation and inflation expectations moving in a “troublesome way.”	Less dovish – signals limited rate cuts despite slower growth.
Fed Williams, Bostic, and Vice Chair Jefferson emphasize a wait-and-see approach to rate cuts amid economic uncertainty.	Less dovish – cautious approach, no immediate easing bias.
Fed Musalem says tariffs will likely weigh on the economy and labor market, but monetary policy is ready to respond to changes in outlook.	Dovish – open to easing if downside risks materialize.
Fed Waller says the Fed could cut rates in H2 2025 if tariffs stabilize at 10%, but higher tariffs would “handcuff” the Fed by elevating inflation.	Dovish (conditional) – dovish only if tariffs remain moderate.

- Overall, the tone of these statements is **less dovish** compared to earlier in the year, reflecting lingering inflation worries and trade policy uncertainty.
- Only if tariffs remain stable do some Fed officials see room for **more explicit easing** in the second half of 2025.

Current status of U.S. trade talks with key countries following the 90-day tariff pause:

Country/Region	Trade Deal Status	Recent Developments
United Kingdom	✅ Finalized	Deal signed in May 2025, focusing on auto tariffs and greater U.S. market access for beef and ethanol.
China	⚠️ Interim Deal	90-day truce in place, cutting tariffs on both sides; ongoing talks to reach a permanent deal.
India	🔄 Ongoing	Advanced trade deal discussions, targeting a first-phase deal by July 2025.
Japan	🔄 Ongoing	Negotiations underway, with Japan seeking the removal of U.S. auto tariffs.
South Korea	🔄 Ongoing	Working to secure a trade package to minimize impact of U.S. tariffs before July 2025.
Taiwan	✅ Partial Agreement	Officials from both sides held talks last month, to be followed by another one in the coming weeks.
European Union	❌ Stalled	Talks stalled; U.S. threatening 50% tariff on EU goods starting June 1, 2025 delayed till 9 th July.

Surge in Japan's long-term bond yields may cause significant ramifications for global financial markets

On May 23, 2025, Japan's 30-year government bond yields surged to approximately 3.18%, marking their highest level since the bond's inception in 1999. This significant rise is attributed to a combination of domestic fiscal concerns, shifting monetary policies, and broader global financial dynamics. While Japan conducted several government bond auctions in May 2025, with notable developments in the super-long segment which were met **with weak demand leading to record-high yields**. The 20-year JGB auction on May 20 experienced the **weakest demand since 2012** while on May 22 the auction for 10-year inflation-indexed JGBs also saw moderate demand. Other factors which are driving the yields are Fiscal concerns along with monetary policy shifts.

The latest JSDA data shows for the month of April'25 there was unprecedented selling of super-long Japanese government bonds by domestic life and non-life insurers while foreign investors were record buyers. But in month of May both domestic life, non-life insurers and foreign investors were net seller. If this foreign demand stays absent, domestic investors such as insurers and banks will need to step in to stabilize the market.

If yields remain high potential **unwinding of the yen carry trade**, could lead to a stronger yen and increased volatility in currency markets also emerging markets which have benefited from Japanese capital inflows, may face challenges as funds are **repatriated**, leading to potential liquidity issues and asset price declines.

Rupee's FPI-Driven Breakout Reverses; easing DXY & RBI Dividend Offer Support

The Indian Rupee briefly breaks out of recent consolidation phase as significant FPI outflows hit, despite a subdued Dollar index; breaking the ₹86.00/\$ handle after 11th Apr'25 [O: ₹85.4400/\$, H: ₹86.1100/\$, L: ₹85.3550/\$ & C: ₹85.2225/\$]. However, the move reversed quickly before the RBI's expected robust dividend announcement, which supported sentiment around the local currency, leading to an appreciation of 0.34% this week (Last Friday's close: ₹85.5150/\$). The breakout happened when Foreign Portfolio Investors (FPIs) stepped in to buy dollars following news of potential MSCI exclusion. The Dollar Index eased amid concerns following Moody's downgrade of the US sovereign credit rating on 16th May'25, citing mounting worries over the nation's \$36 trillion debt burden. The rating was reduced by one notch to "Aa1" from a top-tier "AAA" rating maintained since 1919 which sent shockwaves through global financial markets. The action follows the agency's 2023 decision to revise its outlook to negative, driven by widening fiscal deficits and rising interest obligations. Mounting US fiscal concerns, coupled with tepid demand for a \$16bln 20Y debt auction, signal declining investor confidence in US sovereign debt—exerting downward pressure on the dollar. (Refer our report: [FX weekly: Progress in trade tariffs sparks relief across markets while tariff impact surfaces in US data](#)).

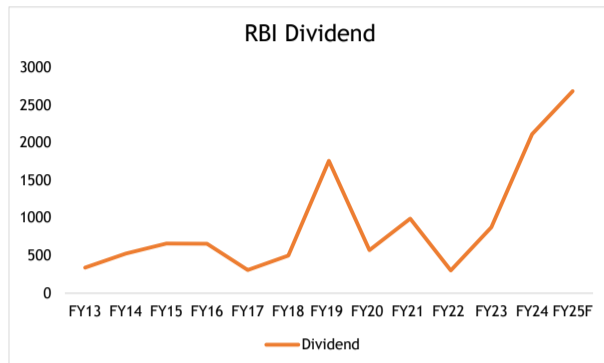
The rupee's Real Effective Exchange Rate (REER) against a basket of 40 currencies, in terms of trade-based weights, fell further to 100.80 in Apr'25 vis-à-vis 101.50 in Mar'25, its lowest level since May'23. While the rupee appreciated by c.2.1% MoM in terms of the 40-currency REER in Apr'25 due to appreciation of the INR in nominal effective terms and narrowing of India's inflation differential with its major trading partners. Notable fact, the RBI recorded a significant increase in net foreign exchange purchases in Mar'25, reaching \$14.4bln—the highest level since Jun'21 vis-à-vis sale of \$1.62bln in Feb'25. This surge was accompanied by \$20bln in buy-sell swaps. These measures aim to boost rupee liquidity within the banking system and manage forward dollar positions effectively.

FPIs flows in the equity segment, continue to be negative this year to the tune of \$11.27bln; however, the positive momentum continues in May'25 after a positive Apr'25 (-\$9.04bln in Jan'25, -\$3.98bln in Feb'25, -\$0.41bln in Mar'25, \$0.51bln in Apr'25 and \$1.64bln in May'25). On 21st May'25, a brief episode of FPI selling occurred, marked by a significant \$1.3bln outflow from shares of a major e-commerce company – which likely faced exclusion from the MSCI index. Additionally, a few stop losses were triggered amid short covering, likely driven by speculative news of potential defence-related buying, adding to the volatility during the week. However, investor sentiment quickly rebounded, and capital flows turned positive the following day, lending support to the Indian Rupee. In the equity segment, FPIs turned net seller in the week to the tune of \$560mln vis-à-vis \$521mln a week ago and outflows continued in debt segment to the tune of \$617mln vis-à-vis \$581mln from the prior week. While FAR-related flows have remained strong so far this year, totalling \$4.60bln, they have turned negative in May 2025, recording an outflow of \$0.72bln – a continued trend from Mar'25, saw an outflow of \$0.63bln.

India's foreign exchange reserves declined by \$4.89bln to \$685.73bln for the week ended 16th May 16, 2025 – primarily driven by a sharp \$5.12bln drop in gold reserves, which fell to \$81.22bln. With this decline, total reserves now stand \$19.13bln below the all-time high of \$704.86bln. Notably, a \$2.22bln increase was attributed to valuation adjustments. This suggests the central bank has maintained its efforts to curb forex market volatility. Our analysis indicates that FYTD26 Balance of Payments (BoP) dynamics remain positive, with a surplus of approximately \$11.28bln. Historically, there has been a strong correlation between FX reserves—adjusted for valuation effects—and the BoP position.

Brent crude oil prices averaged \$65.9/bl in Apr;'25—the lowest monthly level since Apr'21. This represents a 6.8% decline MoM and a sharp 25.1% drop YoY, reflecting a combination of geopolitical tensions, rising supply, and slowing global demand amid the escalating US-China trade conflict. Meanwhile, OPEC+ raised output for the first time since 2022, amplifying supply-side pressures and contributing to the price slide. In contrast, these lower oil prices continue to support positive sentiment toward the Rupee (touched highs of \$66.63/bbl on 21st May'25; current levels: \$64.58/bbl).

Rupee momentarily broke consolidation but reverted to its range



REER has remained consistently below the 5-yr average for the past 3-months

FPI flows into the equity markets have continued to be positive in May'25, nevertheless FAR related flows continue to be negative.

FX Reserves decline on account of a sharp drop in gold reserves

Low Brent crude prices continue to buoy Rupee sentiment.

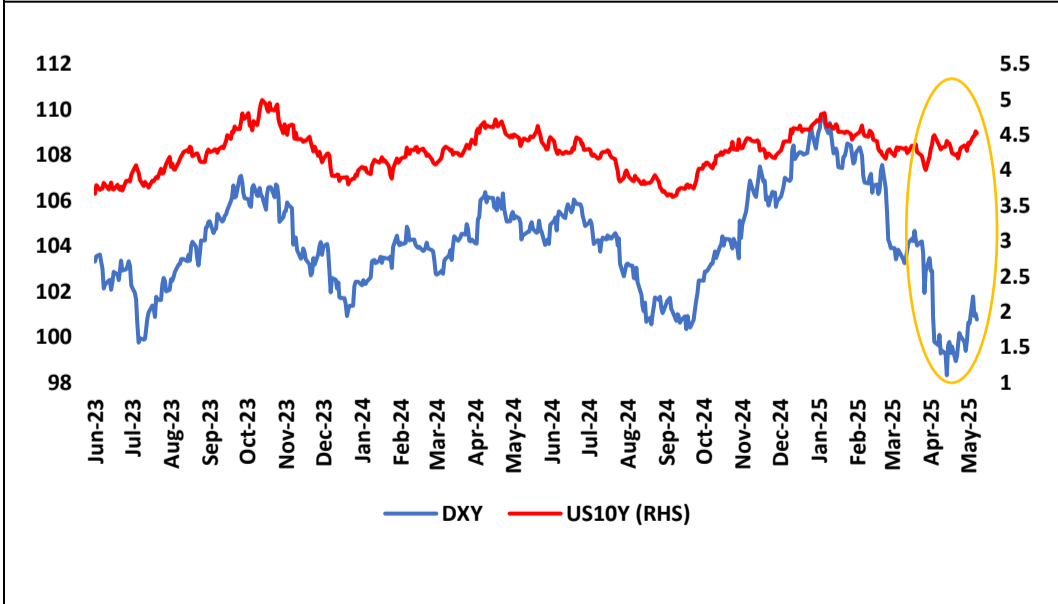
The sensitivity of India's CAD to oil prices remains high, with every \$10/bbl change in crude impacting the annual CAD by \$15bln. Given the decline in average Brent crude prices from \$77/bbl in FY25 to around \$68/bbl in FYTD26, the CAD faces a potential downside risk of 0.3%-0.4% of GDP purely on account of lower oil import costs.

With most domestic uncertainties now behind, us and global conditions showing signs of easing, Rupee volatility continues to subside. Sentiment has been buoyed by prospects of an interim trade agreement between India and the US, potentially to be announced before July 8. New Delhi is reportedly seeking a full exemption from the additional 26% tariff on Indian exports—a move that, if successful, could further support the rupee and help it consolidate around current levels. However, sustained dollar demand from major importers and oil companies at lower levels continues to provide a floor for the USD/INR pair. Technically, the USD/INR pair has respected our previously identified levels. We now anticipate a sideways movement in the Rupee, with support seen around ₹84.80/\$, a decisive break below this level could open the door to ₹84.45/\$. On the upside, resistance is expected near ₹85.90/\$, and a breach of that could push the pair towards ₹86.80/\$. Looking ahead, we are closely monitoring two key risks: A potential overshoot in the US Dollar Index (DXY) beyond current technical levels & any fresh escalation in cross-border/trade tariff tensions, which could weigh negatively on Rupee sentiment.

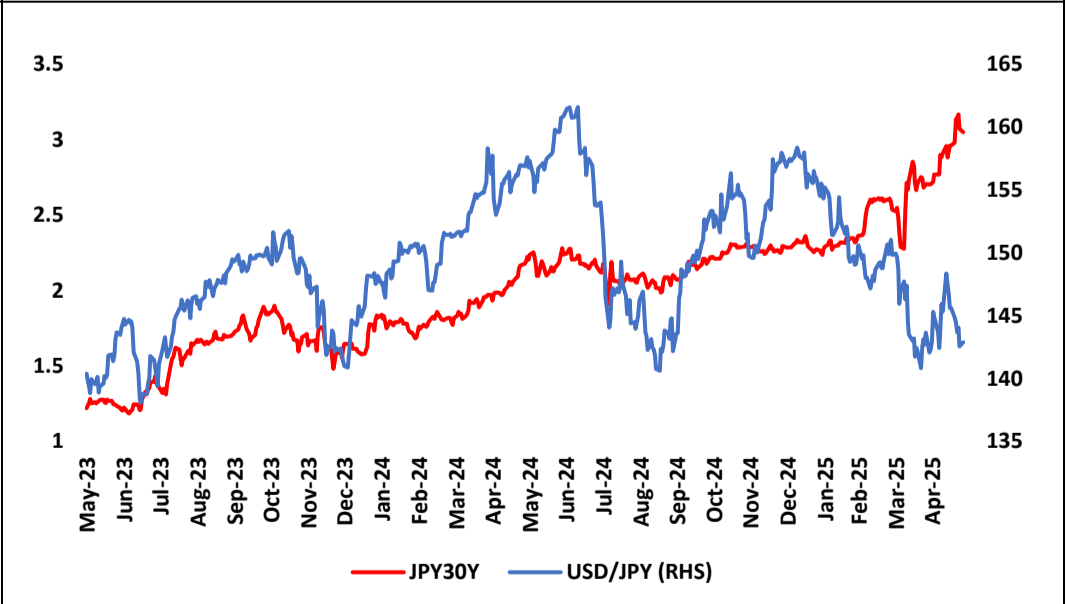
Rupee to gain support from a weaker DXY and anticipated strong FPI inflows.

Central bank Policy Rates			Fig 1.
	Current	End of 2024	YTD Change 2025 in BPS
Advanced Economies			
Australia	3.85%	4.35%	-0.5
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)	3.00%	3.10%	-10
India	6.00%	6.50%	-0.5
Indonesia	5.50%	6.00%	-0.5
Philippines	5.50%	5.75%	-0.25
South Korea	2.75%	3.00%	-0.25
Taiwan	2.00%	2.00%	0

US dollar struggling despite the yield surge and has decoupled (Fig 2)

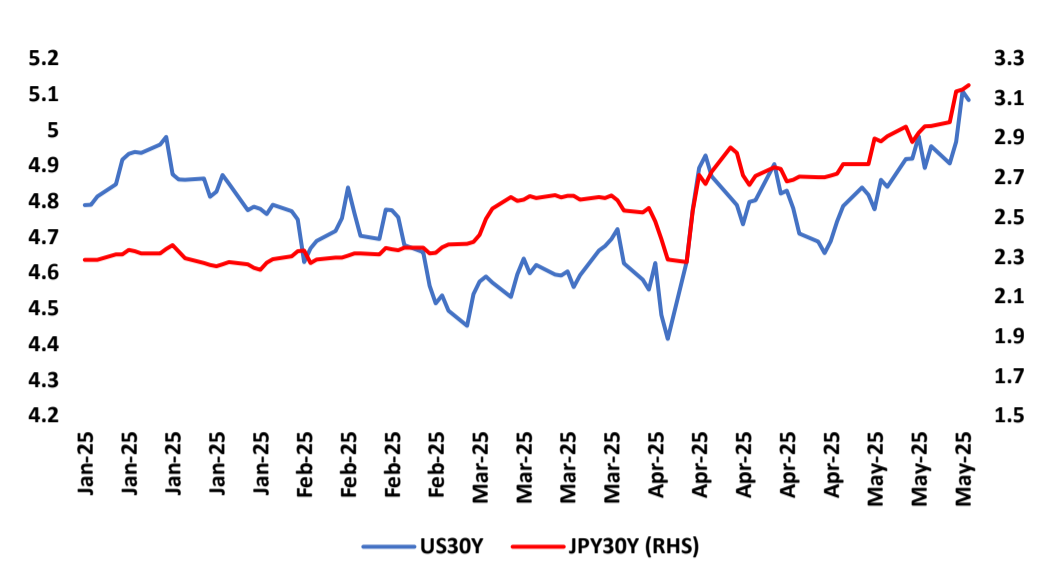


Rise in yields in longer tenor has led to strength in JPY (Fig 3)

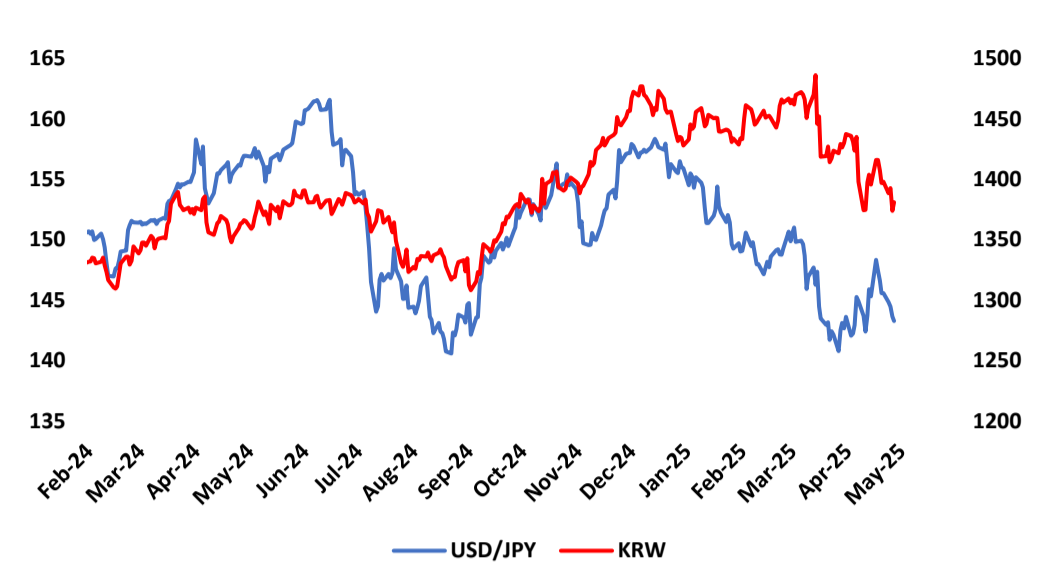


Source: Bloomberg, Reuters, UBI research

There is broad-based rise in global yields, reflecting increased fiscal risk, shifting monetary expectations, and declining demand in sovereign debt markets

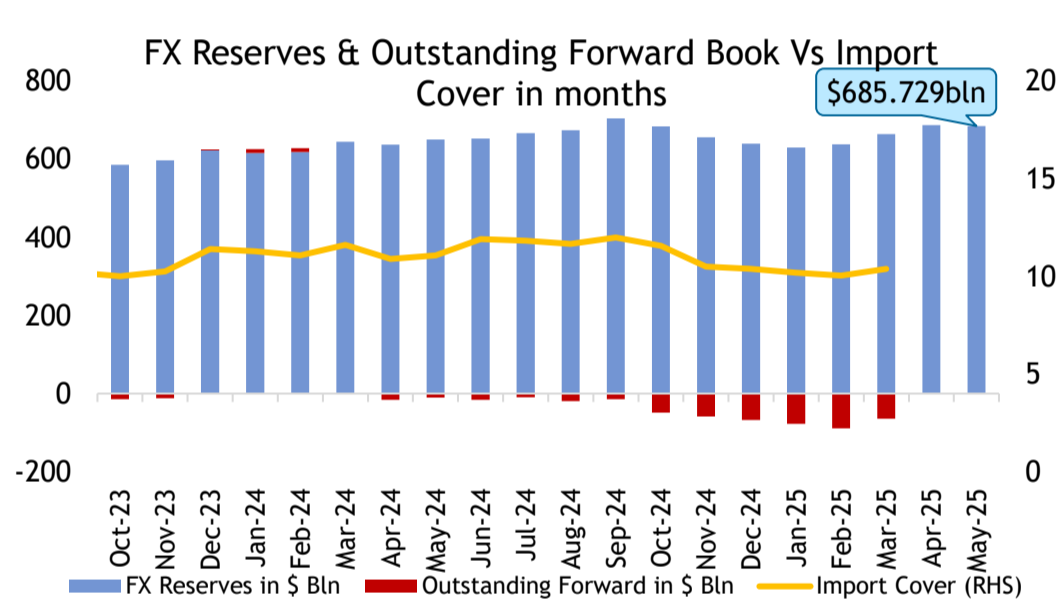


Trade discussion led to volatility in KRW and JPY (Fig 5)

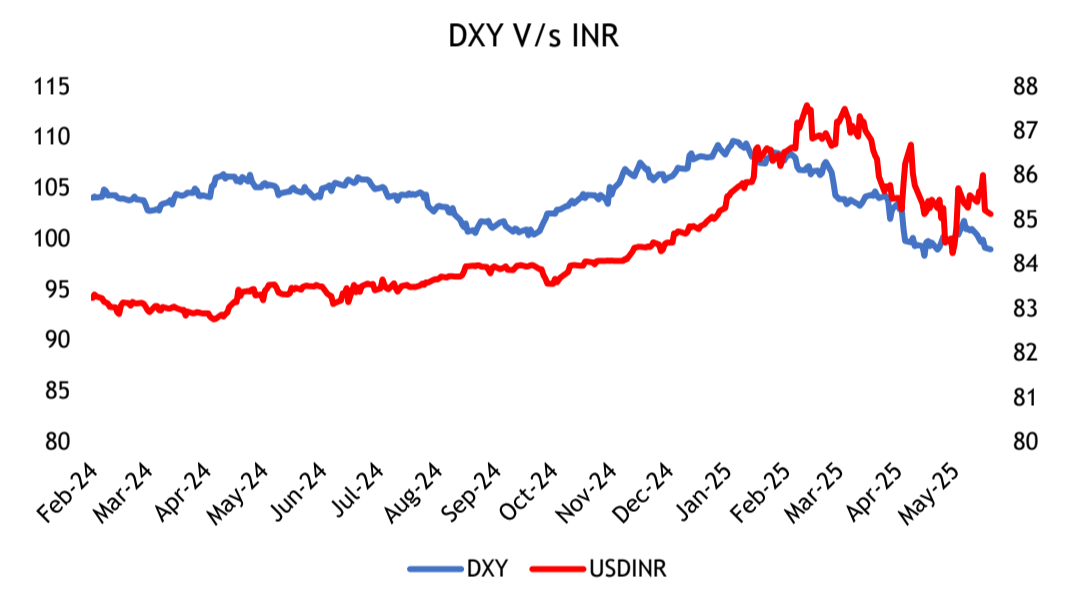


Source: Bloomberg, Reuters, UBI research

FX Reserves decline on account of a sharp drop in gold reserves (Fig 6)

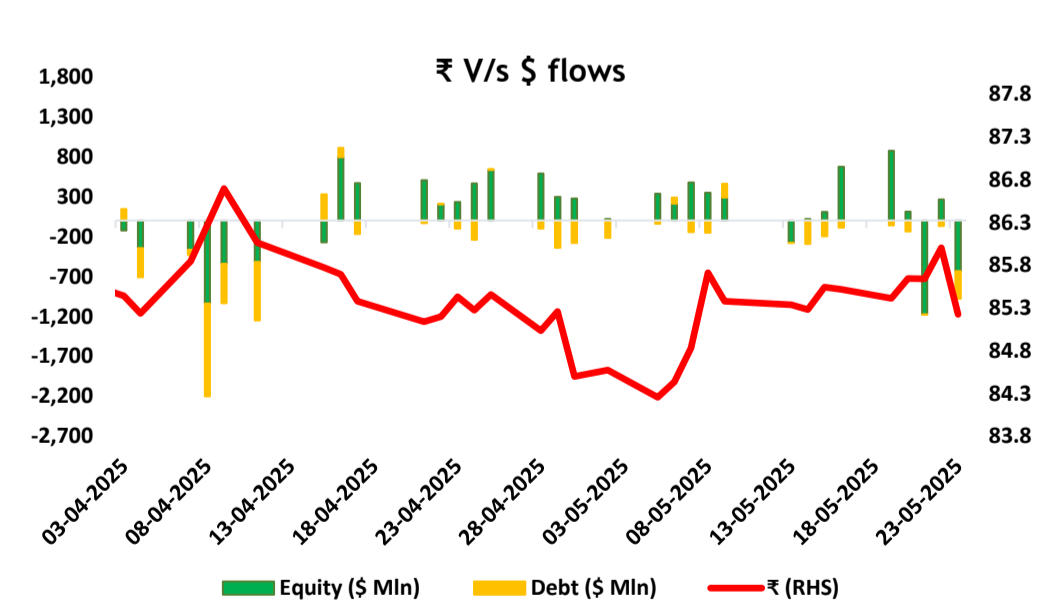


INR broadly in sync with DXY (Fig 7)

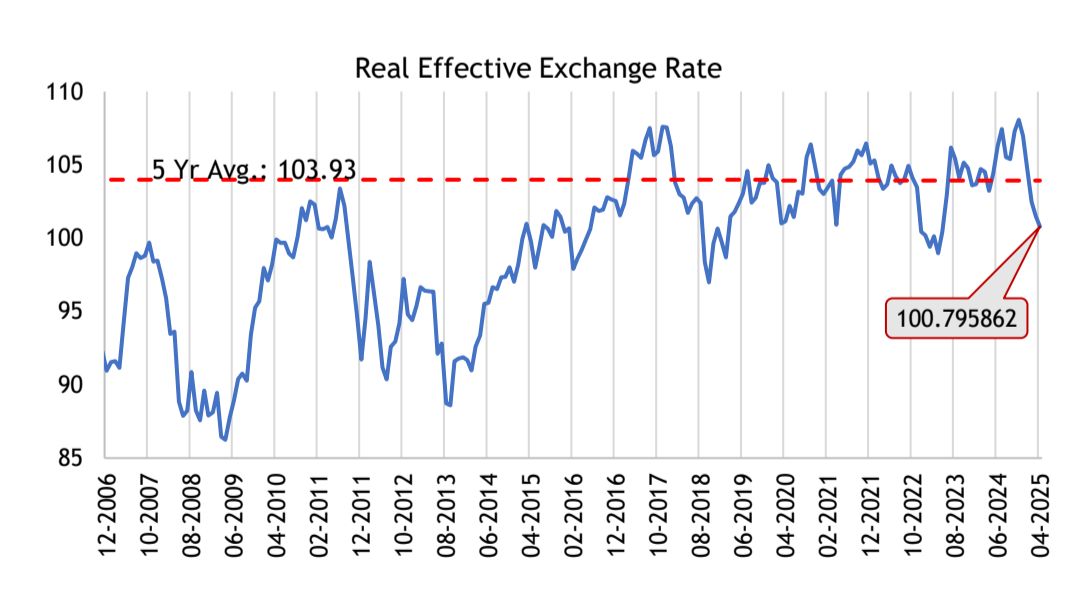


Source: Bloomberg, Reuters, UBI Research

Rupee consolidation continues in Weekly trend (Fig 8)



REER continues to ease in Apr'25 its lowest level since May 2023 (Fig 9)



Source: Bloomberg, Reuters, UBI Research

Banking & Economic Research Team	
Kanika Pasricha Chief Economic Advisor	kanika.pasricha@unionbankofindia.bank
Suneesh K	suneeshk@unionbankofindia.bank
Nidhi Arora	nidhiarora@unionbankofindia.bank
Rajesh Ranjan	rajeshranjan@unionbankofindia.bank
Jovana Luke George	jovana.george@unionbankofindia.bank
Amit Srivastava	asrivastava@unionbankofindia.bank
Dhiraj Kumar	dhirajkumar@unionbankofindia.bank
Akash Deb	akash510@unionbankofindia.bank
Shreyas Bidarkar	shreyas.bidarkar@unionbankofindia.bank
Rohit Yarmal	rohitdigambar@unionbankofindia.bank
S. Jaya Laxmi	s.jayalakshmi@unionbankofindia.bank

Disclaimer:

The views expressed in this report are personal views of the author(s) and do not necessarily reflect the views of Union Bank of India. Nothing contained in this publication shall constitute or be deemed to constitute an offer to sell/ purchase or as an invitation or solicitation to do so for any securities of any entity. Union Bank of India and/ or its Affiliates and its subsidiaries make no representation as to the accuracy; completeness or reliability of any information contained herein or otherwise provided and hereby disclaim any liability regarding the same.