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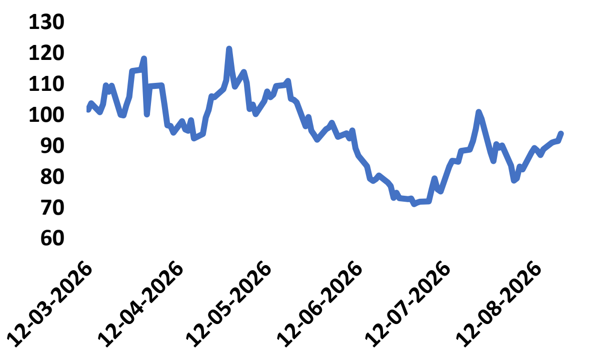
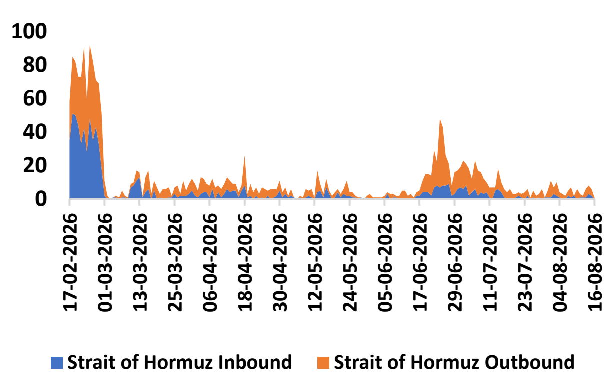
Hormuz transit disruptions have driven oil prices higher (fig1)



Source: Refinitiv

Strait of Hormuz Vessel Traffic collapsed in March and has not recovered (Fig 2)



Source: Refinitiv

Market-Implied Path (Fed-Funds Futures snapshot) (Table 1)

Meeting	Implied Rate	Cumulative Change
16 Sept 2026	3.70%	08 bp
28 Oct 2026	3.75 %	12 bp
09 Dec 2026	3.85%	22 bp
27 Jan 2026	3.90%	26 bp
17 Mar 2026	3.96%	33 bp
28 April 2026	3.98%	35 bp
09 June 2026	4.00%	37 bp

Next meeting probabilities: **No change 6 %, 25 bps hike 31 %**

*The dominant macro theme remains one of **elevated geopolitical and fiscal risk, but resilient market adjustment**. The US-Iran conflict remains unresolved and the Strait of Hormuz is still severely impaired, with vessel traffic around **85-93%** below normal. Yet the global oil system has absorbed the disruption better than initially feared through rerouting, supplier substitution and inventory drawdowns, preventing the collapse in Gulf exports from translating one-for-one into a global shortage. Brent has therefore failed to sustain levels above $100/bbl. We retain a **base case near $85/bbl. through end-2026, within a broader $82-92/bbl. range**, although continued inventory depletion leaves the market vulnerable to renewed escalation. (Refer: THE HORMUZ PARADOX: How global oil flows absorbed a historic supply disruption and what it means for Brent through end-2026)*

***US long-term yields are likely to remain structurally elevated**, driven primarily by persistent fiscal deficits, heavy Treasury issuance, higher term premium and strong capital demand, including AI-related investment. These pressures pushed the 30-year yield above **5.3%**, its highest since 2007. The Treasury's decision to at least double certain 10-30Y liquidity-support buybacks from $2bn to $4bn per operation helped reverse part of the sell-off partially, but should be viewed as a market-stabilisation measure rather than a solution to the underlying fiscal and debt-supply problem. We therefore retain a higher-for-longer view, with the **US 2Y expected in a 3.95–4.40% range and the 10Y in 4.50–4.85% through end-2026**.*

*Fed communication has also turned more hawkish. The July FOMC minutes showed broader concern over persistent inflation and greater willingness to tighten if necessary. However, the market reaction at the short end was notable: **the 2-year yield still moved lower**, reflecting softer underlying inflation and suggesting that markets remain reluctant to fully price another hike. Core inflation has moderated from its May peak, goods inflation is contributing very little and services pressures have eased, although shelter and some residual services inflation remain sticky. We therefore continue to expect the Fed to **hold rates at 3.50-3.75% through year-end**, while acknowledging a meaningful risk of one 25bp hike if core services, wages or inflation expectations reaccelerate.*

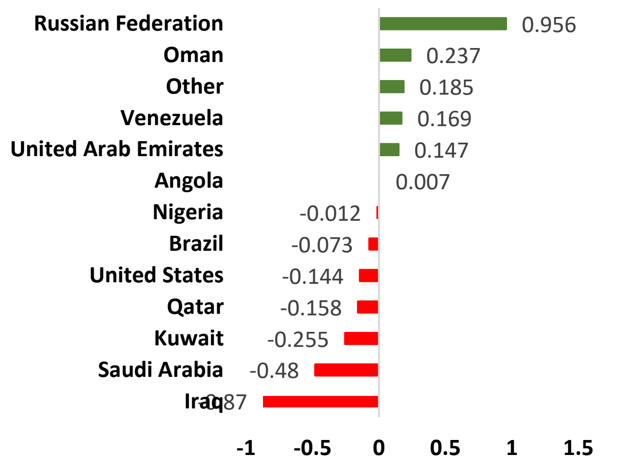
*The dollar retains a **flat-to-lower bias**, with DXY expected broadly within **98.0–101.5** unless stronger US inflation or a renewed rise in Treasury yields restores support. The broader FX backdrop therefore remains sensitive to incoming US macro data and central-bank communication.*

*For the rupee, the backdrop is relatively comfortable. Despite the strong mobilisation under the **FCNR(B)** scheme, the RBI brought forward its closure, and banks are now active in the market ahead of the deadline. Capital-flow support, improved external buffers and RBI's FX position should help contain volatility, although oil and the dollar remain the key external risks. We **expect USD/INR to trade broadly in a 94.50-96.00** range over the coming month.*

*The key factors to watch are **oil and Middle East tensions**, incoming US macro data, Fed communication, and the impact of Treasury buybacks on long-end yields. Our central view remains one of **contained but elevated oil and Treasury yields**, a **Fed hold**, a flat-to-softer dollar and a relatively range-bound rupee, with the main risk coming from renewed **geopolitical escalation** or a reacceleration in US inflation.*

- ♣ Geopolitical Risks Persist, but Market Stress Remains Contained
- ♣ Intervention Fatigue: USD/JPY's Uneasy Truce at 160
- ♣ EUR/USD: Euro Resilience- Increasingly a USD story than Euro area growth Story
- ♣ INR supported by capital flows & BoP surplus, Hormuz and oil uncertainty caps rupee gains beyond 95/$ for now

India plugged the Gulf shortfall mainly with Russian barrels-Total import fell by only 5.8% (fig3)



Source: UBI research Refinitiv

Hormuz Disruption Persists, but Oil Market Adjustments Limit the Shock

The US-Iran conflict remains a key source of global market risk, with the Strait of Hormuz still severely disrupted. Vessel traffic through the Strait remains around 85–93% below normal, indicating that the physical disruption has not meaningfully reversed.

However, the oil shock has been absorbed better than initially feared. Saudi Arabia and the UAE have rerouted exports through Yanbu and Fujairah, while importers have substituted away from disrupted Gulf supply. India replaced much of its lost Gulf crude with Russian, Omani and UAE barrels, limiting the decline in total imports, while weaker Chinese demand reduced competition for replacement supply.

The adjustment has not been costless. Commercial inventories in the US and China have been drawn down materially, meaning part of the resilience has relied on finite buffers rather than rerouting alone.

Our base case is therefore for Brent to remain broadly range-bound near $85/bbl through end-2026, within a wider $82-92/bbl. range. A genuine recovery in Hormuz-dependent exports from Iraq, Kuwait and Qatar would favour the lower end, while renewed escalation or deeper inventory depletion would push prices toward the upper end.

Hormuz remains severely disrupted, but rerouting, substitution and weaker Chinese demand have contained the global oil shock. Brent is expected around $85/bbl, within $82-92/bbl through end-2026

Oil risks remain two-sided: export recovery from Iraq/Kuwait/Qatar would ease prices, while renewed escalation or deeper inventory draws would push Brent higher

Will the Fed Raise Rates in 2026? Hawkish Minutes Raise the Risk, but Hold Remains the Base Case

Fed hold remains the base case despite hawkish minutes. Rates are expected at 3.50%-3.75% through end-2026, with a hike likely only if core services, wages or inflation expectations reaccelerate.

Our base case remains that the Fed will keep the policy rate unchanged at 3.50%–3.75% through end-2026, although the probability of one 25bp hike remains significant.

The case for tightening strengthened after the July FOMC minutes showed broader concern over persistent inflation. Three policymakers had already voted for an immediate 25bp hike, while several participants favoured a more restrictive stance and a larger group indicated that further tightening could become necessary if inflation remained above the 2% target. This suggests that the hawkish shift extends beyond the three dissenters and that the hurdle for another hike has fallen.

Inflation risks nevertheless remain significant. Energy prices and geopolitical tensions could create renewed price pressure, while tariffs, fiscal deficits and strong AI-related investment may keep demand and input costs firm. If these pressures begin feeding into wages, services inflation or inflation expectations, the case for further tightening would strengthen.

However, a hike is still not our central scenario. Recent employment, inflation and consumption data have softened, suggesting that existing monetary restraint is already slowing the economy. Tightening further against largely supply-driven inflation could weaken employment without materially addressing the source of the price shock.

The key distinction will therefore be between temporary inflation pressure and persistent second-round inflation. One firm inflation print is unlikely to be enough. A hike becomes much more likely if core inflation remains consistently strong, oil and tariff pressures spread into services and wages, inflation expectations rise and labour-market conditions stabilise.

Latest CPI composition supports patience. Core inflation has moderated from its May peak, with goods inflation contributing very little and services pressures also easing. Shelter remains the largest source of core inflation, while some residual services stickiness persists. The composition therefore supports an extended Fed hold despite the hawkish July minutes, unless core services and wage pressures reaccelerate.

AI investment and fiscal spending reinforce the upside risk but are not independent reasons to hike. The Fed will respond to their macroeconomic effects: if investment sustains excess demand and prevents inflation from returning toward target, tightening becomes more likely; if productivity improves without generating broader price pressures, the Fed can remain on hold.

Of the remaining meetings, September appears a relatively high hurdle for a hike given softer recent data, leaving October or December as more plausible windows if inflation reaccelerates. December provides policymakers with the most additional evidence on inflation, employment and growth before deciding whether tighter policy is necessary.

US Treasury Yields: Structural Pressures Persist, but Buybacks May Cap Long-End Stress

US Treasury yields are likely to remain elevated, with fiscal deficits, heavy issuance, geopolitical inflation risks and AI-related capital demand keeping upward pressure on the term premium, particularly at the long end

US Treasury yields are expected to remain elevated and volatile through the remainder of 2026, with risks still tilted upward, particularly at the long end. Persistent fiscal deficits, heavy Treasury issuance are increasing borrowing requirements and keeping the term premium elevated. Higher oil prices and renewed geopolitical risks have also reinforced inflation concerns, while rising yields themselves increase government debt-servicing costs and add to fiscal sustainability concerns.

These pressures were evident this week as the 30-year Treasury yield touched 5.33%, its highest since 2007, while the 10-year moved above 4.70%. The move reflected a combination of fiscal and supply concerns, higher global yields, geopolitical risks and continued competition for capital.

AI-related investment remains another structural source of pressure. Large-scale spending on data centres, semiconductors, power generation and grid infrastructure is supporting growth but also increasing demand for capital and potentially keeping real interest rates higher. AI-driven productivity gains could improve growth and fiscal outcomes over time, but these benefits remain uncertain and are likely to materialise gradually.

Treasury buybacks may limit disorderly long-end moves but do not change the underlying higher-for-longer story. We retain a broad 3.95%-4.50% range for the 2Y and 4.45%-4.85% for the 10Y through end-2026.

A new counterweight has, however, emerged at the long end. The US Treasury announced that it would at least double the size of certain liquidity-support buybacks in the 10–30-year sector, from $2 billion to at least $4 billion per operation. The announcement helped reverse part of the sell-off, with long-duration yields falling sharply from their highs.

The expanded buybacks should improve secondary-market liquidity and may limit disorderly increases in long-term yields. However, they do not address the underlying fiscal or debt-supply problem. Unlike Fed quantitative easing, Treasury buybacks are primarily a debt-management tool and do not materially reduce the government's overall financing requirement. They should therefore be viewed as a stabilising mechanism rather than a fundamental downward driver of yields.

At the short end, Fed policy remains the main influence. Chair Kevin Warsh's limited forward guidance increases sensitivity to inflation, labour-market and growth data, while recent Fed communication has kept the possibility of further tightening alive if inflation remains persistent. This should continue to provide some support to the 2-year yield.

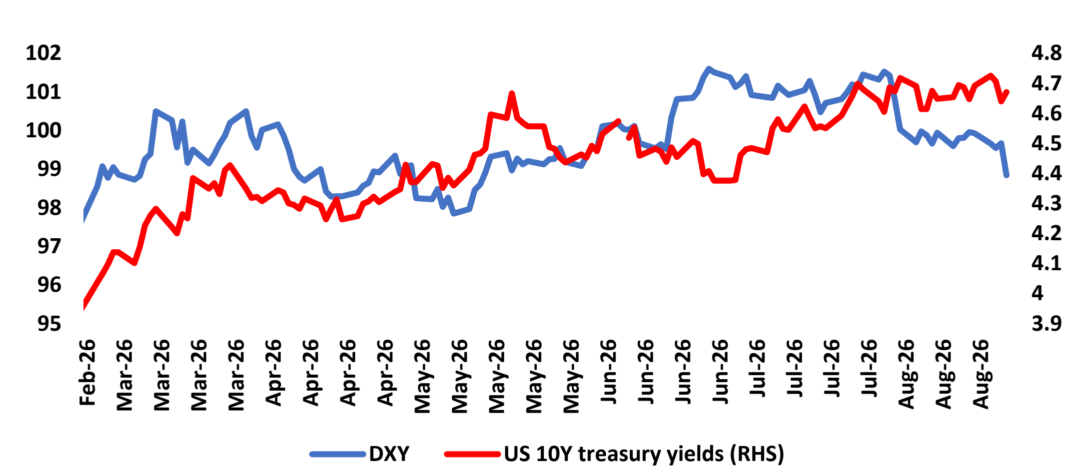
The dollar retains a flat-to-lower bias as softer Fed tightening expectations and lower long-end yield support reduce its relative-rate advantage. We expect DXY at 98.0–101.5, with risks tilted toward the lower half.

Overall, our higher-for-longer view remains intact, although Treasury buybacks introduce an important near-term cap on extreme long-end moves. Fiscal deficits, heavy issuance, geopolitical and inflation risks, AI-driven capital demand and an elevated term premium should keep long-term yields supported, while buybacks may reduce volatility during periods of market stress. We therefore retain our broad 2026 ranges of 3.95%–4.50% for the US 2-year and 4.45%–4.85% for the 10-year.

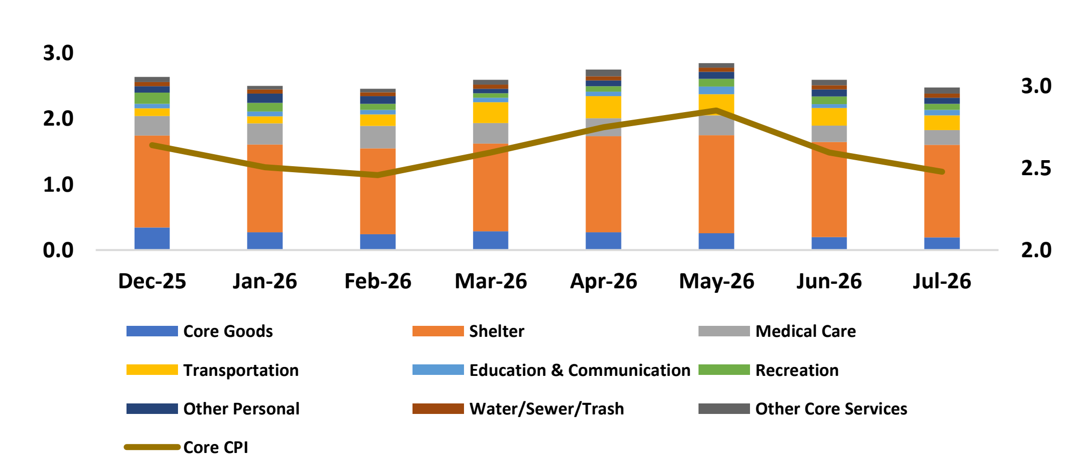
The US dollar retains a flat-to-lower bias as easing Fed tightening expectations and the Treasury's expanded long-dated bond buybacks reduce some of the yield support that had underpinned the currency. With underlying inflation also moderating, the hurdle for a sustained dollar rebound is rising.

Absent renewed inflation pressure or a fresh rise in US yields, we expect DXY to trade broadly in a 98.0–101.5 range, with risks tilted towards the lower half.

DXY broke down from its 99.50-100.00 range after intervention *in the Treasury market. (Fig 4)*



US Core CPI: Broad-Based Moderation in Inflation Pressures (Fig 5)



Source: Bloomberg, UBI research

♣ Intervention Fatigue: USD/JPY's Uneasy Truce at 160

USD/JPY remains biased modestly higher near term, as intervention has slowed but not reversed yen weakness and carry conditions remain supportive of the dollar.

The yen story has been dominated by a tug-of-war between an increasingly hawkish BoJ and a US dollar that refuses to weaken decisively. A joint Japan-US FX intervention at the end of July briefly knocked USD/JPY off its highs (~164.80), but the effect has proven short-lived. What is notable is that this recovery happened even as US-Japan yield spreads narrowed normally a yen-supportive setup because elevated energy prices and unusually low cross-asset volatility have kept the carry trade attractive enough to absorb it. On the policy side, BoJ Governor Ueda's hawkish language has pushed September rate-hike odds up to roughly 64% (priced by October 77%).

BoJ Turns More Hawkish, but Yen Weakness Remains Hard to Reverse

1. Intervention slowed the move but didn't reverse it. End-July's coordinated Japan-US FX intervention forced the fastest weekly unwind of leveraged-fund short-yen positions since summer 2024, per CFTC data, and briefly pulled USD/JPY off its highs. That relief has largely faded: the pair has climbed back toward the 160 handles, a reminder that official action tends to buy time rather than change trend without a fundamental catalyst behind it.

The BoJ's increasingly hawkish stance is the main downside risk for the pair; a September hike or stronger guidance could pull USD/JPY lower, while disappointment would likely weaken the yen further.

2. The BoJ has turned noticeably more hawkish. Governor Ueda signalled the BoJ could "accelerate the pace of rate hikes," a tone echoed in the central bank's Summary of Opinions and in press reports that Tokyo now backs another move. Swaps markets have moved to price close to a 64% probability of a September hike (essentially fully priced by October), up sharply from around 40% right after the intervention. Having leaned this hard into the hawkish narrative, the BoJ now faces a high bar to disappoint without undermining the credibility of its recent FX action.

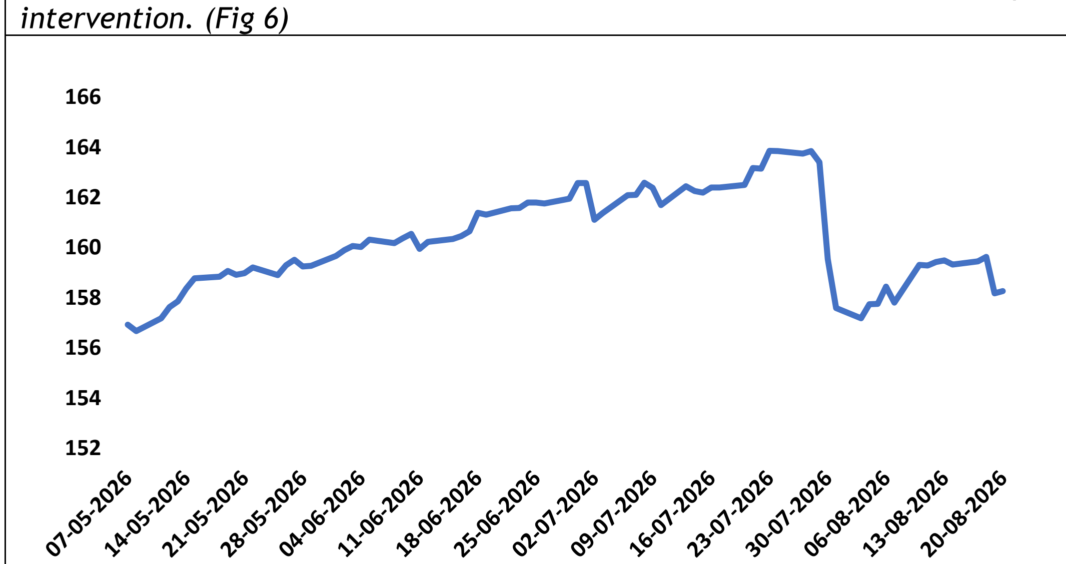
3. US data has softened, but not enough to shift the Fed. July payrolls surprised sharply to the downside (-23k vs. +80k expected), yet the unemployment rate actually improved to 4.1%, blunting the dovish read-through. Both CPI and PPI inflation cooled from June's pace, but the dollar index has stayed resilient near the 100 level and markets continue to lean toward the Fed holding rates through year-end rather, which keeps a floor under the greenback.

A sustained move toward the mid-150s likely requires either a confirmed BoJ tightening move or a sharper US slowdown; otherwise, the pair is likely to remain volatile around 158-160 with upside risks.

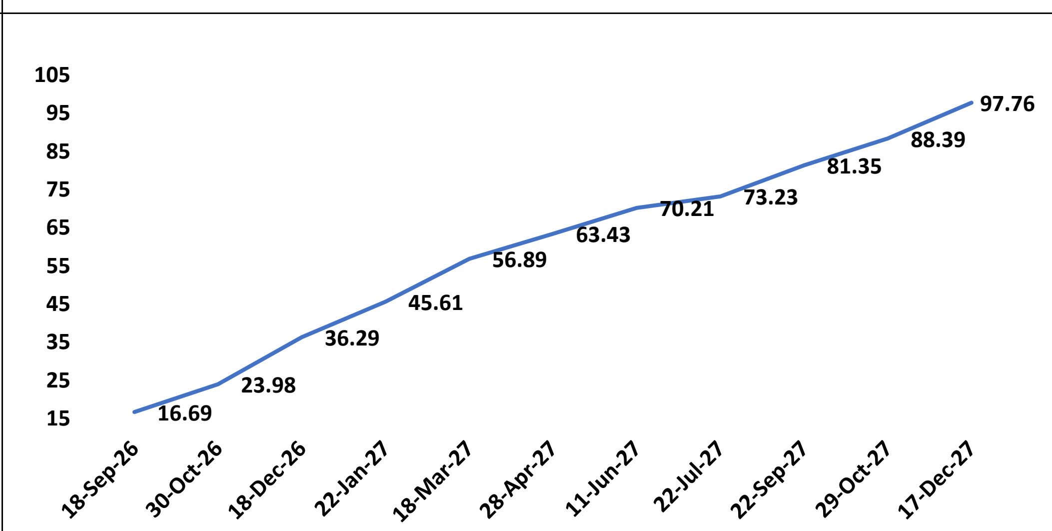
4. Speculative positioning has reset. The intervention-driven short-covering left less crowded in short-yen positions. That reset removes some of the squeeze risk that had built up and has made it easier for USD/JPY to grind higher again without triggering another disorderly unwind.

USD/JPY VIEW: USD/JPY remains two-way near term around 158–160, but the balance of risks favours modest upside unless the BoJ validates a September hike. Sticky US inflation, steady Fed policy, elevated energy costs and favourable carry conditions would keep the yen under pressure, while a hawkish BoJ, softer US data or renewed intervention could trigger a sharp reversal. Japan's GDP, CPI and trade data, alongside the FOMC minutes and Chair Warsh's Jackson Hole address, are the key catalysts. We would avoid chasing the pair above 163: a sustained move toward the mid-150s requires either a confirmed BoJ hike or a material US slowdown; otherwise, the path of least resistance remains slightly higher.

USD/JPY has retraced about half of the decline seen after the US-Japan intervention. (Fig 6)



BoJ: Market Pricing of Cumulative Rate Hikes (bps) (Fig 7)



Source: Reuters, UBI research

♣ EURO/USD: Euro Resilience- Increasingly a USD story than Euro area growth Story

EUR/USD remains mildly bullish in the near term, supported more by softer Fed expectations and a weaker dollar than by a strong euro-area growth story.

Euro showed volatility of late, from the late-June trough around 1.1330–1.1350 to current levels of 1.1576 by mid-August, the euro has recovered roughly 2%. But compared with mid-June levels, EUR/USD is still broadly flat. The important point is, the recovery has occurred despite relatively limited evidence of a major improvement in the euro-area growth story. It has been primarily a USD repricing trade than a euro dominant trade.

What Euro Area Data says?

In the Euro area, Q2 growth for 2026 of 0.4% is substantially stronger than the ECB's June baseline assumption. But the ECB still projects only 0.8% full-year growth in 2026, rising to 1.2% in 2027. While the domestic demand is relatively resilient, exports remain constrained by competitiveness and trade-policy uncertainty. Headline HICP was around 2.9% in July, substantially above the ECB's 2% target. The recent inflation increase is predominantly energy-driven. Core HICP excluding energy and food is projected at 2.5% in 2026 and 2027 by ECB. Unemployment is around 6.3%, and the ECB expects it to remain at that level in 2026 before declining gradually.

A relatively hawkish ECB, reduced US-EU trade uncertainty and resilient euro-area growth provide additional support to the euro, although higher energy costs remain a key risk.

US-EU Trade Deal:

The tariff dispute has largely been settled between EU and US, but the relationship is not fully resolved—non-tariff barriers and sectoral issues remain the main risks. From 1 July 2026, the EU eliminated tariffs on US industrial goods and provided preferential access for selected US agricultural and seafood products. While, 2025 Turnberry framework established a maximum, all-inclusive 15% US tariff on most EU exports. It applies to autos and a broad range of manufactured goods, with some exemptions.

The US–EU trade agreement is EUR-positive versus the tail-risk scenario of a full transatlantic trade war, but the 15% tariff itself remains a meaningful drag on European competitiveness.

ECB and Rate path

The main downside risk is a renewed Fed repricing: stronger US inflation or labour data could lift Treasury yields and the dollar, capping further EUR/USD upside.

The ECB held rates unchanged in July, but the energy shock has pushed euro-area inflation higher. July inflation was reportedly 2.9%, above the ECB's 2% target. A Reuters poll has 83% of economists expecting a 25 bp ECB hike in September, taking the main refinancing rate to 2.65%.

On the other hand, US data have softened-July retail sales came in below market expectations, July employment showed unexpected job losses, July CPI was 3.4% YoY, down from 3.5%, while core CPI eased to 2.5%. Markets have therefore sharply reduced the probability of another Fed hike in September. In fact, The Reuters economist poll now has a strong majority expecting the Fed to keep rates at 3.50–3.75% through year-end.

That has been the major catalyst for the recent EUR/USD rally.

EUR/USD VIEW: For the next 1-2 months, we expect EUR/USD to remain mildly bullish, on the back of slightly hawkish ECB, slightly dovish FED expectations. The rising energy prices is pushing euro area inflation upwards, thereby pressuring the ECB to likely raise rates at upcoming meeting.

For EUR/USD, the bigger near-term positive is now the combination of reduced trade uncertainty + resilient euro-area growth + a potentially more hawkish ECB. However, if the Fed rate hike expectations turn the tables, and markets price in rate hike by FED if the upcoming CPI and jobs data in US is strong, UST yields may remain further elevated, and push inflows into US, thereby pressuring EUR/USD.

♣ INR supported by capital flows & BoP surplus, Hormuz and oil uncertainty caps rupee gains beyond 95/$ for now

FPI Inflows into equities have turned positive for past 2 months, and the pace of inflows is good in August'26 so far

Indian Rupee which came under pressure at the start of 2026 due to war in gulf and thereby rise in oil prices, saw significant downward pressure (~7.6%) towards 96.96 from 90 levels against USD in a short span of time. Such large moves usually happen in a 2-3-year period, but this time it happened in only 3-4 months. Indian equities also remained under pressure and traded with sideways to negative bias in the same period. FPI outflows were net negative in Jan to May'26 period at ~23 Bn. outflows. All these negative factors were pressuring rupee, and RBI's FX reserves also depleted from $725 Bn. at the start of gulf war late Feb'26 to $667 Bn. by the end of June'26. USD index also moved from 97 levels to 101.5 levels from Feb end to July end.

To boost foreign capital inflows, Indian Government scrapped long-term capital gains tax on investments by foreign institutional investors (FIIs) in government securities through an Ordinance issued in early June'26. The move was aimed at making Indian debt markets more attractive to overseas investors and supporting the rupee amid rising crude oil prices and geopolitical uncertainties. The RBI also allowed more securities to be included in the FAR route, thereby aiding bond market, and catapulting FPI investment into debt market. RBI also announced new measures in June'26. to attract capital flows into Indian market, such as concessional swap facilities to banks for new FCNR (B) deposits, ECBs and OFCBs raised for the coming few months. These cumulative measures have aided rupee, along with some cooling in oil and dollar index, and replenished RBI's FX reserves by the end of July.

Going forward, multiple factors are at play to guide the rupee.

RBI MPC minutes were relatively hawkish than RBI press conference post August MPC meeting

Key themes directing ₹ movement:

1. Capital Flows Incentive schemes provide cushion to RBI's FX kitty →

With a view to strengthen our balance of payments and incentivize capital inflows, RBI had announced a series of measures including a facility for offering concessional swaps for fresh FCNR(B) deposits, Overseas Foreign Currency Borrowings (OFCBs) and External Commercial Borrowings (ECB) inflows, on June 5, 2026. This facility was operationalized on June 8, 2026, and is available up to September 30, 2026 (now reduced to 31st August'26) for the FCNR(B) deposits and up to December 31, 2026, for the OFCBs and ECBs.

FCNR-B Deposits:

These deposits are expected to form huge chunk among capital flow incentivization scheme. As per RBI data, till 13th August, USD 52.30 Bn. has been mobilized through FCNR(B) deposits support scheme announced by RBI. Based on the encouraging response to the Swap Facility for FCNR(B) deposits and the resultant forex inflows, it has been decided by RBI on 14th August that the Swap facility for FCNR(B) deposits will be available only for deposits mobilized till August 31, 2026. As there are still 17 days to go, and banks actively seeking deposits before the deadline, momentum is expected to continue in August. Deposit generation of about USD 60 Bn. looks an easy task, which is roughly 9% FX reserves as of pre-measures announcement- a commendable figure, for sure!

These flows can support RBI's FX Reserves kitty to aid rupee whenever required.

OFCBs and ECBs:

Overseas Foreign Currency Borrowings (OFCBs) and External Commercial Borrowings (ECBs) borrowing schemes were also part of capital flows incentive schemes announced by RBI in early June'26. Till 13th August, ~ $2.8 Bn. of OFCBs and $1.74 Bn. of ECBs have been raised by Indian players. The Scheme for ECBs and OFCBs will continue to be open till December 31, 2026. These two routes will also replenish RBI's FX- reserves.

FPIs turning Net Buyers in recent months-Composition remains mixed

FY'27 FPI Flows in USD Mn.					
Category	**Apr**	**May**	**Jun**	**Jul**	**Aug (till 20th)**
Equity	-6,474	-3,450	-5,157	2,123	2,497
Debt-General Limit	-826	-10	3,235	3,039	-65
Debt-VRR	-329	-161	341	-1,413	7
Debt-FAR	-14	462	2,273	322	43
Total	-7,643	-3,159	692	4,071	2,482

FPI's remained net sellers in Apr-May of this financial year-lead by equities selling on the back of ongoing war in middle east. Capital flows from equity markets were also diverted to AI led rally outside India, which pressured Indian equities for first quarter of FY27. Nonetheless, RBI's decision to expand FAR (Fully Accessible Route) for gilt papers, and the GoI's decision to exempt foreign investors from taxes on interest income and capital gains from Govt. securities has improved inflows into domestic Govt. bonds, with more than 2.5 Bn. inflows so far in this FY through FAR route alone post June reforms. Inflows into equities too, have turned positive for past 2 months, and the pace of inflows is good in August'26 so far.

However, India is still not being added to the Bloomberg Global Aggregate Index yet. Bloomberg Index Services Ltd. (BISL) deferred the decision again on July 31, 2026, saying it needs more time for recent market improvements to become established in practice. This development slowed pace of inflows into FAR route in August.

3. **Middle East Geopolitical Risk and Oil Dynamics Matter→**

Middle East tensions remain elevated, with renewed attacks around the Strait of Hormuz and Bab el-Mandeb increasing global energy-supply risks. Brent crude has moved back toward \$90/bbl, after fluctuating in \$80-\$100 levels reflecting a higher geopolitical risk premium and concerns over disrupted tanker flows. Persistent disruption could keep oil prices elevated, with the latest forecasts pointing to continued supply constraints through 2026–27. For India, higher crude prices could widen the import bill, pressure the INR and increase imported inflation. Many fragile truce arrangements are not helping to anchor oil prices lower. A prolonged Hormuz disruption is negative for Indian equities, bonds and the rupee.

4. **Improving External Balance Dynamics →**

India's Balance of Payments in FY27 should move back into modest surplus in FY27, despite a wider current-account deficit. The key improvement is likely to come from stronger debt/FDI and other foreign-currency inflows, following recent policy measures to attract capital. India's Balance of payment (BoP) moved to surplus at US\$2.9 Bn after remaining in deficit for last two months. However, Avg. Q1 FY 2026-27, BOP remained in deficit at US\$ (-) 2.7 Bn vis-à-vis surplus of US\$ 1.7 Bn in same period previous year. While current a/c deficit widened, capital a/c moved into surplus; contributing to overall BOP surplus. The improvement in BOP was however not broad-based: the current account deficit was 3 months high at US\$ (-) 6.2 Bn in Jun'26, while foreign investment (FDI+FPI) moves to positive territory for the first time in last one year at US\$3.8 Bn. 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. We expect India's CAD% to GDP at 1.1% in FY 27, if oil prices sustain in the range of US\$85-90/bbl, and FY27 BOP to remain in surplus.

5. **REER Signals Undervaluation & Forward Book Build-up by RBI →**

The Rupee's REER against a basket of 40 currencies (Base: 2022-23=100), rose marginally to 88.05 in Jun'26 from the low of 86.14 touched in May'26, which was 13 year low. RBI Governor Sanjay Malhotra said in an interview in May'26, that 'RBI believes the rupee may no longer be overvalued (REER>100) after its recent depreciation & could, in fact, be undervalued in both nominal and real effective exchange rate (REER) terms'. Despite the currency being undervalued (REER<100), recent uptick in June was mainly due to sentiment and inflows around capital flow measures announced by RBI.

Rupee's sharp depreciation was arrested by RBI via interventions in FX-market. Inflows from FCNR (B) deposits are filling up RBI's FX-kitty, and RBI likely used some of these proceeds to retire its near-term FX forward liabilities. As per data, RBI's near term forward sell liabilities stood at ~$29 Bn.(1-3 month bucket) as of May'26 end. Data suggests RBI used FCNR proceeds to retire part of these liabilities, and now its forward book in long-term maturity profile has swelled by more than USD 8 Bn. at the end of June'26. RBI's FX Reserves stood at USD 707 Bn. as on 7th Aug'26.

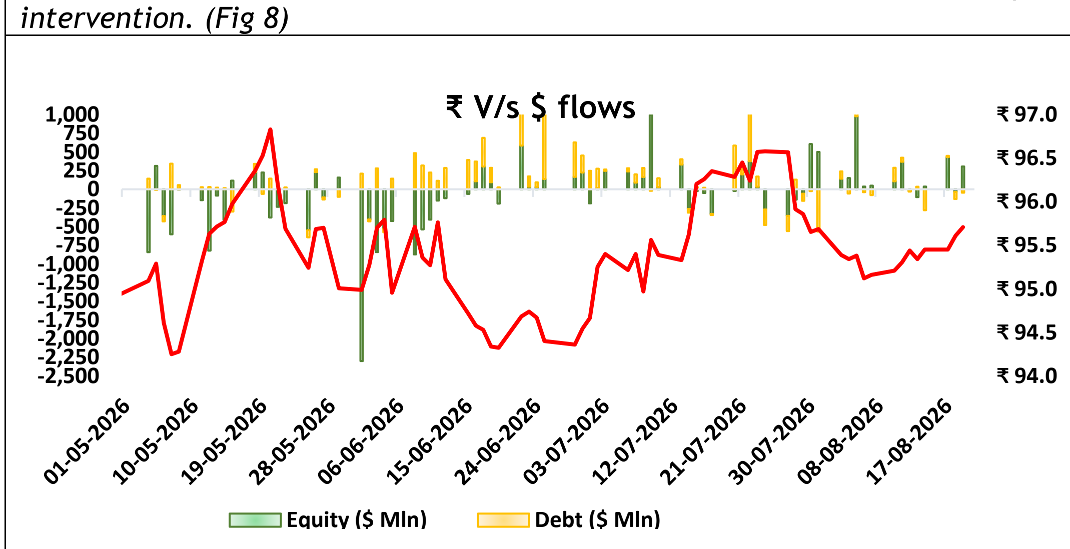
Rupee Outlook:

Indian Rupee is expected to remain rangebound with slight appreciating bias in the coming month. Globally, sentiments are mixed. Prolonged US-Iran war, uncertainty around safe Hormuz passage, and fragile truce arrangements is keeping oil prices elevated around $85-$90 levels so far. On the other hand, increasing prospects of US Fed not raising interest rates in Sept. meeting (64% chance as on 18th Aug'26) is keeping dollar index grounded below 100 levels for past few weeks. Both these nullifying factors are keeping USDINR exchange rate stable around 95 levels.

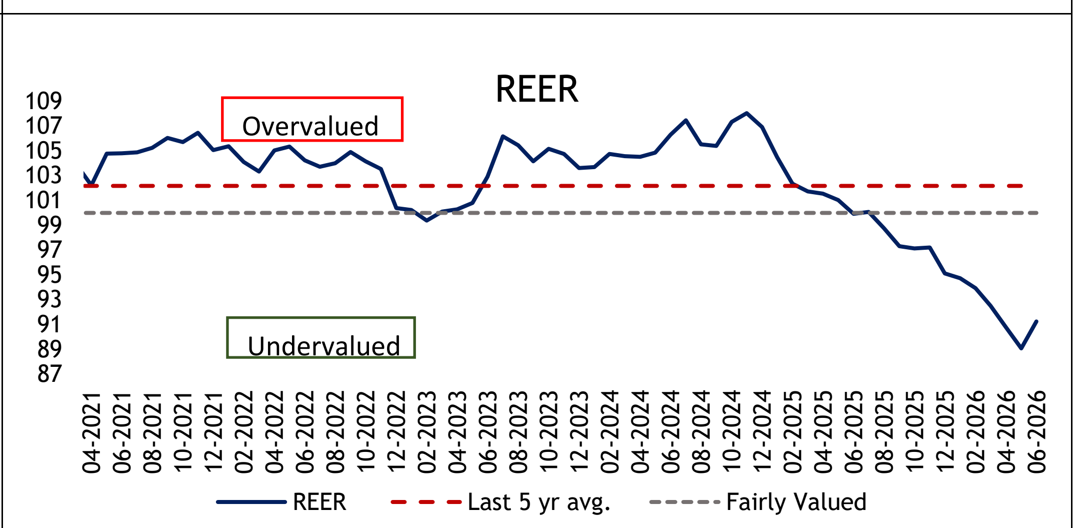
Domestically, FPIs are back again to invest in Indian equities, and Govt's & RBI's debt FAR investment incentives is also attracting FPIs, making them turn bullish on Indian markets, albeit at a moderate pace. RBI's capital flow incentives are attracting FCNR (B), ECB and OFCB flows, thereby aiding RBI's FX kitty. So far, more than $56 Bn. have been mopped up under this scheme, and is likely to pull more than $70 Bn. as per market estimates. India's trade deficit has widened to 6-month high of ~$32 Bn.

Any rise in oil prices and DXY will put pressure on rupee, but with RBI sitting on a comfortable FX reserves, is likely to contain the volatility in rupee, and avoid too much negative fluctuations on the exchange rate for the coming months, is what we believe. Considering these factors, we expect rupee to trade in a range of 94.50-96 in the coming month.

USD/JPY has retraced about half of the decline seen after the US-Japan intervention. (Fig 8)



BoJ: Market Pricing of Cumulative Rate Hikes (bps) (Fig 9)



Source: Reuters, UBI research

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