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2025 marked a decisive shift toward **trade fragmentation**, with tariffs and export controls reshaping flows, China rerouted exports, while **India emerged relatively better placed** through resilient exports, FTAs, and supply-chain diversification

This year's global macro and FX story was defined by a shift from **peak policy divergence to gradual convergence**, as the Fed moved into an easing cycle, the ECB paused, and the BoJ continued normalisation. Markets repeatedly repriced the **soft-landing versus recession debate** as data oscillated between resilience and slowdown. Layered on top of this was a **renewed wave of U.S. tariffs and trade fragmentation**, with export controls and higher duties accelerating tectonic shifts in global trade and capital flows from supply-chain diversification and "friend-shoring" to a more regional, bloc-driven pattern of commerce and investment.

Despite these shocks, **emerging market exports proved more resilient than feared**, helped by diversification of market access, particularly in Asia. The **artificial intelligence investment boom** underpinned risk assets and kept the structural productivity narrative alive. **Commodities sent a mixed signal** as gold and silver at or near all-time highs reflected demand for hedges against geopolitical, fiscal and inflation risks, while **crude oil slipping below the USD 60 mark** underscored softer global demand and ample supply. All of this unfolded against mounting **fiscal challenges and bond-market pressures**, with **large deficits** and heavy sovereign supply pushing term premia higher and sharpening market scrutiny of high-debt issuers. **Notably, many of the feared "Trump 2.0" macro and market outcomes viz. tariff-driven growth damage, a sharply stronger dollar, and a widening growth-policy differential proved more muted than expected in 2025**, while fiscal expansion instead showed up primarily through higher debt, elevated term premia, and tighter market-led financial conditions.

Together, these themes framed a year in which FX, rates, and commodities traded less on simple growth/inflation cycles and more on shifting structural narratives around policy, trade, and risk premia, underscoring the **transition to a more multipolar, protectionist landscape** that rewards nimble positioning in quality assets, diversification, and inflation hedges into 2026.

The U.S. dollar has weakened ~ 9% this year amid an increasingly uncertain tariff environment under the Trump administration, with several flashpoints threatening to extend the downside. **Markets are focused on the Fed Chair choice** whether Hasset, Waller, or Warsh as a more Trump-aligned Chair pushing for structural change at the Fed would likely reinforce yield-curve steepening. The dollar's path will be driven by U.S. growth and Fed policy; a new Chair could tilt the FOMC toward faster cuts, reinforcing a weaker-dollar bias into 2026. As per BofA global research report (fig3,4) **2025 flows signalled measured risk-on: equity inflows were dominated by passive ETFs** while active funds saw persistent redemptions, alongside steady demand for bonds and money-market "liquidity buffers." **By region, U.S. equities drew the largest inflows (~\$398bn YTD), then Europe (~\$53bn) & China (~\$44bn).**

In Asia, tariff uncertainty has **reshaped trade more than it has derailed** it China's exports to the U.S. fell sharply under higher duties, but Beijing offset the drag by **diversifying shipments toward Europe and intra-Asia**, keeping overall exports resilient and lifting the 2025 trade surplus above \$1trn, while the yuan stayed broadly stable to slightly firm, hovering around 7.0 USD/CNY. India, despite facing a 50% U.S. tariff, also saw export resilience, with total exports (goods + services combined) still growing (Nov'25 up ~15-16% y/y), helped by an active FTA-led market diversification push; however, the **India-U.S. Bilateral Trade Agreement remains "advanced"** but without a clear timeline, and the rupee weakened ~5%, briefly printing fresh record lows above 91/\$ on tariff-linked outflows and risk aversion even as it corrected back towards 89 threshold.

Looking ahead to 2026, the key questions remain unresolved that will policy convergence deliver a durable soft landing, or will fiscal stress and trade fragmentation dominate market pricing? Can AI-driven productivity gains offset the drag from protectionism and higher term premia? And for FX markets, will a weaker dollar become a sustained trend, or merely a pause before renewed volatility? How will these tensions resolve or will define the next phase for global assets and determine whether 2026 rewards risk-taking or reinforces the case for caution, diversification, and inflation hedges?

- ♣ Global Trade Chessboard: Tariffs, Fragmentation, and the Re-Routing of Growth
- ♣ Euro 2025: A Resilient Currency in a Year of Divergence
- ♣ Japan: The Yen's Volatile Path to BoJ Lift-Off
- ♣ Rupee clocks ~5% down-move amid capital flow volatility; eyes on trade deal

Tariffs fed into inflation and lifted the fiscal premium, but the growth hit was milder than feared; markets delivered a nuanced mix of a softer dollar, record gold, sticky long yields, and subdued oil rather than a clean “Trump trade”

The year transitioned from peak policy divergence to convergence, diluting simple USD-carry trades and making growth, fiscal risks, and geopolitics the dominant drivers of FX and cross-asset performance into 2026

Trade Policy, Tariffs, and Fragmentation Risks: A Global Chessboard in Motion

The global trade landscape in 2025 increasingly resembled a high-stakes chessboard, where every tariff moves, export control, and bilateral deal reshaped positioning across regions. U.S. tariff actions and technology restrictions accelerated a faster fragmentation of trade than capital, with countries scrambling to secure access through negotiated deals rather than relying on multilateral rules. Meanwhile China’s exports to the U.S. fell sharply under higher tariffs, but diversion toward ASEAN, Europe, and new product segments kept overall exports resilient and pushed the trade surplus to record highs, reinforcing the idea that trade routes are re-routing rather than collapsing.

For India, the chessboard has so far tilted more favourably despite U.S. tariffs, overall exports (goods and services) remained resilient, the trade deficit narrowed, and the economy benefited from lower oil prices. India’s active FTA strategy, improving macro credibility (including rating tailwinds), and positioning as a trusted supply-chain alternative have helped cushion growth impacts and attract longer-term interest, even as near-term FX and portfolio flows stayed volatile. More broadly, this fragmentation has made geopolitics a core market driver, increasing FX sensitivity to tariff exposure, external balances, and supply-chain roles rather than just rate differentials. How this global trade chessboard ultimately plays out in 2026 that whether it hardens into rival blocs or stabilises into a negotiated equilibrium will be critical in determining growth dispersion, capital flows, and relative asset performance across regions.

Trump 2.0: When Campaign Economics Met Market Reality

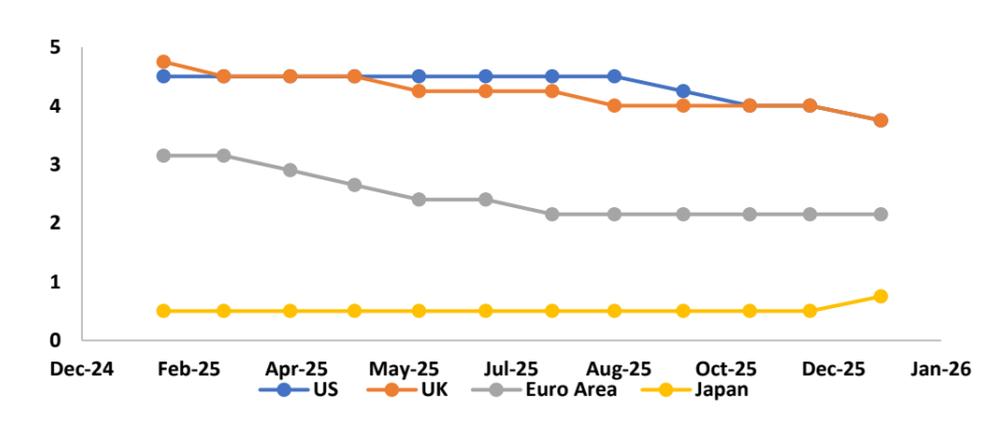
2025 was a noisy year of cross-currents as FX markets saw a softer dollar despite persistent policy uncertainty, gold ran to record highs as investors paid up for hedges, and long-end yields stayed sticky (or edged higher) despite Fed cuts, reflecting a rising “fiscal premium” and heavy supply. Even energy defied the geopolitical script despite wars and periodic supply constraints, oil stayed comparatively subdued, consistent with a market that increasingly priced ample supply/production flexibility and softer demand, and aligning with Trump’s campaign-era “drill, baby, drill” message that policy would prioritise higher output and lower fuel costs.

Against that backdrop, the pre-election “Trump 2.0” macro narrative largely fractured into timing effects, tariffs did show up as an inflation impulse (a meaningful contributor to recent PCE inflation), but the growth hit was less dramatic than feared, with activity supported by consumers and capex (AI included). On the fiscal side, the warning lights were real U.S. debt rose to fresh records (~\$38T in late-2025) reinforcing bond-market pressure. And while the “Trump trade” initially looked textbook (equities and the dollar up, bonds down) right after the 2024 US election result, 2025 was more nuanced.

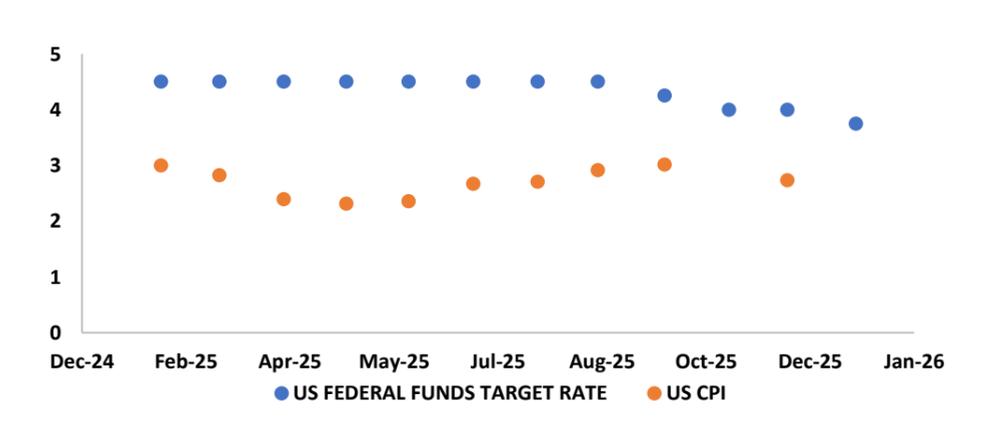
Global Macro Backdrop: From Peak Divergence to Convergence

Markets began 2025 pricing an aggressive Fed easing cycle (~100-125bp of cuts) reinforced by Trump’s election campaign message for a weaker dollar and easier financial conditions alongside expectations of ECB easing and gradual BoJ normalisation. The year ultimately delivered a shift from peak policy divergence to gradual convergence, as the major central banks moved onto less clearly separated paths: the Fed pivoted into an easing cycle against weak labor market, but stayed cautious amid fiscal risks and

Key policy rates of G7 countries from policy divergence to gradual convergence (Fig 1)



Despite sticky inflation and uncertainty due to tariff the Fed has cut rates in 2025 (Fig 2)



Source: Refinitiv workspace, UBI research

tariff-linked inflation uncertainty; the ECB paused after earlier easing, signalling comfort with disinflation but lingering concern over fragile growth; and the BoJ continued its slow, steady normalisation after years of ultra-easy policy.

With the FOMC split and growth signals cooling, the USD stays data-driven near term 99-103 if the Fed pauses, but 96-98 becomes likely if cuts resume.

As this played out, markets moved away from the simple “divergence trade” (long USD, short low-yielders) and toward constant re-checks of how quickly policies were converging, with front-end rate gaps narrowing at times and FX driven more by relative growth and fiscal headlines than by policy rates alone. The shift was bumpy as data flipped between resilience and slowdown, so investors kept resetting the soft-landing vs recession call, and each inflation print, jobs report sparked outsized moves across rates, FX and risk assets making macro trading feel more headline-led and stop-start than in the prior cycle.

FX flows (YTD)

Regional equity flow patterns reflect ongoing rotation toward U.S. assets and selective EM exposure (fig3)

Region	Flow YTD (US\$ mn)	Trend
US	398,475	Strong inflows
Europe	52,951	Modest inflows
Japan	-6,967	Outflows
China	44,423	Firm inflows
India	-4,380	Modest outflows
Brazil	2,557	Small inflows
EM (ex-China)	~62,000	Selective inflows

Source: BofA Global Research

YTD asset-class flows suggest persistent investor preference for passive equity, bonds, and liquidity buffers (fig4)

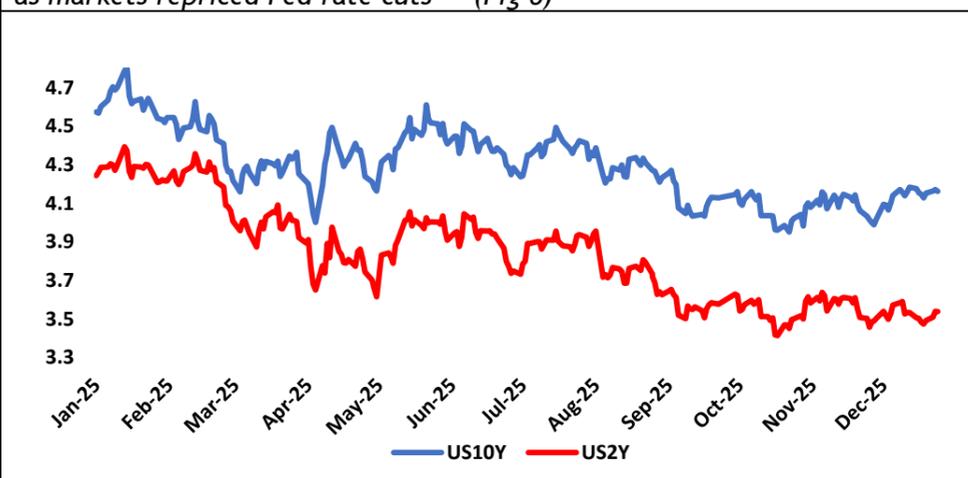
Asset Class	Flow YTD (US\$ mn)	Conclusion / Read-through
Equities	793,489	Broad risk-on sentiment, improving earnings confidence
Equity ETFs	1,375,563	Structural rotation toward passive exposure
Long-only equity funds	-582,558	Sustained active manager redemptions
Bonds	740,094	Stable demand for carry/duration
Money market funds	1,101,820	Continued appetite for liquidity buffers
Commodities	150,639	Moderate inflation/real-asset hedging demand

Source: BofA Global Research

US dollar set for worst year since 2003 and has depreciated ~10% this year (Fig 5)



Yields stayed volatile, with the US 10-year broadly around mid-4% levels on shifting growth and inflation signals, while the US 2-year eased more visibly as markets repriced Fed rate cuts (Fig 6)



Source: Bloomberg, UBI research

♣ Euro 2025: A Resilient Currency in a Year of Divergence

2025 was a year of euro resilience amid diverging monetary policies and global uncertainties. EUR/USD staged a notable recovery after a weak start, opening near multi-year lows and falling to 1.0175 in mid-January on ECB easing expectations and broad USD strength. From that trough, the euro rallied steadily, trading around 1.17-1.19 a roughly 14% gain supported by Fed easing expectations and improving Eurozone sentiment.

Key Eurozone themes behind the EUR move

- **ECB-Fed divergence narrowed:** The ECB delivered four 25bp rate cuts in 2025, with the last one in June, and then paused easing, while the Fed accelerated cuts. This compressed yield spreads and reduced the USD's carry advantage.
- **Disinflation but uneven:** Headline neared target; elevated service inflation limited scope for deeper ECB easing, cushioning EUR downside.
- **Growth stabilised:** Weak but positive momentum avoided recession, reinforced by fiscal support and declining energy drag.
- **Political risks receded:** Election-related volatility dissipated; fiscal tensions lingered but tail risks eased, supporting EUR resilience.
- **Dollar narrative shifted:** Softer U.S. data and fading "U.S. exceptionalism" turned the broad USD cycle moderately bearish, supporting EUR/USD recovery.

ECB policy spotlight

In Dec'25 the ECB held policy rates steady, keeping the deposit facility at 2% after eight cumulative cuts from the 4% peak. The Governing Council reaffirmed the disinflation trend and upgraded the growth outlook, effectively signalling the end of the easing cycle unless shocks re-emerge. Markets have priced a prolonged hold through 2026, with consensus centred around stable policy (~2.15% by end-2026), and only marginal tightening risks if inflation edges up.

Baseline view for EUR/USD

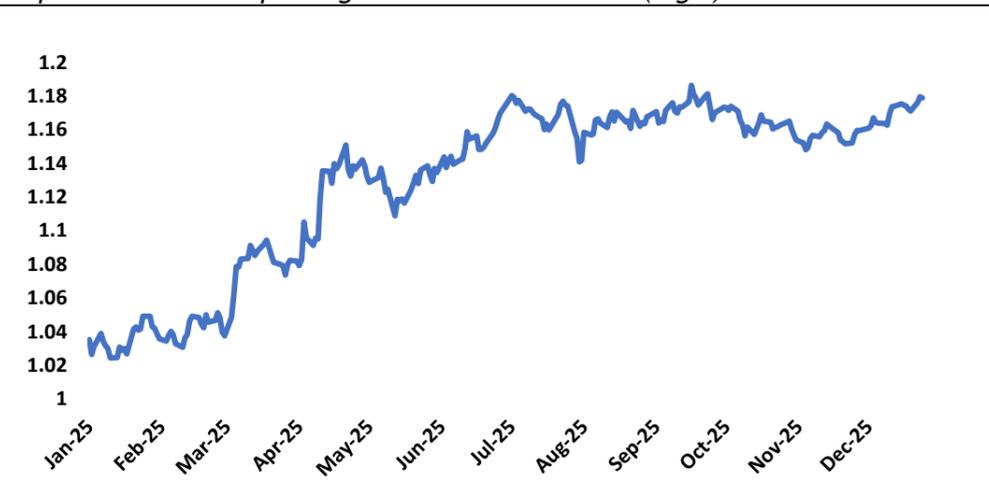
ECB staff project ~1.2% GDP growth and inflation just below 2% in 2026 a "close-to-target, low-trend growth" backdrop. With policy on hold, EUR/USD is expected to trade range-bound with a mild topside bias as fading USD strength as the Fed eases and risk sentiment normalises should support the pair. Upside remains capped by soft growth and political/energy uncertainties; downside cushioned by the end of the ECB cutting cycle and a structurally less "exceptional" dollar narrative. Technically we see **EUR/USD broadly range-bound but with a mild topside bias**, gravitating toward ~1.22 by end-2026 within a 1.20-1.25 corridor, as Fed-ECB rate differentials narrow and Eurozone growth/inflation settle into a steady, near-target "muddle-through" regime.

EUR/USD rebounded strongly from early-year lows as ECB-Fed divergence narrowed, Eurozone growth avoided recession, and political risks faded, delivering a ~14% recovery from the January trough

The ECB's pause after June effectively marked the end of the easing cycle, cushioning EUR downside

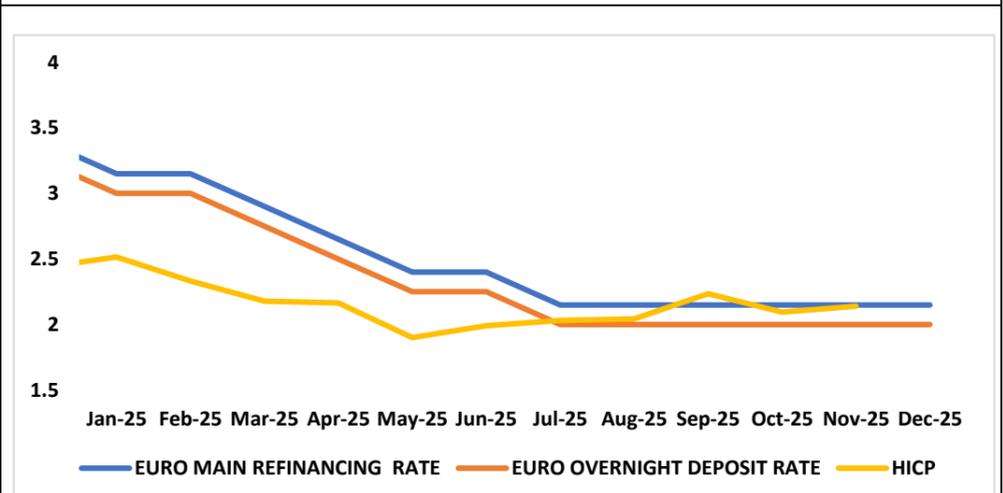
With policy on hold and USD strength fading, EUR/USD looks range-bound with a mild upside bias, supported on dips and gravitating higher as rate differentials compress into 2026

The euro rallied steadily, and has gained ~14% gain supported by Fed easing expectations and improving Eurozone sentiment. (Fig 7)

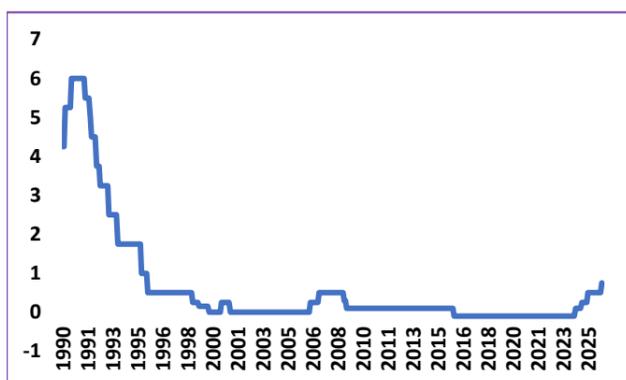


Source: Reuters, UBI research

Euro zone inflation has largely returned to target of 2% (Fig 8)



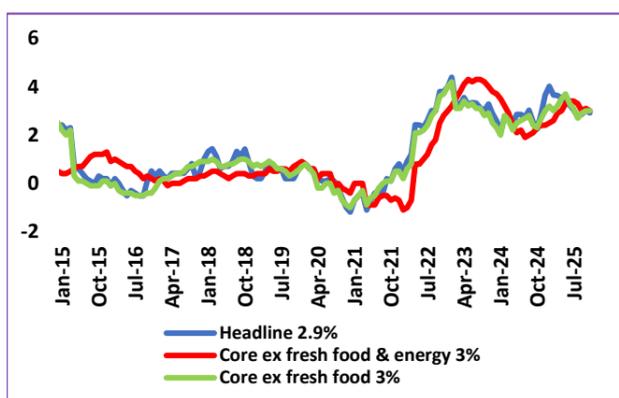
Bank of Japan raised rates to a 30-year high but did not offer clarity on future hikes (Fig 9)



Source: Reuters, UBI research

Headline Inflation stays elevated ~3% (Fig 10)

Source: Reuters, UBI research



♣ Japan: The Yen's Volatile Path to BoJ Lift-Off

The yen saw extreme volatility in 2025, initially appreciating about 12% against the dollar in the first four months before giving back those gains in the second half; YTD, USD/JPY is almost unchanged at around -0.01%. For most of the year, the BoJ remained highly cautious, keeping rates on hold while it waited for clearer evidence of durable domestic demand and wage growth, against a backdrop of uncertainty from U.S. reciprocal tariffs.

The turning point came in September, when USD/JPY's sharp reversal coincided with Prime Minister Takaichi's election and her ambitious fiscal stimulus plans, which raised concerns that BoJ normalisation could be delayed. As the yen weakened rapidly, imported inflation risks rose, prompting a hawkish pivot. With tariff risks receding, Governor Ueda signalled readiness to raise rates, and the BoJ delivered a widely expected 25bp hike while keeping the door open to further tightening. The BoJ highlighted growing confidence in sustained inflation and wage gains, yet stressed that real interest rates remain "significantly" negative and that financial conditions are still highly accommodative, laying the groundwork for gradual normalisation in 2026.

Four Structural Drivers of FX in 2025

1) BoJ Normalisation Takes Root

The BoJ delivered a 25bp hike, lifting the short-term rate from -0.50% to -0.75%, while Governor Ueda offered neutral forward guidance. Despite the move, real rates remain significantly negative and financial conditions accommodative. If the October 2025 outlook materialises, the BoJ sees scope for further gradual tightening, even as uncertainties around the U.S. economy and trade policy have eased but not disappeared. Markets currently price around 50bp of BoJ hikes in 2026.

2) Yields at Multi-Decade Highs: Real Rates Still Negative

Japanese government bond yields are sitting near multi-decade highs, driven by the BoJ's exit from ultra-loose settings, higher term premia, and larger issuance linked to fiscal stimulus. Yet real rates remain firmly negative, as inflation has risen faster than nominal yields.

3) Domestic Growth, Wages and Inflation Regime Shift

Japan's 2025-26 story hinges on whether the economy has truly shifted out of its low-inflation equilibrium. Solid but unspectacular growth, gradually rising wages and more frequent price hikes support the BoJ's normalisation case. A setback in wage momentum would cap further tightening and limit yen appreciation potential.

4) External Risks: Tariffs, Global Demand & Safe-Haven Flows

The U.S.-Japan trade deal capped reciprocal tariffs on key Japanese goods at around 15%, removing the risk of steeper duties and easing trade uncertainty. This clarity helped stabilise auto and machinery exports, reducing downside pressure on the yen, while the improved trade backdrop combined with gradual BoJ policy tightening narrows medium-term real rate differentials, reinforcing a lower USD/JPY bias.

USD/JPY Base Case: 145-150 Gravity

Technically our base case sees USD/JPY trading in a broad 140-155 range in 2026, with gravity around 145-150. The outlook is one of gradual normalisation rather than a regime break: the BoJ is likely to tighten cautiously, keeping real rates still negative but less deeply so, while the Fed eases from restrictive levels and narrows rate differentials. The pro-growth fiscal stance under the new government, combined with reduced tariff uncertainty after the U.S.-Japan trade deal, should support domestic demand and exports.

We see downside breaks below 150 as conditional on a faster-than-priced BoJ hiking path and/or global risk-off that revives the yen's safe-haven role, while upside risks above 155 would require a renewed "higher-for-longer" Fed narrative.

Rupee remained under depreciation pressure from FPI outflows & global dollar strength.

India's new FTAs with New Zealand and Oman, alongside ongoing talks with Canada, the US, and EU/UK, expand zero-duty access, attract investments, and boost exports in textiles, gems, pharma, autos, and IT services.

Rupee clocks ~5% down-move amid capital flow volatility; eyes on trade deal

During this month, the Indian rupee traded under sustained depreciation pressure, driven by persistent FPI outflows particularly from equities amid global risk aversion and dollar strength. Net capital outflows continued to dominate near-term currency dynamics, although external fundamentals provided support, led by resilient services exports, steady remittance inflows, and a moderating trade deficit, alongside progress on trade diversification through recent agreements with New Zealand and Oman and improving US-India trade prospects. The IMF has endorsed this approach, reclassifying India's exchange rate regime to a *crawl-like arrangement* and noting adequate foreign exchange reserves and strong macroeconomic fundamentals. Looking ahead, the rupee is expected to remain range-bound with moderate volatility, with trade and export momentum providing support, while global monetary conditions and FPI flow trends continue to pose downside risks. [Refer Report: [FX weekly: Fed Cuts, likely Hawkish BoJ: Markets Enter a New Volatility Regime](#)]

🔑 Key Drivers for Rupee Movement:

- **Thaw in India - US Diplomatic Trade Tariffs:** The *India-New Zealand FTA* grants 100% zero-duty access for Indian exports, with \$20bln in NZ investments over 15 years and safeguards for sensitive sectors like dairy. The *CEPA with Oman* provides zero-duty access on ~98% of Omani tariffs while India liberalizes ~78% of its imports, boosting trade in gems, textiles, pharma, and autos. India will start *ToR talks with Canada*, and *trade talks with the US* advance amid strong exports despite high tariffs. *Ongoing EU negotiations and existing UK agreements* further diversify markets and strengthen India's competitiveness in textiles, engineering goods, gems, and IT services.

Key Recent Developments:

Date	Event	Details
Nov-05	Piyush Goyal Update on Talks	Commerce Minister Piyush Goyal states negotiations are "going on very well" with 5 rounds completed since March; emphasizes addressing "sensitive, serious issues" like tariffs, while protecting farmers & MSMEs. First tranche of agreement by November.
Nov-14	Positive Developments in Tariff Talks	Senior US official notes "positive developments" on resolving tariffs and Russian oil imports; deal eyed by year-end to normalize trade.
Nov-17	LPG Import Deal Signed	Indian PSU oil firms conclude 1-year contract for 2.2 MTPA LPG imports from US Gulf Coast (2026 delivery), aimed at balancing trade; not directly tied to BTA but signals goodwill amid tariff pressures.
Nov-17	First Tranche "Nearing Closure"	Commerce Secretary Rajesh Agarwal announces six rounds of talks completed; BTA phase 1 focuses on reciprocal tariffs (25% broad levy + 25% oil surcharge) and US market access in dairy, EVs, and agro-products. India seeks relief for textiles, gems, and shrimp.
Nov-18	Goyal Signals "Good News Soon"	Piyush Goyal indicates pact nearing completion if "fair and equitable"; prioritizes safeguards for farmers, fisherfolk, and small industries against US demands in agriculture and autos.
Nov-20	Tariff-Cut Plan Preparation	India readies concessions on US industrial equipment, chemicals, and engineering goods; US pushes for access in autos, dairy, and high-tech manufacturing.
Nov-24	Russia Oil Import Cuts	Major Indian refiners halt new December orders for Russian crude, aligning with US pressure; expected to boost BTA momentum by easing tariff justifications.
Nov-28	Optimism for Year-End Seal	Commerce Secretary Agarwal: "Only a matter of time" for first tranche closure before Dec 31; two parallel tracks—full BTA and immediate framework for tariffs. Most issues resolved; political-level fixes for sticking points like agriculture.
Dec-10	Advancing work on the first phase of the BTA	Deputy USTR Rick Switzer and supported by chief negotiator Brendan Lynch visiting India. US Under Secretary of State Allison Hooker is also in India this week to deepen strategic ties.
Dec-11	Diplomatic engagement	PM Modi held his third call with US President Trump , reviewing bilateral relations (including trade). Chief Economic Adviser predicts deal ; Most issues resolved; surprised if not signed by March; parallel discussions on tariff framework and comprehensive pact.
Dec-12	Negotiation feedback	A senior US negotiator praised India's "best-ever" market-access offer , though sticking points remain (agriculture, dairy).
Dec-15	Following six rounds of bilateral trade talks	India and the United States are on the brink of finalising an initial framework agreement, Commerce Secretary Rajesh Agrawal said.

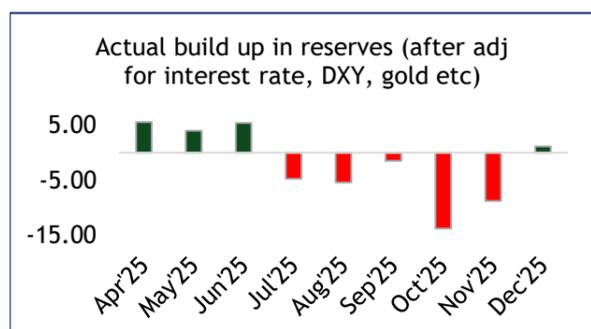
DXY slipped to 97.8-98.0 in Dec'25 (-1.74% MoM, -10% YTD) on Fed dovish bets, easing pressure on emerging market currencies.

Nov'25 trade deficit narrowed to \$24.5bln, led by a sharp correction in gold and NONG deficits, keeping FY26 CAD comfortable near ~1% of GDP.

FPIs sold \$1.32bln in Dec'25 (YTD \$17.71bln), citing global rate, currency pressures; domestic buying and macro cues support.

Brent crude traded ~\$60-\$62/bbl, supported by geopolitical tensions and U.S. data

Month	Change in total FX reserves	Build-up in reserves (after adj for interest rate, DXY, gold etc)
Apr'25	22.73	5.58
May'25	3.36	4.00
Jun'25	11.3	5.41
Jul'25	-4.59	-4.73
Aug'25	-3.96	-5.4
Sep'25	6.01	-1.46
Oct'25	-10.5	-13.76
Nov'25	-3.51	-8.76
Dec'25	7.09	1.17



✚ **Dollar Index (DXY)** weakened toward multi-week lows around 97.8-98.0, driven by persistent expectations of Federal Reserve rate cuts and a softer monetary stance into 2026. The dollar has declined nearly 10%, marking its largest annual drop since 2017, despite pockets of strong U.S. economic data. Market sentiment remains tilted toward a dovish outlook, with softer labor market signals & Fed policy uncertainty weighing on the greenback. This weaker dollar environment has generally eased external depreciation pressures on emerging market currencies, while ongoing global volatility and capital flow dynamics continue to influence short-term FX and forward market behavior. On a MoM basis, fell by **-1.74%**, and they reflect a **YTD decline of -10%**.

✚ **Merchandise trade deficit** narrowed to **\$24.53bln** in Nov'25, delivering a positive surprise and reflecting a sharp normalization from the record Oct'25 peak of **\$41.68bln**. In terms of sectoral drivers of trade dynamics, oil deficit remained elevated with a marginal correction with the latest number at \$10.18bln compared to \$10.84bln the previous month, gold deficit narrowed from record highs of \$16.20bln to \$4.30bln in Nov'25. NONG deficit narrowed by \$4.59bln MoM to \$10.05bln from \$14.64bln on the back of impact of normalization in volatile sub-segments. We expect the CAD to remain favorable at around 1% of GDP in FY26, that said post the Oct'25 trade data shock, we had revised our CAD forecast to 1.7% of GDP however with sharper than improvement in Nov'25 and resilience in Service exports we see the external sector fundamental staying favorable.

✚ **Foreign Portfolio Investors (FPIs)** continued their aggressive selling in Indian markets in Dec'25, withdrawing **\$1.32bln** for the month and bringing YTD net outflows to **\$18.03bln** as of 26th Dec'25. **FAR flows totaled \$6.59bln YTD**, however in contrast, debt category witnessed an outflow after Jun'25 at **-\$1.15bln**, it reflects profit booking and higher US yields compressing carry; prompting global investors to pare duration risk, rather than any deterioration in India's fundamentals. FPIs are likely to remain cautious this month, with early outflows driven by global rate & currency pressures, though domestic buying and positive macro cues may moderate selling & stabilize flows.

✚ **Brent crude oil** traded around the low-to-mid \$60/bbl, with intermittent rallies above **-\$62** driven by geopolitical tensions, including Venezuelan export disruptions and Russian supply concerns, and stronger-than-expected U.S. economic data. Despite these short-term supports, the market remains range-bound, weighed by expectations of a global supply surplus in 2026. The IEA has slightly lowered its forecast for the 2026 oil glut, providing modest optimism, but overall sentiment remains cautious, suggesting that Brent is likely to experience continued volatility with short-lived spikes rather than sustained upward trends.

✚ **FX reserves** increased by \$4.37bln to **\$693.32bln** for the week ending 19th Dec'25 (covering ~11 months of imports), driven mainly by a **\$1.64bln** rise in FCA to \$559.43bln and **\$2.62bln** gain in **Gold**. This gain puts FX reserves \$11.54bln short of the all-time peak of \$704.86bln reached on 27th Sep'24. A valuation gain of \$1.87bln was also noted in this week, with a cumulative of **~\$(23) bln** since **Sep'25** highlighting the central bank's ongoing efforts to stabilize the FX market. Our analysis suggests a BoP deficit of **~\$(18) bln** for FYTD26, with FX reserves (excluding valuation effects) continuing to align closely with BoP trends.

✚ **The Rupee's Real Effective Exchange Rate (REER)** against a basket of 40 currencies (Base: 2015-16=100), in terms of trade-based weights, remained unchanged at **97.51 in Nov'25** vis-à-vis 97.51 in Oct'25 (revised upwards from 97.47), after a significant drop from the all-time highs of 108.08 in Nov'24. Notable fact, the RBI recorded a **net FX sale in Oct'25 of \$11.88bln** vis-à-vis sale of \$7.91bln in Sep'25. Notably, the rupee though still undervalued (REER <100) has weakened sharply, driven more by sentiment around the US trade-tariff truce than by fundamentals. Any positive signals on an India-US BTA could push the REER back toward the neutral 100 mark in the coming months, indicating room for a real-value correction.

✚ **Forward premiums** across tenors, reflecting heightened hedging demand amid persistent FPI outflows, year-end dollar liquidity glut, and depreciation pressures. The 1-M forward premium surged to **~55 paisa**, its highest in over six years, while longer-dated premia also widened, signaling increased hedging costs and market expectations of continued INR volatility. In response, the RBI introduced a USD/INR buy-sell swap facility (**~\$10bln**), which helped ease short-term pressures. Despite these interventions, the forward curve remains skewed toward higher premia, underscoring sustained depreciation risks and ongoing capital outflow pressures, consistent with broader currency dynamics.

INR likely range-bound ₹88.50-₹90.50, volatile; supported by RBI's liquidity measures, sensitive to USD, oil, capital flows, and India-US trade.

Outlook (₹ - INR)

The Indian Rupee is expected to remain under moderate pressure and to trade with bouts of volatility over the next month, likely trading range-bound. The USD/INR forward premium hit a three-year high as banks swapped excess dollar deposits to meet year-end regulatory limits, driving strong forward demand from foreign banks and importers hedging rupee risks amid rising spot rates. The Reserve Bank of India has initiated substantial liquidity measures, including bond purchases and USD/INR swap operations totalling around \$32bln, aimed at stabilizing the currency and easing stress in the forward market. However, persistent capital outflows, strong U.S. dollar strength, and elevated oil prices may keep the rupee weak or sideways. RBI liquidity operations and the USD/INR swap transaction, could temporarily support the rupee. Global factors such as U.S. Federal Reserve policy, inflation data, and foreign investment flows will also influence the currency.

From a technical standpoint, the rupee is expected to trade between ₹88.50 and ₹90.50 throughout the next month. Sustained domestic equity inflows or tangible progress in India-US trade negotiations could strengthen the INR toward ₹88.80/\$, with ₹88.50/\$ acting as a key interim support. If an India-US BTA is finalized; the appreciation threshold for the rupee could shift meaningfully. Conversely, any bearish catalysts such as delays in resolving US-India tariff issues are likely to face strong resistance near ₹90.10/\$, a break above this zone could trigger a move toward ₹90.50/\$. Overall, geopolitical and tariff developments will remain central drivers of market sentiment.

We have consistently noted that the rupee's recent weakness reflects overshooting due to negative sentiment rather than fundamentals. Based on the Real Effective Exchange Rate (REER), the currency appears undervalued by ~2.5%. Our analysis indicates that over a three-year horizon, the rupee typically adjusts via an average annual depreciation of 3-4%, aligned with India-US inflation and interest rate differentials. Given that the rupee has already weakened by ~5% this calendar year and cumulatively ~9% in last 3 years (since March 2023), we do not expect significant or runaway depreciation pressures in the currency.

Near-Term Trajectory: Range-bound with Volatility

Base Case: Expect rupee to trade range-bound ₹88.50-₹90.50 till end-January.

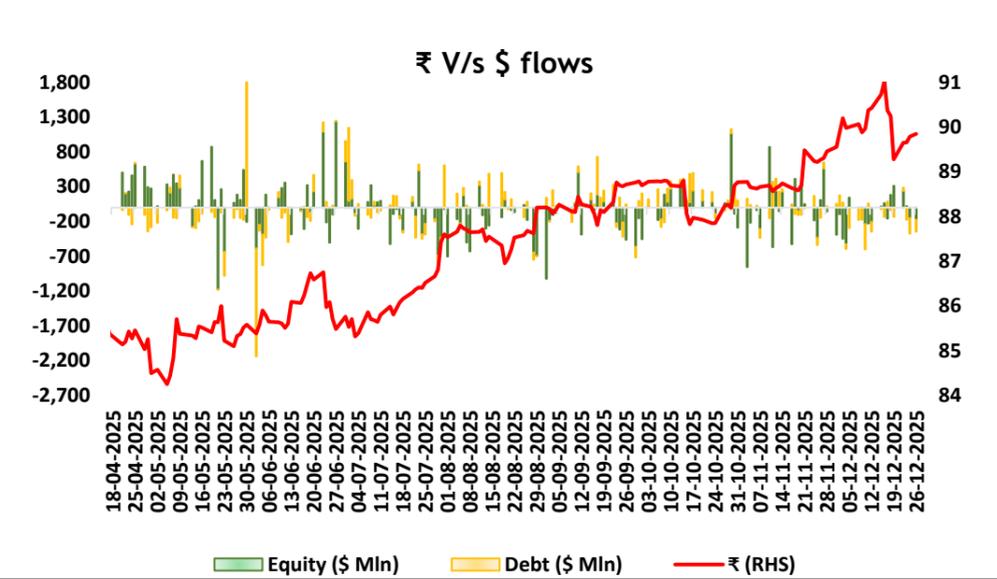
Bullish Scenario (Rupee Strengthens): If India-US BTA finalizes and FII inflows resume USD/INR could stabilize near ₹88.00-₹88.50. This assumes lower crude oil prices and weakening USD globally.

Bearish Scenario (Rupee Weakens Further): Delay in US-India trade tariff truce or sticky global inflation could push it to ₹91.90/\$.

Rupee weakens by ~3-5% an annual average basis over a 3-year period

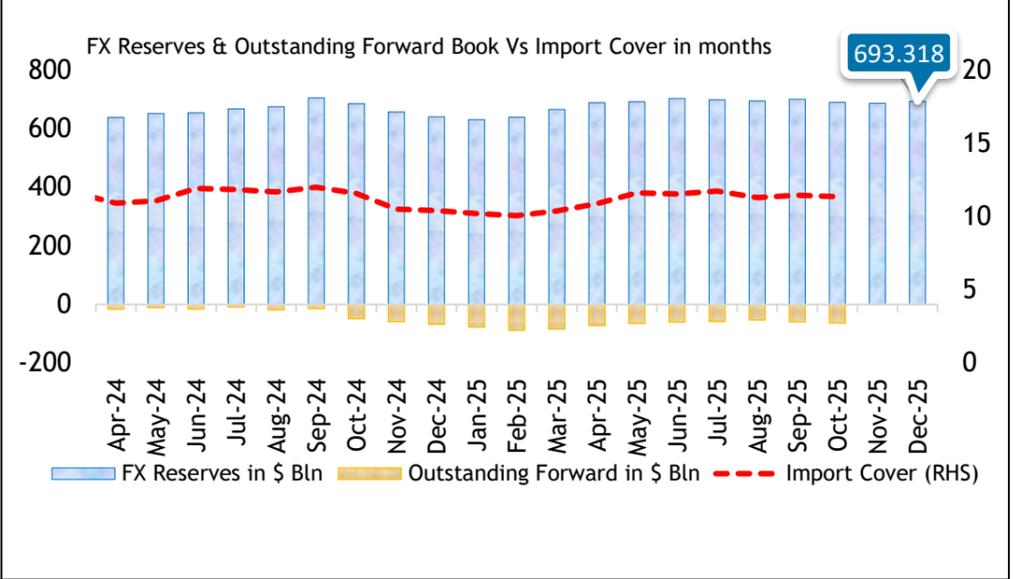
Year	INR level	USD/INR Annual Move	3 Year Total	3 Year Avg.
Mar-10	44.9000			
Mar-11	44.5900	-0.70%		
Mar-12	50.8700	12.35%		
Mar-13	54.2800	6.28%		
Mar-14	59.9100	9.40%	28.02%	9.34%
Mar-15	62.4950	4.14%		
Mar-16	66.2500	5.67%		
Mar-17	64.8450	-2.17%	7.64%	2.55%
Mar-18	65.1700	0.50%		
Mar-19	69.1500	5.76%		
Mar-20	75.6600	8.60%	14.86%	4.95%
Mar-21	73.1050	-3.49%		
Mar-22	75.7875	3.54%		
Mar-23	82.1650	7.76%	7.81%	2.60%
Mar-24	83.4000	1.48%		
Mar-25	85.4775	2.43%		
Dec-25	89.8500	4.87%	8.78%	2.93%

Rupee traded volatile amid trade tariff truce & FPI outflows (Fig 11)

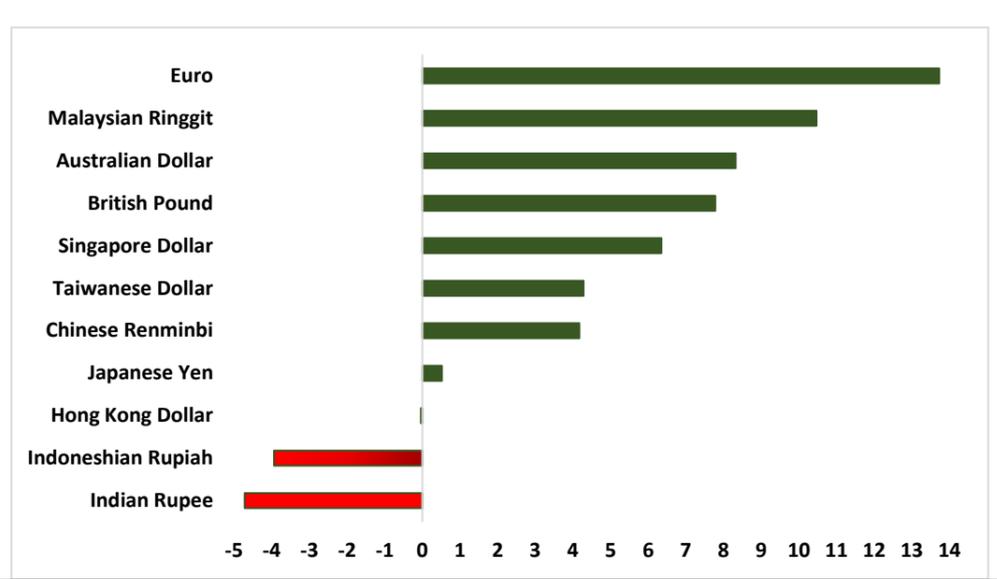


Source: Bloomberg, Reuters, UBI Research

FX reserves rise amid surge in gold assets & FCA (Fig 12)

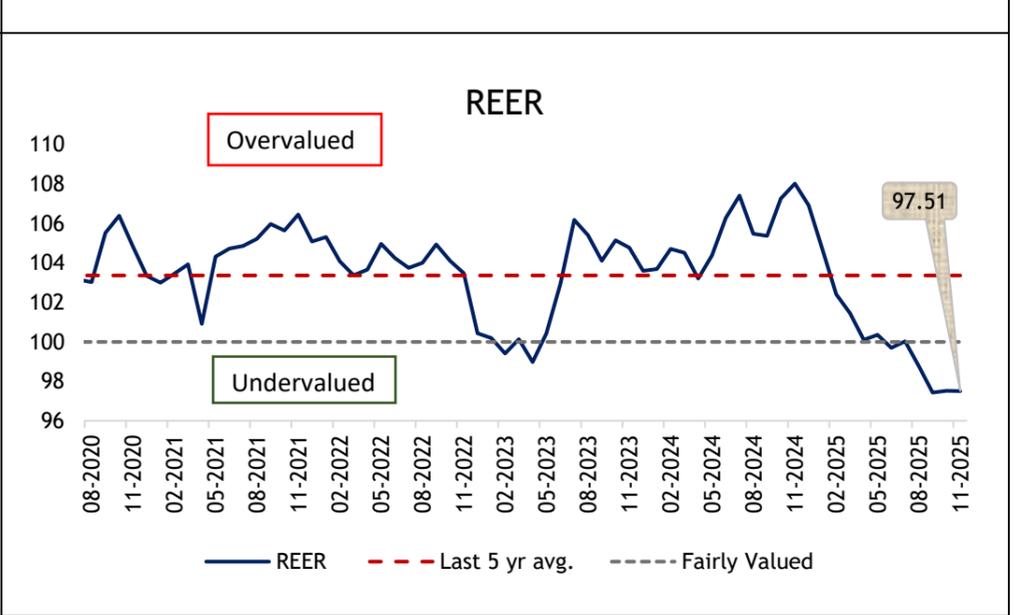


Rupee has underperformed among peers; % Change since Jan'25 for major currencies (Fig 13)

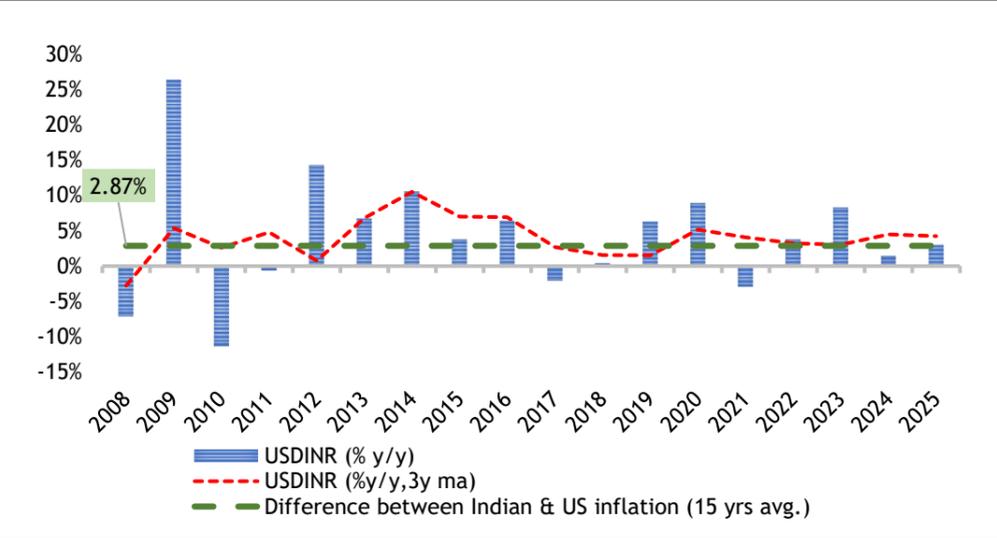


Source: Bloomberg, Reuters, UBI Research

REER remain unchanged in Nov'25; reflecting Undervaluation (Fig 14)

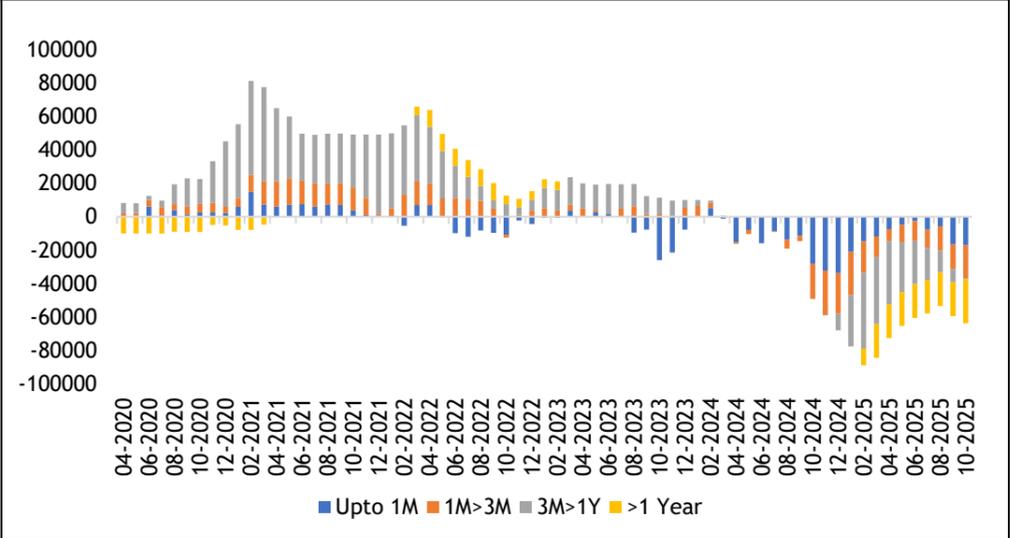


As per Balassa Samuelson effect, Rupee clocks avg. annual depreciation of 3% over a 3-year cycle (Fig 15)



Source: Bloomberg, Reuters, UBI Research

RBI's short positions rise for the 2nd consecutive month in Oct'25 (Fig 16)



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