

Global Markets: Special FX

The USD rose in December with movement in treasury yields as well as the cautious Fed, aided also by dovish comments from the BOE and BOJ. We also took heart from the INR once again being allowed to see volatility, in line with our past notes. In line with past FX views, we see current levels of the USD priced to perfection on the hawkish side – with potential for moves lower in the neutral Fed rate priced from 4%, potential for increase in the ECB neutral rate, likely cautious BOE given fiscal levers, eventual BOJ hikes, and potential for CNY appreciation. We also adjust the INR midpoint for recent moves.

Exhibit 1 - Projections for FX markets – INR midpoint raised, others held

	INR	EUR	GBP	JPY	CNY
Jun'25	85.50-86.50	1.06-1.08	1.32-1.34	142-144	7.05-7.25
Sep'25	86.00-87.00	1.07-1.09	1.33-1.35	141-143	7.10-7.30
Dec'25	86.50-87.50	1.08-1.10	1.33-1.35	140-142	7.15-7.35
Mar'26	86.00-87.00	1.08-1.10	1.32-1.34	139-141	7.20-7.40
Jun'26	86.50-87.50	1.09-1.11	1.32-1.34	139-141	7.25-7.45
Sep'26	87.00-88.00	1.09-1.11	1.32-1.34	139-141	7.25-7.45
Dec'26	87.50-88.50	1.09-1.11	1.32-1.34	139-141	7.25-7.45
Mar'27	87.00-88.00	1.09-1.11	1.32-1.34	139-141	7.25-7.45

Source: Axis Bank Economic Research.

USD rises with treasury yields and cautious Fed

The USD was somewhat weaker in the first week in line with weaker US ISM PMI, despite French political turmoil, with the INR also appreciating after the RBI eased FCNR deposit rules. However, the next two weeks saw steady gains in the USD, with steady moves up in treasury yields as well as the cautious FOMC, along with slightly dovish BOE comments and the BOJ holding rates. The last few days of the year saw a holiday lull, but for in the INR where the NDF market led spot to close near all-time highs.

INR: Volatility returns after long wait

We have been pointing at the untenability of the low volatility regime since at least July, arguing that this would eventually lead to faster depreciation – which has come to pass with a now-weaker position of FX reserves. This also comes with unfavourable BOP trends, potentially lower availability of global savings, and a CAD exposed to widening with a pickup in growth. These will likely be masked in Q4 with reversal of speculative positions and return of some FPI, though the RBI will likely limit appreciation so as to rebuild FX reserves. Longer term steady weakening remains on the cards, likely at the normal Rs. 1.5-2.0 per year pace, but this also depends on the level of volatility allowed.

Is the USD once again priced for perfection?

The USD was last priced for perfection after the jumbo Fed rate cut, and might now be again – albeit on the other side given market pricing of the Fed neutral rate at 4% and the ECB's below 2% given fiscal and tariff contrasts, while JPY rate hikes are not seen, and the CNY is seen depreciating over time. However, these appear to be extreme positions, likely to see reversal in the next few months, allowing the EUR to gain, the GBP to gain further, and the JPY even more so. We also argue again that a weaker CNY is not a given.

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