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INDIA; INDIA SURPASSES JAPAN TO BECOME THE FOURTH LARGEST ECONOMY | **May 26, 2025**

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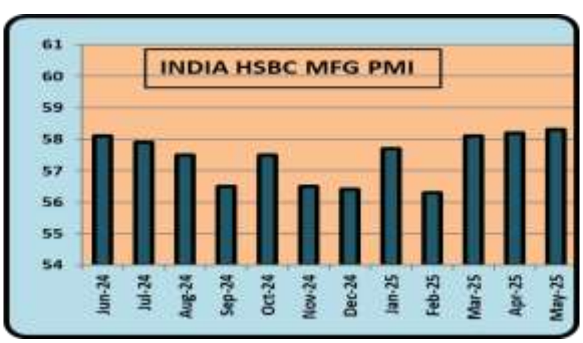
Indian rupee had a roller coaster ride last week, falling to as low as 86.11 to a dollar as dollar demand from importers and volatility in domestic equity markets lent support to the greenback despite weakness in the Dollar index last week. However, towards the end of the week, the tide turned in favour of the Indian rupee, with inflows and exporters' dollar sales lifting to the rupee with about 0.35% gain from the previous week at 85.21 to a dollar level. Equity market benchmarks ended a volatile trading week with about 0.7% losses.

Meanwhile, data releases during the week were mixed. India's infrastructure output expanded by 0.5% from the previous year in April of 2025, the least in eight months, to slow down from the upwardly revised 4.6% growth rate in the earlier month.



Further, the HSBC India Composite PMI rose to 61.2 in May 2025 from 59.7 in April, topping market expectations of 59.4 and marking the highest point since April 2024, flash data showed. It was the 46th straight month of private sector expansion, driven by the strongest service sector growth in 14 months while manufacturing growth remained stable. Output went up the most in over a year, fueled by robust services activity. New orders gained at the quickest rate since April 2024, led by a pickup in demand at service firms. Sub-indexes for foreign sales, employment growth, back log of orders and sentiment improved. Mfg. PMI rose slightly to 58.3 in May from 58.2 in April, exceeding expectations of 58.0. The Services PMI Business Activity Index surged to 61.2 from 58.7.

In a significant development, the RBI said it would transfer a record Rs.2.7 crore as dividend payout for the Government of India. The income came from high gross dollar sales, foreign exchange gains, and consistent increase in interest income. The significant surplus in the dividend payout was primarily due to the active participation of the central bank in the foreign exchange market. Notably, the RBI was the biggest seller of foreign exchange reserves among Asian central banks in January 2025. Throughout the year, the RBI implemented various strategies to stabilise the rupee, including substantial dollar sales. As of September 2024, India's foreign exchange reserves totalled $704 billion. Following the peak reserves recorded in

September 2024, the RBI sold a significant amount of dollars to ensure currency stability. Till February 2025, the gross dollar sales stood at $371.6 billion, higher than the $153 billion recorded in the previous year. The dollar sales have added to the RBI's foreign exchange gains. The RBI also earned from rupee securities. As of March 2025, its holdings in rupee securities had increased from ₹1.95 lakh crore to ₹15.6 lakh crore. However, a decline in G-Sec yields affected the mark-to-market (MTM) gains, but the total interest income rose consistently. with RBI's surplus transfer, the fiscal deficit of the central government could ease by 20 to 30 basis points from the budgeted estimate of 4.5 per cent to 4.2 per cent of GDP. The Union Budget FY26 estimated a total dividend income of ₹2.56 lakh crore from the RBI and public sector financial institutions. After the RBI's surplus transfer, the amount will be higher than the budget estimates. The RBI hiked the Continent Risk buffer rate. Otherwise, the transfer would have been higher. The Contingent Risk Buffer, a protection measure against future risks, was kept in the range of 7.5 per cent to 4.5 per cent of the central bank's balance sheet. The dividend payout was calculated according to the updated Economic Capital Framework, which the RBI's Central Board approved in its meeting on May 15, 2025.

In another significant development, the Niti Aayog declared that India has overtaken Japan to become the fourth largest economy. The size of the economy currently stands at $4.187 bn. He further stated that India may soon surpass Germany and become the third-largest economy in the world.

The April edition of the World Economic Outlook (WEO) report by the IMF mentioned that the nominal GDP for fiscal year 2026 is estimated to touch nearly $4,187.017 billion, slightly more than the GDP of Japan, projected at $4,186.431 billion, ANI reported, citing WEO.

WEEK AHEAD FOR INDIAN MARKETS

In the week ahead, the rupee is likely to extend its gains in the early part tracking the other Asian currencies against the USD. On the data front, April Industrial and Manufacturing Output data will be released on Wednesday. On Friday, Q4 GDP data will be released.

HEDGING STRATEGY: - For Imports: Hedge for payables up to end Aug 2025 near or below 84.80.

For Exports: Hedge partial exports above 85.70 levels.

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GLOBAL SCENARIO						May 26, 2025	
MARKETS LAST WEEK							
	Open	High	Low	Close	Pre. Week	Range	Sentiment
DXY	**100.91**	**100.91**	**99.05**	**99.11**	**101.09**	**94.50-105**	**Negative**
USD/INR	**85.44**	**86.12**	**85.11**	**85.22**	**85.52**	**83.50-85.70**	**Negative**
EUR/USD	**1.1166**	**1.1375**	**1.1157**	**1.1362**	**1.1163**	**1.1075-1.1700**	**Positive**
GBP/USD	**1.3281**	**1.3543**	**1.3245**	**1.3537**	**1.3283**	**1.2675-1.3800**	**Positive**
USD/JPY	**145.54**	**145.55**	**142.42**	**142.56**	**145.70**	**137.75-148.00**	**Negative**

INTERNATIONAL MARKETS

US

The dollar index (DXY) ended about 1.95% lower last week on fears of ballooning fiscal deficit amid bond market losses. This is in addition to the Moody's downgrading of US Credit rating from AAA to Aa1. The House of Representatives passed the reconciliation bill which was dubbed the "One Big Beautiful Bill act" and will have to go through the Senate, though nothing is written on the stone. However, experts estimate that the bill in its current form could add between $3 trillion to $4.5 trillion to the national debt over the next ten years. The bill promises tax cuts, which is the extension of President Trump's 2017 Tax cuts and Jobs Act, in addition to several new tax breaks for households. In addition, the bill promises spending cuts, but may not be enough to cover the tax cuts and added interest payments. The bond markets witnessed a sharp sell off with the two year and ten-year yields rising this week, though the 30-year yield has also gone up. In addition, President Trump has threatened the EU with higher tariffs from June 01.

The surge in treasury yields, if continued could send mortgage rates higher further. Last week, the average 30-year mortgage rate inched up to 6.86%, much higher than the 4% average rates in the long term. As a result, home sales slipped 0.5% in April to 4.0 million units' annual space. The decline left sales down 2.2% year-to-date and down nearly 40% from their 2021 peak. Alongside, home prices also surged strongly reducing the affordability. There were 1.3 million existing single-family homes listed for sale in April, down 22% from April 2019.

High mortgage rates also pose a challenge to builders. New home sales jumped 10.9% in April, but this follows a hefty downward revision to March's sales pace. Home sales are down 1.9% year-to-date. The median sale price declined 2.0% y/y, reflecting increased use of price cuts by builders. Although new home sales have been relatively more resilient than existing home sales on account of these incentives, recent macro headwinds have reduced builder confidence and slashed sales expectations. Inventory remains highly elevated weighing on the pace of construction. The situation could improve only if the Federal Reserve cuts interest rates further.

US PMI figures, were upbeat. Manufacturing output improved to 52.3 from 50.2 in April, while the Services PMI rose to 52.3 from 50.8 in the same period. As a result, the Composite PMI surged to 52.1 after posting 50.6 in April, a two-month high. The survey also pointed to price pressures building up in the economy due to tariffs.

Trade tensions somehow returned amid the lack of progress in negotiations and fresh tensions between the United States (US) and China. Both countries agreed on a 90-day truce and reduced massive retaliatory tariffs a couple of weeks ago, boosting the market's optimism. However, things deteriorated after the US issued an industry warning against using Chinese chips, targeting the Asian giant Huawei. By the end of the week, Washington and Beijing agreed to maintain communication, but optimism among investors faded. In addition, Japan expressed dissatisfaction about the tariffs on automobile imports. On Friday, President Trump issued a warning on Europe threatening 50% tariffs due to lack of progress in trade talks.

EUR

EURUSD steadily moved higher supported by weak US Dollar. Data from Eurozone have provided uncertain economic outlook. May PMI figures from Eurozone support the view of a broadly stagnating economy, with the overall Composite PMI falling into contraction territory at 49.5, below expectations of 50.6.

The Eurozone May PMI figures showed the broad view of stagnating economy. with the overall composite PMI falling into contraction territory at 49.5, below expectations of 50.6. While May's manufacturing PMI figures slightly outperformed expectations—coming in at 49.4 versus expectations of 49.2— it remains in contraction territory. Both France and Germany showed modest improvements in their manufacturing sectors. However, the most notable surprise was the sharp decline in services PMI to 48.9, marking its first dip into contraction this year. This was primarily driven by Germany, while France saw little change. Tariff-related uncertainty appears to be filtering through multiple sectors, weighing on sentiment and activity across the region. Trade tensions between US and Europe has returned again. Through a Truth Social post on Friday, Trump claimed trade talks with the EU are going nowhere, and once again repeated that the sole purpose of the European Union was "to take advantage of the US on trade."

Germany released the IFO Survey, showing a modest uptick in Business Climate, up to 87.5 in May from the 86.9 posted in April. Expectations improved to 88.9, although the assessment of the current situation missed expectations and printed at 86.1. Additionally, ECB President Christine Lagarde hit the wires on Friday and warned international trade will be "changed forever" by trade-related tensions triggered by the US decision to impose tariffs on most major trading partners

GBP

GBP/USD climbed above $1.35 level for the first time since February 2022, lifted by upbeat economic data and weak US currency.

In the UK, the May composite PMI also remained in contraction even as it rose to 49.4, from 48.5 in April. The Mfg. PMI unexpectedly fell to 45.1 while services PMIs rose more than expected to 50.2, moving back into expansion after April's decline. Overall, while there are some signs of resilience, sluggish sentiment across key sectors along with policy uncertainty suggests that the broader recovery remains tentative, even after a solid start for the U.K. at the beginning of the year.

On the price front, data was mixed. U.K. April CPI inflation beat expectations when it quickened to 3.3% y/y, the actual figure came in higher at 3.5%. Core and services inflation also ticked higher to 3.8% and 5.4%, respectively. These increases were largely driven by seasonal factors around the Easter holiday, as well as one-off effects such as the rise in employer national insurance contributions and minimum wage increases announced in the latest budget. A closer look at the data shows large increases in energy prices as the electricity price cap was raised, as well as an outsized increase in water prices. Housing and transport costs also contributed the quickening of inflation. Meanwhile, consumer confidence rebounded in May, with households showing greater optimism about personal finances and a higher willingness to spend on large purchases. Adding to the positive mood, Ofgem announced a 7% cut to the energy price cap starting in July, easing household pressure after multiple previous increases. Still, inflation remains sticky, climbing to 3.5% in April, above forecasts. Markets are pricing in a 50% chance of a Bank of England rate cut by August and possibly another by year-end. Read with the solid GDP data released last week, the inflation figures are consistent with the BoE remaining cautious with the pace of monetary easing.

JPY

Main driver for the USDJPY has been the up move in the Japanese Government bond yields. The 30 Year JGB yield jumped above 3% for the first time in 30 years. The yield on Japan's benchmark 10-year bond rose by 5.5 basis points to 1.57%, its highest level since March 28. Super-long bonds also saw strong upward movement, with the 20-year yield climbing to 2.595% and the 30-year yield touching 3.17%, indicating growing pressure on the long end of the yield curve.

Further stress came from weak demand at the 20-year bond auction, which saw reduced investor appetite, pushing yields on the 20-, 30-, and 40-year JGBs up by 15–17 basis points. Political uncertainty has also added to the volatility. Japan's Prime Minister commented on the fiscal situation being worse than that of Greece at the height of the European crisis makes the situation trickier." Such remarks have intensified investor concerns, triggering a sell-off in longer-term Japanese bonds.

Coming to the USDJPY, investors are forced to repatriate investments from the US treasuries, sending the US Yields higher.

Meanwhile, data from US showed Japan's April CPI surprised on the upside. Both headline inflation and CPI less fresh food came in at 3.6% and 3.5%, respectively. The uptick was largely fueled by elevated food and energy prices, with rice prices soaring by 98.4% year-over-year.

Meanwhile, tensions also arose between the US and Japan, as the latter is unwilling to fulfil US demands. Furthermore, the Japanese government made it clear that there is no use for an agreement unless Washington eliminates tariffs, particularly a 25% levy on autos and car parts. Talks seem to have stalled after Japan's top trade negotiator Ryosei Akazawa noted Japan will not rush to seal a trade deal if that puts the country's interests at risk.

CRUDE OIL:

Crude oil prices closed lower last week on worries about hitches in trade talks and worries about demand. WTI Crude futures ended about 1.46% while Brent Crude futures ended about 0.7% lower, despite the driving season beginning next week. Markets are closely tracking the development on the nuclear talks between the US and Iran. US has threatened to freeze crude oil exports from Iran.

WEEK AHEAD

This week calendar is shortened by the Memorial Day holiday on Monday. The macroeconomic calendar will include some interesting events in the upcoming days. The US Federal Open Market Committee (FOMC) will release the Minutes of the latest meeting on Wednesday, while a revision of the US Q1 Gross Domestic Product (GDP) will be out on Thursday.

The focus will shift to Germany on Friday, as the country will release April Retail Sales and the preliminary estimate of the May Harmonized Index of Consumer Prices (HICP). Also on Friday, the US will publish April Personal Consumption Expenditures (PCE) Price Index figures, the Federal Reserve's (Fed) favorite inflation gauge.

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MARKETS LAST WEEK			
	Clsng as per 23-05-25	Clsng as per 16-05-25	Change
Mibor 3M	5.73	5.78	-0.05
Mibor 6M	5.62	5.7	-0.08
Swap 1 Y	5.59	5.63	-0.04
G-sec 1 Y Yield	5.841	5.892	-0.05
G-sec 10Y Yield	6.222	6.316	-0.09
US 2Y Yield	3.999	3.991	0.01
US 10Y Yield	4.507	4.443	0.06
Ger 10Y Yield	3.989	2.598	1.39
Jap 10Y Yield	1.523	1.448	0.08
Gold	3357.51	3203.65	153.86
Silver	33.48	32.29	1.19
Brent Crude	64.78	65.41	-0.63
WTI Crude	61.58	62.49	-0.91
Nifty 50	24853.15	25019.8	-166.65
BSE Sensex	81721.08	82330.19	-609.11
DXY	99.11	101.09	-1.98

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