

Currency Outlook

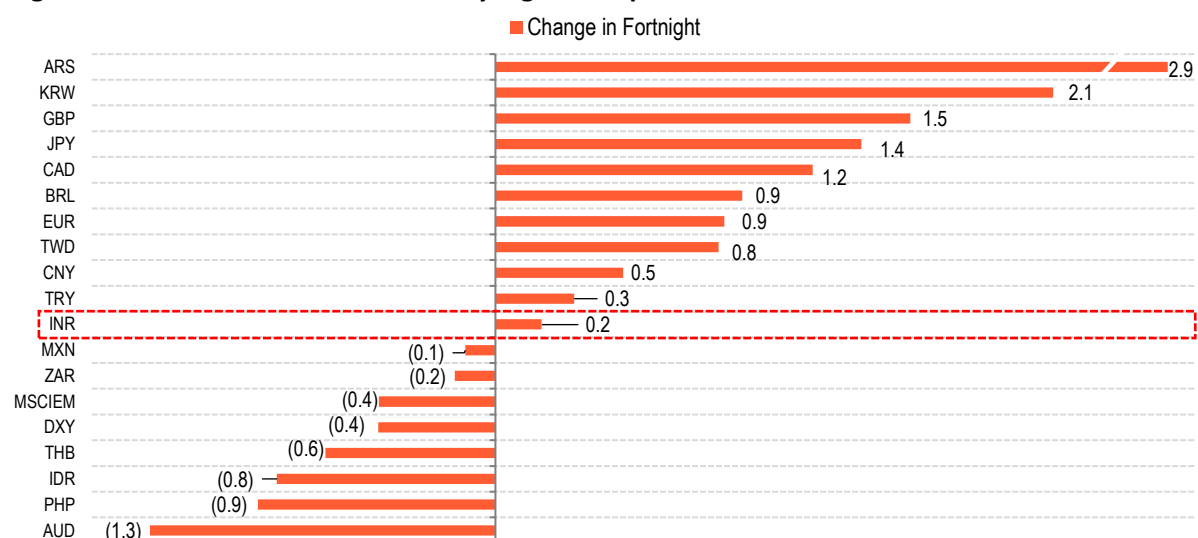
INR is likely to remain range-bound

Global economy was once again beginning to stare at the possibility of economic slowdown as fears re-emerged over the possibility of economic recession in US owing to another banking crisis. US officials are already in talks of providing a possible FDIC receivership to First Republic. A lot is at stake for Fed now, as it considers the next rate action given the stubbornly high inflation, elevated wage growth, credit crunch scenario and uncertainty in global growth. Amidst these developments, DXY weakened by 0.4% in last fortnight. Rupee has relatively performed better than the Asian peers and is expected to trade in the range of 81.5-82.25/\$ in the next fortnight. Markets will now wait Fed's and ECB's rate decision next week.

Movement in global currencies

Global currencies continued to garner strength against the dollar. The weakness in DXY was evident as it declined by 0.4% amidst the macro developments surrounding US market. A weaker than anticipated growth in the US economy kept the investors on the edge. The annualized GDP for Q1CY24 was noted at 1.1% against a growth of 2.6% in the last quarter. The moderation was led by slowdown in non-residential fixed investment and private inventory investment. Moreover, core PCE price index, Fed's preferred gauge of tracking inflation remained elevated at 4.6% in Mar'23 (4.7% in Feb'23). Separately, labor market remains tight with jobless claims declining by 16,000 to 2,30,000 against the expectation of 2,48,000 for the week (ending 22-April). Amidst these developments, analysts have priced in 88% likelihood of Fed raising rates by 25bps and might signal for a pause to one of the most aggressive rate hike policy since 1980s.

Figure 1: Global currencies were mostly higher in Apr'23



Source: Bloomberg, Bank of Baroda Research, Data as of 28 Apr 2023 | Note: Figures in bracket denote depreciation against USD

Most of the global currencies registered gains against the dollar with Korean won (2.7%), GBP (1.5%) and Europe (0.9%) contributing the most. For the 7th time in a row, ECB will lift rates in the forthcoming meet with markets anticipating rate hike converging to 25bps hike instead of 50bps increase. These expectations are based on conflicting signs emerging from the economy, with Euro zone escaping recession and expanding by 0.1% (quarterly basis) in Q1CY24 with advance seen across France, Italy and Spain. The growth was boosted by strong export sales in these regions and offsetting subdued household demand. However, growth stagnation in Germany remained a concern. Eurozone inflation eased to 6.9% in Mar'23 (8.5% in Feb'23, yearly basis) and remains way above the ECB's mandate.

Japanese yen climbed up by 1.4%. BoJ policymakers unanimously agreed to continue with the ultra-low interest rates in line with expectation and maintained status quo on yield curve control (YCC) policy. Even as Japan's inflation remains above the BoJ's target range of 2% (Mar'23: 3.2% vs 3.3% in Feb'23), the Governor noted the inflationary pressure are more of transitory in nature and driven by cost-push.

INR appreciated by 0.2% in the last fortnight (up to 28 Apr 2023) and for the month, it has appreciated by 0.4%. Apart from dollar weakness, FPI inflow and lower oil prices can explain the strength in INR.

Outlook for INR

Global markets turned cautious once again amidst renewed concerns of banking crisis looming for the second time in the last 2-months along with the debt ceiling standoff in the US. Additionally, other major data releases including US GDP, PCE, jobless claims and employment cost index is expected to strengthen the case for a rate hike by Fed as inflation pressure remains stubbornly high. With this, the federal fund rate will be in the range of 5%-5.25%, thus making the credit crunch, a more realistic situation. Crude oil prices declined for the second straight week amidst uncertainty and subdued economic data print from US, thereby weighing in on the demand outlook. Lower oil prices are positive for INR. India's forex reserves declined marginally by US\$ 2.2bn to US\$ 584.3bn as of 28 Apr 2022 (from 586.4bn last week). RBI intervention in order to support rupee due to ongoing macro developments have resulted in the dip in forex kitty.

The domestic currency is bolstered by improvement in external outlook, FPI flows in green and support from lower crude prices. Overall, we expect a range of 81.5-82.25/\$ in the next fortnight.

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