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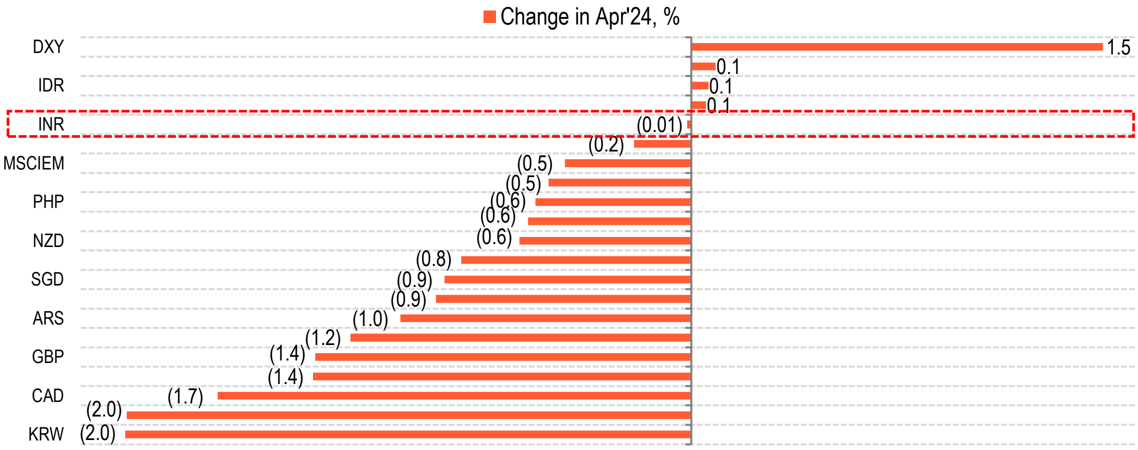
Currency update

In Apr'24 so far, INR has depreciated marginally. Most global currencies were under pressure as dollar strength resurfaced led by diminished possibility of a Fed rate cut in Jun'24. Even so, the performance of INR was much better relative to other peers, given that India's macro fundamentals remain fairly robust. Robust FPI inflows in both equity and debt segment further supported INR. However, risk to INR outlook stem from an escalation of tensions between Iran and Israel which can push oil prices higher as well as a further pushback in Fed's anticipated rate cut cycle. We expect INR to trade within a range of 83.40-83.50/$ in the next fortnight, in the absence of any fresh shocks. For the year, we remain positive on INR and foresee a range of 82.5-83.5/$.

Movement in global currencies in Apr'24

Major global currencies were weaker against the dollar in Apr'24. DXY index, which is a proxy for dollar, surged by 1.5% in Apr'24. The rally in the dollar was brought about by a belief that the Fed rate cut cycle, which was widely expected to start from Jun'24, is likely to be delayed. The same was reaffirmed by macro data from the US which showed continued stickiness in US inflation. CPI inflation in the US accelerated to 3.5% in Mar'24, from 3.2% in Feb'24. On the other hand, labor market conditions were also buoyant. Additions to non-farm payrolls was much higher than expected at 303,000 in Mar'24 (est. 200,000), with wage growth remaining largely steady at over 4%. Several Fed officials also alluded to the possibility of lower quantum of rate cuts in 2024, even as the Fed dot plot had predicted the possibility of 3 rate cuts this year. Increased tensions in the Middle-East have further fueled the demand for dollar due to its safe-haven appeal.

Figure 1: Movement in global currencies in Apr'24



Source: Bloomberg, Bank of Baroda Research | Note: Data as of 12 Apr 2024 | Figures in brackets indicate depreciation against the dollar

Most global currencies were lower, weighed down by the resurgence in dollar strength. EUR depreciated by 1.4% as ECB indicated that rate cuts are likely to start by Jun'24. Easing inflation in the region supports this view. EM currencies were under pressure with the MSCI EM currency index falling by 0.5%.

Performance of rupee

INR depreciated by a modest 0.01% or 1paise, even though it touched a life-time low of 83.45/$ during the period. However, the depreciation in INR was much lower than the median depreciation of 0.9% in the sample of the above currencies. The trading range was 83.15/$-83.45/$, with annualized daily volatility at 2.2% compared with 1.7% in the last month.

Outlook

Despite strong fundamentals, an adverse global environment weighed on INR pushing it towards a record low. Going ahead, two key factors will shape the trajectory of INR. First, the timing and magnitude of Fed rate cuts. The possibility of a rate cut in H1 CY2024 has been effectively ruled out, which is fueling the current rally in dollar. The Fed is likely to err on the side of caution and wait for a meaningful slowdown in the economy before cutting rates, thus supporting the higher for longer narrative. Even if Fed rate cuts start in H2, the possibility of smaller rate cuts seems most likely. This suggests that the dollar strength is unlikely to abate in the near-term. Second, the recent conflict in Middle East, if sustained, can have spillover effect on global oil prices. With the global oil supply and demand dynamics already in a precarious position, the recent conflict has the potential to throw it into disarray. A sustained increase in global oil prices will translate into a higher import bill for India, pushing the trade deficit higher. So far, the impact on this front has been muted with brent oil prices trading virtually unchanged at ~ US$ 90/bbl. However, if oil prices were to increase to US$ 100/bbl, increased volatility in the exchange rate cannot be ruled out.

On the positive side, India's strong external position will continue to underpin the strength in INR. With a lower merchandise trade deficit in FY24, robust services and remittances receipts and buoyant FPI inflows, rupee has a lot going in its favor. RBI's strong external buffers currently standing at a record-high of US$ 649bn should support INR in case there is any intermittent pressure on the currency.

We hence expect INR to trade in a range of 83.40-83.50/$ in the fortnight. Over the medium-term, we continue to believe that the INR is likely to trade with an appreciating bias.

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