

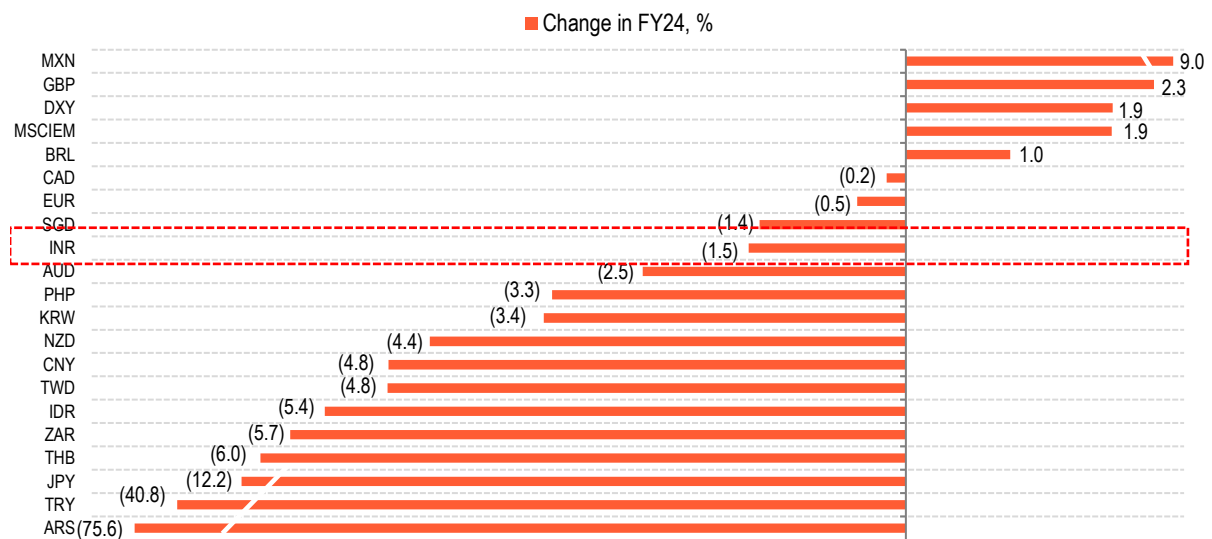
Currency update

INR depreciated by 0.6% in Mar'24, reversing the gains it made in the last 3-months. With this, the INR ended FY24 1.5% lower. This was much better than last year when it had depreciated by 7.8%. A favorable domestic as well as global landscape along with efficient management by the RBI, ensured that the depreciation in INR was much more orderly. With Fed rate cuts expected to begin from Jun'24, dollar strength is likely to wane, which would be a tailwind for INR. This along with robust foreign inflows and comfortable trade deficits will ensure that INR trades with an appreciating bias in FY25. We expect INR to trade in a narrow range of 82.50-83.50/\$. At a record US\$ 642.6bn, RBI's foreign exchange reserves are more than enough to cushion the rupee against any volatility.

How did INR perform vis-à-vis other global currencies in FY24?

INR ended FY24 lower by 1.5%, after depreciating by 7.8% in FY23. It must be noted that in the same period, DXY has strengthened by 1.9%. Hence, a stronger dollar can explain much of the decline in the rupee. In fact, a stronger dollar has weighed on almost all major currencies in FY24. Almost all major EM currencies have depreciated against the dollar, with currencies such as Turkish Lira (TRY) and Argentinian Peso (ARS) depreciating sharply. While there were country specific idiosyncratic factors at play, a stronger dollar did weigh on most EM currencies.

Figure 1: Movement in global currencies in FY24



Source: Bloomberg, Bank of Baroda Research | Note: Data as of 29 Mar 2024 | Figures in brackets indicate depreciation against the dollar

When compared with other major global currencies, INR has performed better. The median depreciation in the above basket of currencies was 4.6%, which was much higher than the depreciation seen in INR. On the other hand, currencies such as CNY and JPY have depreciated more than the median depreciation.

What can explain the rupee's over performance?

A combination of robust macro fundamentals, along with comfortable external position and benevolent global backdrop kept INR mostly range bound in FY24. Year-end dollar demand and weakness in Chinese Yuan lead to heightened volatility in USD/INR pushing it to a record close in the last few days of FY24. Before Mar'24, INR had appreciated steadily for the last 3 months. Apart from a lower trade deficit and robust foreign inflows, prospects of a Fed rate cut, and lower oil prices also supported the INR. Apart from this, RBI's effective intervention in the foreign exchange market also ensured that volatility in the exchange rate remained contained.

Going ahead, we expect INR to trade with an appreciating bias. This is because:

- India's GDP growth is expected to maintain momentum next year as well, which will continue to draw foreign investors to India.
- In terms of India's external position, the situation is quite comfortable.
- Robust services inflows and a recovery in demand in key markets will ensure that exports pick up, keeping the trade deficit in check.
- We expect CAD in the range of 1.2-1.5% of GDP in FY25.
- This is likely to be funded by a robust surplus on account of foreign inflows. FPI inflows are likely to see a further pickup in coming months as India gets included in global indices. FDI and ECB too will pick up as the global rate cycle reverses.
- This suggests that the balance of payments is likely to remain in a surplus even in FY25.

Also, the global economic landscape will favor a stronger rupee. Global rates are headed lower, with the Fed likely to be leading the way. Fed rate cuts are imminent, with the first rate cut being priced-in in Jun'24. This is likely to be followed by two more rate cuts in 2024. Hence the relative attractiveness of the dollar is likely to diminish. This will benefit the INR.

We hence expect INR to trade in a range of 82.50-83.50/\$ in FY25.

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