

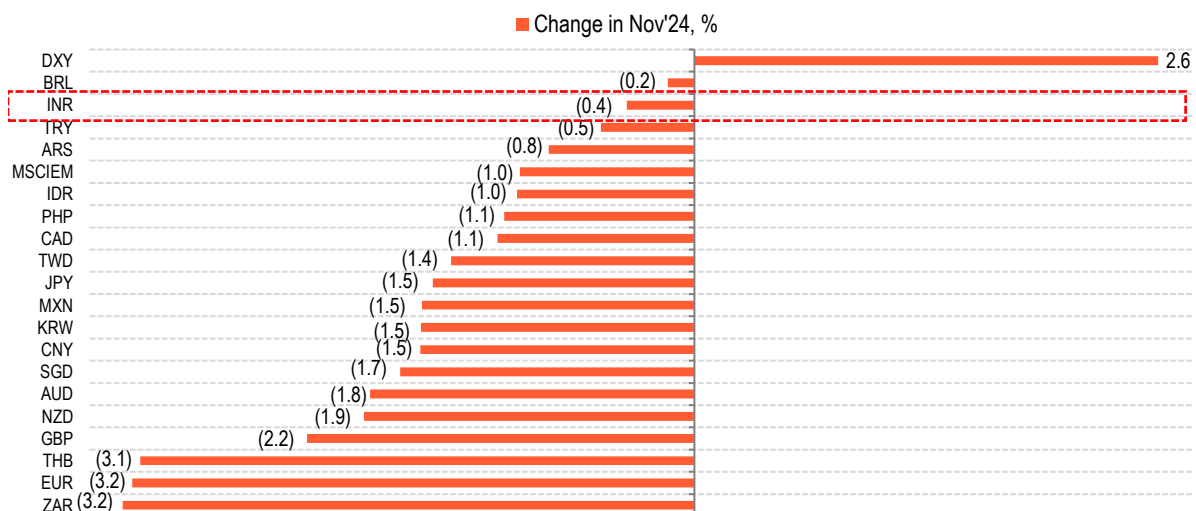
Currency update

INR has remained under pressure and traded near a record low for most of the sessions in Nov'24. It depreciated by 0.4% in the month so far, building up on a 0.3% depreciation in Oct'24. A stronger dollar has been the major reason behind the continued pressure on the domestic currency. The dollar has strengthened after the US election results, with the proposed policies of the incoming President being viewed as inflationary. This in turn has diminished expectations of future rate cuts, boosting the value of dollar. All major currencies globally have been hit hard. In this respect, INR has been an outperformer as the extent of depreciation has been limited. We believe that the depreciation in domestic currency reflects the volatility in global financial system and should not necessarily be viewed as negative. A weaker currency, particularly at a time when CNY is also depreciating will help in maintaining the country's export competitiveness. We expect the currency to trade in the range of 84-84.5/\$ in the near-term. Over a longer horizon, we expect the currency to anchor around 83.5-84/\$.

Movement in global currencies in Nov'24

Global currencies continued to depreciate even in Nov'24, as the dollar raced ahead. DXY index, which measures the dollar's value against a basket of currencies rose by 2.6% in Nov'24, after climbing 3.2% in Oct'24. With this, the index is now at its highest level since last November. A win for the Republican nominee Donald Trump in the US Presidential elections has led to expectations of higher growth and inflation in the US. Proposed policies by the incoming President, including tariff policies and fiscal policies, are deemed to be positive for growth, while also proving to be inflationary in the medium to long term. This complicates the job for the Fed, which has reduced rates by a cumulative 75bps in the current easing cycle. Given the Fed's recent experience with taming inflation, it is likely that it will take a more cautious approach this time around. Hence, there is a growing belief that the Fed rate cut cycle might end prematurely than what was believed before the election results. This has resulted in a surge in US treasury yields and consequently the dollar.

Figure 1: Movement in global currencies in Nov'24



Source: Bloomberg, Bank of Baroda Research | Note: Data as of 15 Nov 2024 | Figures in brackets indicate depreciation against the dollar

Global currencies depreciated in the range of 3.2% to 0.2% against the dollar in Nov'24. The performance was evenly spread across both EM as well as Advanced currencies. EUR and GBP depreciated by 3.2% and 2.2% respectively. EM currencies depreciated by 1%, even as a few currencies such as ZAR and THB depreciated by over 3%.

Performance of rupee

While INR touched multiple record-lows in the last few trading sessions, its relative performance when viewed in comparison to its other peers has been stronger. Compared with a median depreciation on 1.5% in the sample of 20 currencies, INR depreciated by only 0.4%. This is particularly significant given that this period was marked by a sharp surge in DXY as well as continued FPI outflows. The FPI outflows are concentrated largely in the equity segment with weak corporate results driving the exodus. However, we believe that the moderation in corporate profitability is cyclical in nature and can be attributed to base normalization after a sustained period of double-digit profit growth. Further, FPIs continue to remain net buyers in the domestic market in FY25, with inflows of about US\$ 7bn (upto 14 Nov 2024).

Outlook

Indian rupee is likely to remain under pressure in the near-term. This is due to two inter-related factors-FPI outflows and dollar strength. We expect INR to trade in the range of 84-84.5/\$ in the near-term. Over the medium to long-term, we remain positive on the rupee. Capital flight from the domestic market is not unheard of historically. However, this time India is in a much better shape to deal with the situation. India's external and fiscal deficit remain largely in check, and growth remains on a strong footing. RBI has built a robust buffer of over US\$ 675bn, which is likely to be used judiciously by the central bank to defend the domestic currency. Overall, given India's robust macro fundamentals, the recent bout of FPI outflows is likely to be only temporary. For FY25, we expect FPI inflows to be positive at US\$ 20-25bn in FY25. Further, India's trade deficit in Oct'24 also inched up. However, buoyant services and remittances receipts are likely to keep CAD contained.

The sudden capital flight from EM markets appears to be a knee-jerk reaction to repricing of Fed rate cut cycle and the re-election of Donald Trump. This is likely to reverse as investors readjust their expectations amid more clarity on US fiscal as well as monetary policy. EM markets continue to be attractive for investors seeking higher returns. India's growth fundamentals remain on a strong footing with GDP growth expected to be above 7% even by a conservative estimate. This makes India a significantly more attractive option for foreign investors over a long-term horizon which bodes well for the rupee.

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For further details about this publication, please contact:

Economics Research Department
Bank of Baroda
chief.economist@bankofbaroda.com