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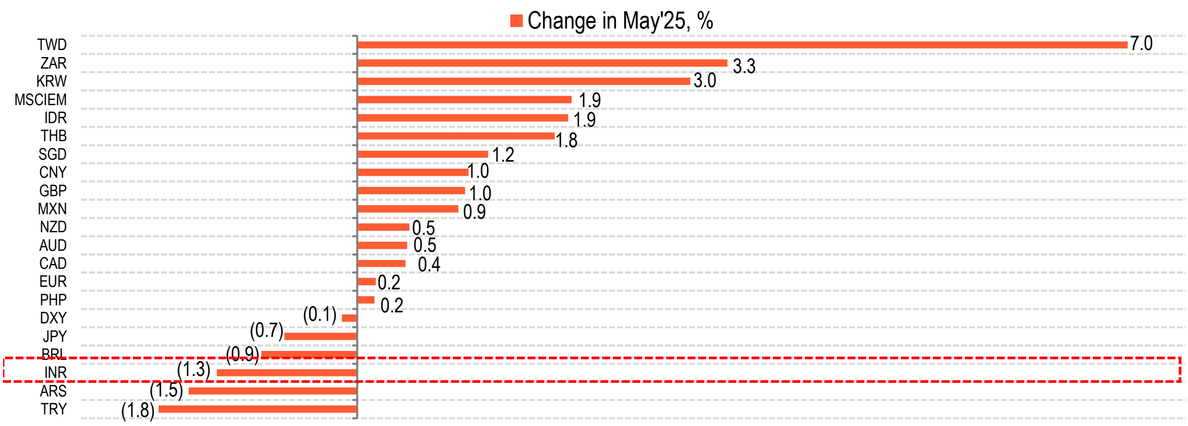
Currency update

In a turnaround of events, INR depreciated by (-) 1.3% in May'25, after appreciating by 1.1% in Apr'25, and 2.4% in Mar'25. Less sharp decline in the US dollar (-0.1%) due to revival in global trade tensions, and escalated geo-political tensions between India and Pakistan during early May'25, impacted INR's rally. INR fell by (-) 1.2% in the first fortnight of May'25, before stabilizing in the second fortnight (0%). Weak economic data (consumption demand, impact of tariffs on growth, labour market slowdown) from the US in the second fortnight of May'25 led to US$ falling by 1.5% in that period, erasing gains (1.4%) made in the first fortnight. Losses in INR were contained by lower oil prices and FPI inflows. Going forward, as trade tension are expected to escalate in the coming weeks, pressure on INR will remain. However, strong domestic fundamentals (GDP growth, inflation, and monsoon), lower international oil prices will help limit the losses. We expect INR to trade with a depreciating bias in the near-term in the range of 85-86/$.

Movement in global currencies:

Global currencies continued to appreciate against the dollar in May'25. DXY fell only marginally by (-) 0.1% last month, following (-) 4.6% decline in Apr'25. It depreciated mainly in the second fortnight of May'25 (-1.5%), following strong gains (1.4%) made in the first fortnight. US BEA data re-confirmed that GDP (QoQ basis) contracted in Q1CY25, by (-) 0.2% versus (-) 0.3% as per advance estimates. Upward revision to gross private domestic investment (24.4% versus 21.9%), was offset was downward revisions to domestic consumption (1.2% versus 1.8%) and net trade. This is reflective of the economic cost of US' tariff policies. Consumption growth has hit the lowest level since Q2CY23, while net contribution of trade to % change in Real GDP was more negative than previously expected. Softening inflation growth—core PCE down to 2.5% in Apr'25 versus 2.7% in Mar'25; and muted consumer sentiment has also led investors to believe that Fed will lower rates by 2-3 times this year, beginning from Sep'25. Further supporting this argument is slowdown seen in the labour market. The 4-week moving average of continuing jobless claims has risen to 1.89mn as of week ending 29 May 2025—highest level since Nov'21. From a peak of ~110, the DXY has fallen by 9.7% in May'25.

Figure 1: Movement in global currencies in May'25



Source: Bloomberg, Bank of Baroda Research | Note: Data as of 30 May 2025 | Figures in brackets denote depreciation against the dollar

Amongst the currencies which gained the most at the cost of the dollar were EM currencies. In particular, Taiwanese dollar, South African Rand, Korean Won, Indonesian Rupiah, Thai Baht and MSCI EM index appreciated more than the median level gain (1%) recorded in May'25. GBP and CNY also made notable gains, while other DM currencies such as EUR, CAD, AUD and NZD rose less sharply. UK-US trade deal and initial truce between US and China supported their respective currencies. However, more recently Trump administration has announced escalation in tariffs on steel and aluminium imports from 4 Jun 2025, and trade tensions with China have also resurfaced, implying revival in pressure on global currencies going forward.

INR performance:

INR depreciated by (-) 1.3% in May'25, after appreciating by 1.1% in Apr'25 and by 2.4% in Mar'25. Pressure on domestic currency was higher than usual in May'25, as the median deprecation in the sample of 6 currencies was (-) 1.1%. The currencies which fell by more than INR were Argentine Peso (-1.5%) and Turkish Lira (-1.8%). In the previous two months, rally in INR was supported by change in RBI's forex strategy, lower oil prices, sharp decline in US$, and moderating domestic inflation. In May'25, while domestic fundamental still remain resilient, revival in global trade uncertainties has again led to relative strengthening of the dollar. A small decline in the DXY index in May'25 (-0.1%), less sharp fall in average international oil prices (-3.7% versus -7% in Apr'25), and elevated geo-political tensions between India and Pakistan, exerted pressure on the domestic currency. Losses were limited by notable foreign fund inflows in May'25 at US$ 3.64bn versus outflows of US$ 2.34bn in Apr'25.

Outlook:

Given renewed global trade tensions, outlook for INR has risks attached to it. While on the positive side, domestic fundamentals remain strong—driven by sustained GDP growth, cooling inflation and prediction of normal monsoon, which is critical for agriculture and rural growth. However, externally, trade tensions have resurfaced. Trump administration has raised the tariffs on steel and aluminium imports to 50% from 25% earlier, starting from 4 June 2025. This will not only hurt Indian exports, but also growth in major economies like China, Japan and Eurozone. Also, trade tensions between US and China and have again escalated, which will lead to higher demand for safe haven currencies like the US$ and Japanese Yen. FPI inflows may also get impacted. This in turn will add pressure on EM currencies, including INR. In contrast, lower oil prices will help limit the losses. Overall, we expect that the INR is likely to trade with a depreciating bias, in the range of 85-86/$ in the near term.

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