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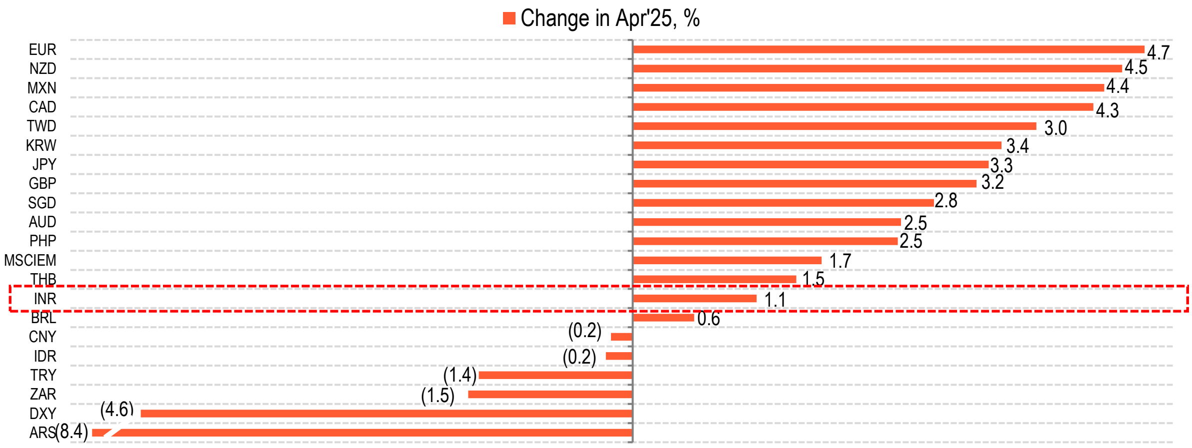
Currency update

INR appreciated further by 1.1% in Apr'25, after appreciating by 2.4% in Mar'25. A sharp decline in the dollar due to a weakening economic outlook and lower global oil prices supported the gain in INR. Equity inflows turned positive in Apr'25 after a gap of 3-months signalling an improvement in investor sentiment. A softer US stance on tariffs has supported an improvement in investor sentiment. US officials have indicated that significant progress has been made on trade negotiations with its trading partners, which is likely to lift investor sentiments. Hence, EM assets could see a gradual recovery in foreign inflows. Given India's strong macro fundamentals and growth prospects, India remains an attractive bet for investors. This along with stable domestic macros and stable external position are likely to provide further support to the INR. We expect INR to trade with an appreciating bias in the near-term in the range of 84-85/$. However, escalation in US-China trade relations poses a significant risk to our view.

Movement in global currencies:

Continuing a trend seen in Mar'25, global currencies appreciated against the dollar in Apr'25. DXY nursed its losses as it fell by another 4.6%. This is interesting since the US$ started the year on a strong note amidst uncertainty over US policies, and found further support from President Trump's nation first policies, most notably the Liberation Day tariff announcements. At the same time, there were growing apprehensions about the economic cost of these policies, with macro indicators signalling a loss in economic momentum. Recent macro data from the US has lent credibility to the fact that businesses and consumers are both affected by the new policies unveiled by the government which has weighed on the dollar. US GDP growth declined in Q1 CY 2025, manufacturing activity contracted, consumer confidence fell, trade deficit rose to a record and job market weakened. As a result, market participants have increased bets of a recession in the US. From a peak of ~109, the DXY has fallen by as much as 9% in Apr'25.

Figure 1: Movement in global currencies in Apr'25



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

Global currencies have gained at the cost of the dollar, with the EUR being the most notable winner. In Apr'25, EUR appreciated by 4.7%, briefly touching its highest level since Nov'21. Expectations of more monetary and fiscal support have lifted the growth prospects of the region. In fact, at 0.4% in Q1, Euro Zone's GDP growth exceeded expectations by a huge margin. Amongst other major currencies, both JPY and GBP rose by 3.3% and 3.2% respectively. EM currencies were also 1.5% higher, with the MXN and TWD being the outperformers. However, CNY depreciated by 0.2% awaiting clarity on US-China trade negotiations.

INR performance:

INR appreciated by 1.1% in Apr'25, building up on a 2.4% gain made last month. However, compared with a median appreciation of 3.2% in the sample of 15 currencies, INR's gain appears to be muted. At 84.50/$, INR closed Apr'25 at a more than 4-month high, erasing almost of its losses of the year. In fact, INR appreciation in the last two months has been remarkable and quite sharp partially reflecting a change in RBI's forex strategy. This can be gauged from the annualised daily volatility which rose sharply to 6.6% last month, compared with 3.7% in Mar'25 and just a little over 1% for much of 2024, INR traded in a wide range of 84.50-86.70/$ in the month. There has been some recovery in foreign inflows in the country, particularly in the equity segment. But, this cannot on its own explain the rupee's appreciation. A combination of interlinked factors including a weak dollar, lower oil prices, stable external deficit, moderating domestic inflation, and an improving domestic growth outlook all have played a part in the rupee's improving fortunes.

Outlook:

The outlook for INR has turned more positive than our expectations last month.

- A slowdown in US growth will exert further pressure on DXY. This will also put pressure on the Fed to cut rates, which will keep the rate differential intact.
- There are other factors at play as well.
    - Tariff related uncertainty is likely to return as we approach the 90-day pause deadline. However, US has signalled an increasingly softer stance on its tariff policies. With the US in advance stages of trade negotiations with its trading partners, the possibility of an all-out global trade war has largely reduced which bodes well for global demand and hence India's exports. Apart from this, there is a growing belief that a US-India trade deal is likely to be finalised before the end of the year which will give India further insulation from any tariff related shocks. In fact, US tariffs are increasingly being viewed as positive for India, providing opportunities for India's exporters from increased trade diversification and rejig in global value chains.
    - On the other side as well, lower global commodity prices, especially oil, will benefit India by lowering the overall import bill.
    - India's services exports can face some headwinds from weakening growth momentum in the US, however, the impact is unlikely to be significant.

Overall, this means that India's external position will remain comfortable in FY26 as well, with the CAD remaining at comfortable levels. Further support for the currency can also come from a recovery in FPI inflows as investors return to EM assets in a controlled and gradual manner. Overall, a mix of favourable external and domestic factor suggest that the INR is likely to trade with an appreciating bias. We expect a range of 84-85/$ in the near term. Key risks include and escalation in US-China trade war, which can have ramifications for the entire world economic order and global financial system.

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