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Currency update

In May'24, INR has traded in the range of 83.10/\$-83.53/\$. The impending elections outcome and expectations of Fed commentary impacted currency movements. The key focus remains on crude price movements which will be supplemented by debt inflows. Given the strong external fundamentals and unchanged stance from the Fed we expect INR to trade in the range of 83.0-83.50/\$, with an appreciating bias for the year.

Movement in global currencies in May'24

Major global currencies strengthened against the dollar in May'24. This was supported by the weakness in DXY which was down by 1.5% after surging by 1.7% in Apr'24. The dollar index has declined on the back of the weaker than expected economic data. Recently, GDP data for Q1CY24 has been revised downwards from the previous estimate of 1.6% to 1.3% on account of slower pace of growth in consumer spending. Next, the PCE data which is the preferred gauge by Fed to monitor inflation (target of 2%), climbed up at similar pace in Apr'24 as it did last month at 2.7% and in line with expectations. On a MoM basis, PCE remained steady at 0.3% for both Apr'24 and May'24, while core data moderated down to 0.2% against 0.3% in Apr'24.

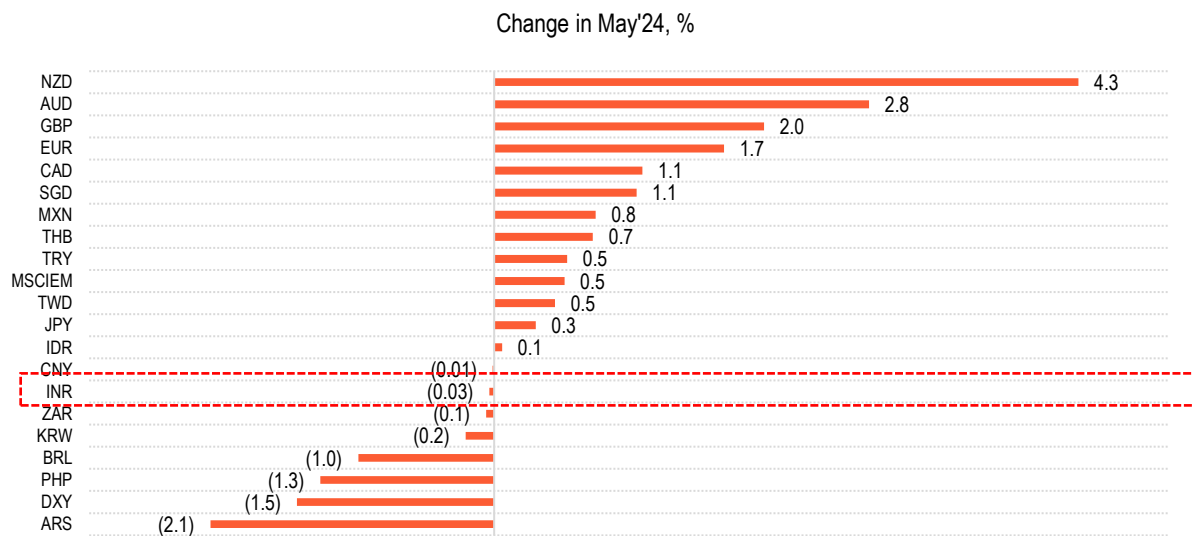
On the other hand, consumer spending inched up at a moderate pace of 0.2% from 0.7% in Mar'24. The inflation reading is tracking sideways and is giving mixed signals. Against these data prints, Fed might have to dial back on the expectation of monetary easing and push the rhetoric of higher for longer through the summer, which seems to be a more likable proposition. Fed officials also in their recent commentary highlighted they don't see the 'urgency or need to make a decision now'.

There is an expectation of a 25bps rate cut this year with 55% chance of a first rate cut in Sep'24, which will be final policy before the US election, scheduled in Nov'24. The Fed has kept the policy rates steady for the last 10 months and they are expected to carefully track inflation for more time before lowering the borrowing costs, given sticky inflation and lowest space of jobs gain in the last 6-months. Furthermore, Fed's Beige book noted the economic activity in the US continued to expand at modest pace during the Apr-Mid May period. On the labor market front, the jobless claims inched up to 219,000 in the preceding week.

Performance of rupee

In May'24, INR depreciated by 0.03% despite most of the global currencies gained against the dollar. The weakness was on account of lower average oil prices and midst sharp FPI outflows of more than US\$ 2bn ahead of the General Election result and. The trading range was 83.10/\$-83.53/\$, with annualized daily volatility at 1.5% compared with 1.6% in the last month.

Figure 1: Movement in global currencies in Apr'24



Source: Bloomberg, Bank of Baroda Research | Note: Data as of 31 May 2024 | Figures in brackets indicate depreciation against the dollar

Outlook

The inclusion of Indian government bonds in global indices will commence from June onwards and the resultant flows would be of interest. Given stable economic fundamentals, lower inflation, strong external position including FPI flows, the rupee will be range bound in June and trade in a range of 83.0-83.50/\$ 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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