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FIRST LIGHT

03 March 2022

RESEARCH

BOB Economics Research | Monthly Economic Buffet

Economic Wrap – February 2022

BOB Economics Research | Currency Outlook

INR to trade at ~76/$ in Mar'22

SUMMARY

India Economics: Monthly Economic Buffet

Last month saw multiple economic and political developments at domestic and global levels. On the domestic front, both fiscal and monetary policies focused on providing support to durable economic growth. Union Budget announced measures to revitalize investment, and RBI committed to maintaining accommodative policy stance to keep rates low. However, with escalating tensions around Russia-Ukraine war, there is pressure on oil prices, which impacts us in multiple ways.

Click here **for the full report.**

India Economics: Currency Outlook

Risks to the INR outlook have increased due to the Russia-Ukraine crisis and the resulting rise in oil prices. FPI outflows have also intensified as investors have turned risk-averse. We believe the dollar will remain strong, supported by safe-haven appeal and Fed stance. Further, with oil prices now at US$ 110/bbl, INR is likely to be under pressure. We expect INR to trade with a depreciating bias in Mar'22 and average ~76/$. RBI's ample forex reserves should limit any sharp downward moves in INR.

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Daily macro indicators

Indicator	28-Feb	01-Mar	Chg (%)
US 10Y yield (%)	1.83	1.73	(10)
India 10Y yield (%)	6.75	6.77	2
USD/INR	75.29	75.34	(0.1)
Brent Crude (US$/bbl)	101	105	3.9
Dow	33,893	33,295	(1.8)
Hang Seng	22,713	22,762	0.2
Sensex	55,859	56,247	0.7
India FII (US$ mn)	**24-Feb**	**25-Feb**	**Chg ($ mn)**
FII-D	(4.1)	71.4	75.5
FII-E	(888.6)	(589.0)	299.6

Source: Bank of Baroda Economics Research

BOBCAPS Research
researchreport@bobcaps.in

MONTHLY ECONOMIC BUFFET

02 March 2022

Economic Wrap: February 2022

Sonal Badhan
Economist

Last month saw multiple economic and political developments at domestic and global levels. On the domestic front, both fiscal and monetary policies focused on providing support to durable economic growth. Union Budget announced measures to revitalize investment, and RBI committed to maintaining accommodative policy stance to keep rates low. However, with escalating tensions around Russia-Ukraine war, there is pressure on oil prices, which impacts us in multiple ways.

Global tensions: With full scale military attack launched by Russia on Ukraine, global markets (equity/debt/currency) have been rattled. Major global economies (US, UK, European union) have also announced severe punitive sanctions on Russia, in order to deter it from taking further military actions. However, as the war lingers on, international oil prices have seen a significant jump. Prices have risen from US$ 95/bbl on 21 Feb 2022 to US$ 105/bbl as of 1 Mar 2022. This is expected to have considerable impact on the Indian economy on multiple fronts, including: trade, currency, inflation, RBI's policy and government's finances.

Domestic policies: To attain resilient GDP growth, both fiscal and monetary policies have extended support to revitalize the economy. While the Union Budget for 2022-23 was an investment centric budget, RBI also extended support by keeping policy rates unchanged for now. In the budget, specific thrust is given to infra for Rs 7.5 lakh crore, of which 65% is for roads, railways and defence. Measures have also been announced to boost segments like hospitality, housing, telecom, solar power, EVs etc. These measures should also help attract private investment.

Key macro data releases: Latest data shows that India's GDP growth is estimated at 8.9% in FY22 (-6.6% in FY21). For Q3FY22, growth is pegged at 5.4% from 8.5% in Q2FY22. With steady revival and resumption of economic activities post Omicron, we expect Q4FY22 growth between 4.8-5.3%. This will push GDP growth to 9.1% in FY22, higher than government estimates. Trade data also supports this analysis.

India's trade deficit in FYTD22 has surged to US$ 154.8bn from US$ 73.6bn in FYTD21. This has been due to higher imports led by revival in domestic activity and higher commodity prices. Exports too have remained buoyant at US$ 338bn in FYTD22, and are likely to exceed the government's target of US$ 400bn in FY22.

Inflation however remains a key concern, at both retail (CPI) and wholesale (WPI) level. CPI was up at 6% in Jan'22 from 5.7% in Dec'21, led by food inflation (5.4% versus 4%). Also, contrary to our expectations of 11.6% WPI in January, WPI has come in at 13%, which is only slightly lower than last month.

CURRENCY OUTLOOK

02 March 2022

INR to trade at ~76/$ in Mar'22

Risks to the INR outlook have increased due to the Russia-Ukraine crisis and the resulting rise in oil prices. FPI outflows have also intensified as investors have turned risk-averse. We believe the dollar will remain strong, supported by safe-haven appeal and Fed stance. Further, with oil prices now at US$ 110/bbl, INR is likely to be under pressure. We expect INR to trade with a depreciating bias in Mar'22 and average ~76/$. RBI's ample forex reserves should limit any sharp downward moves in INR.

Aditi Gupta
chief.economist@bankofbaroda.com

Global macro backdrop: With military hostilities between Russia and Ukraine showing no signs of slowing down, risks to global growth outlook have risen. Commodity prices are surging higher, global yields have fallen and stocks are in deep red. Higher commodity prices, particularly for oil suggest that inflation is likely to remain high. Further, latest round of sanctions imposed on Russia, many of which relate to the financial system, pose considerable uncertainty to the outlook. It also threatens the nascent recovery in global supply chains, still reeling from the pandemic. Thus, the war, along with the sanctions imposed, impart considerable uncertainty and volatility to the global economic outlook.

Global central banks: While Central Banks in several advanced economies signalled a change in monetary policy stance in the beginning of the year, the Russia-Ukraine conflict is likely to question this rhetoric. As outlined above, risks to global growth have risen, and inflationary pressures have mounted further. It would be crucial to watch how Central Banks respond to this shock. Fed Chair's testimony to the Congress scheduled later, will be key.

Currency movement: DXY remained subdued for most of Feb'22 (1-23 Feb 2022), and was lower by 0.4%. However, since then it has strengthened by about 0.3% amidst safe-haven demand. Even JPY has appreciated by 0.5% due to its appeal as a safe-haven asset. On the other hand, EUR has fallen considerably to its weakest level since Jun'20, due to surging oil prices. GBP too has edged lower. On the other hand, AUD has strengthened by 1.2% buoyed by higher commodity prices. EM currencies have fallen in the aftermath of the crisis and are lower by 0.4% since 24 Feb 2022, mainly reflecting a sharp depreciation in RUB. In fact, RUB has depreciated by 12% since the war broke out, to a record-low, even as Russia's Central Bank rose its key interest rate to 20% from 9.5%.

Outlook: The uncertainty around the crisis has resulted in considerable volatility in the forex markets. Investors have sought comfort in safe-haven assets such as gold, dollar and government bonds. We expect dollar to strengthen in the near-term buoyed by safe-haven demand. Further, despite the uncertain outlook, the Fed is likely to hike rates this year, albeit at a softer pace than earlier anticipated. Nevertheless, Fed is likely to outpace other global Central Banks, particularly the ECB (as risks to Euro Area growth have risen sharply), in the rate hike cycle. This along with the backdrop of tightening global financial liquidity conditions suggest that dollar is likely to perform better than other currencies.

INR movement: After depreciating by 0.4% in Jan'22, INR remained range bound and rose marginally by 0.1% between 1 Feb to 23 Feb 2022. However, higher oil prices as a result of the Russia-Ukraine conflict have led to considerable volatility in the exchange rate. In fact INR depreciated sharply by 1.4% on 24 Feb 2022, as oil prices rose by 2.3% (to US$ 100/bbl) amidst Russia's invasion of Ukraine. Since then, INR has remained fairly stable at ~75.5/$.

However, increase in oil prices (currently at US$ 110/bbl) remain a key risk to INR. Higher oil prices pose a risk to India's external stability as it inflates the trade deficit. Our analysis shows that for every 10% increase in oil prices on a permanent basis, oil

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Note: Recommendation structure changed with effect from 21 June 2021

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