FIRST LIGHT

03 April 2025

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SUMMARY

INDIA ECONOMICS: COMMODITY PRICE TRENDS

In the last financial year (Apr'24-Mar'25), it was interesting to see that while metal prices noted some significant increases, energy prices remained muted and agriculture products showed mixed trends. Edible oil prices increased steeply, but prices of rice and wheat remained low. Amongst major metals, gold rose the most and more sharply in H2FY25 (Oct'24-Mar'25), as US Presidential election results increased global growth uncertainties significantly.

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INDIA ECONOMICS: INR PERFORMANCE

INR depreciated by 2.4% in FY25, after falling by 1.5% in FY24. The depreciation pressure on INR manifested largely after the US elections results, with the domestic currency falling by close to 4% in a span of 4-months. This was also exacerbated by persistent FPI outflows, particularly from the domestic equity markets. Despite this, INR's performance when compared with other global currencies was relatively stable, with a stronger dollar weighing on all major currency pairs. However, towards the end of the year, a reversal in dollar strength and FPI inflows into debt, supported a rally in INR, with the domestic currency recouping as much as 2.4% in a single-month alone.

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INDIA ECONOMICS: POLICY RATE

As another financial year passes by, we assess how the spread of interest rates in India vis-à-vis the US has played out. This becomes crucial in determining the direction of investment flows besides affecting currency movements. In terms of key policy rate, the differential between India and US has widened as US rate cut cycle began much earlier compared with India. The higher quantum of cuts by the Fed has resulted in this differential increasing. On the other hand, the yield differential (reflective of market rates) between India and US has exhibited some bit of deviation compared to policy differential.

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COMMODITY PRICE TRENDS

02 April 2025

Commodity price movement in FY25

Sonal Badhan
Economist

In the last financial year (Apr'24-Mar'25), it was interesting to see that while metal prices noted some significant increases, energy prices remained muted and agriculture products showed mixed trends. Edible oil prices increased steeply, but prices of rice and wheat remained low. Amongst major metals, gold rose the most and more sharply in H2FY25 (Oct'24-Mar'25), as US Presidential election results increased global growth uncertainties significantly.

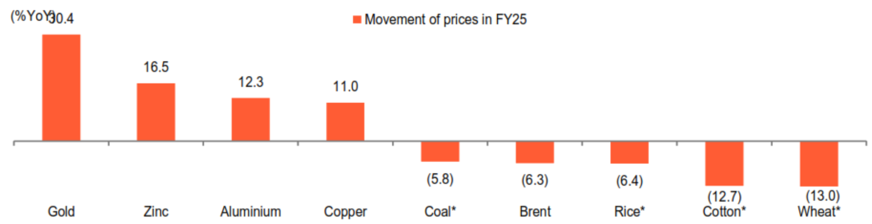
As President Donald Trump made his intentions clear to levy tariffs on US imports, traders front-loaded their demand to evade the initial impact of tariffs, thus leading to higher demand for metals like aluminium, zinc, and copper. However, the increase has remained range bound as China's economy continues to struggle. Gold prices have flourished in the times of increased economic uncertainties.

Agriculture products, particularly oil prices, have been impacted by adverse weather conditions and shift in production towards biodiesel fuels in Indonesia. In contrast, robust production of wheat, rice and cotton led to their prices declining in FY25.

Going forward, as uncertainty regarding the trade war and its impact on economic activity is likely to persist for some time, gold prices are expected to remain elevated. However, other metal prices will note some headwinds in in case demand weakens. Pressure on edible oil production is likely to continue this year which will keep their prices higher some time.

Winners and losers: Looking at some of the major commodity prices, we note that items like gold, zinc, aluminium, and copper registered significant in increase in the last fiscal year (Apr'24-Mar'25), while prices of coal, Brent, and agriculture commodities like rice, cotton and wheat registered decline. On an average, gold recorded the maximum increase as prices jumped by 30.4% in FY25. Zinc, aluminium and copper prices also saw double-digit increase. Geo-political uncertainties and front loading of demand by traders ahead of global trade war supported this trend. Wheat (-13%) and cotton (-12.7%) on the other hand, noted most decline in prices, driven higher supplies. Rice also underperformed last year.

Figure 1: Major commodity price movement in FY25



Source: Bloomberg, World Bank Pink Sheet, Bank of Baroda Research| Note: *Data till Feb'25

INR PERFORMANCE

02 April 2025

Currency market update FY25

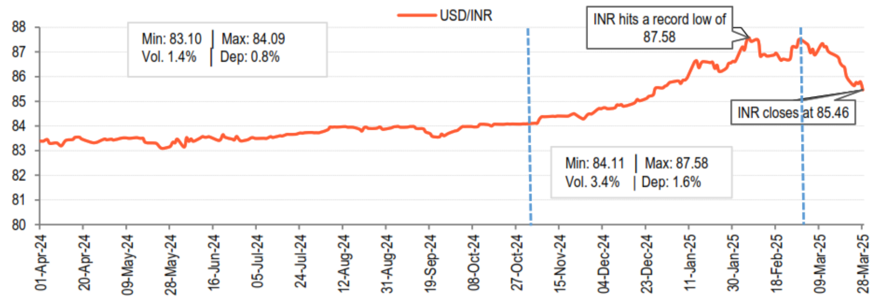
Aditi Gupta
Economist

INR depreciated by 2.4% in FY25, after falling by 1.5% in FY24. The depreciation pressure on INR manifested largely after the US elections results, with the domestic currency falling by close to 4% in a span of 4-months. This was also exacerbated by persistent FPI outflows, particularly from the domestic equity markets. Despite this, INR's performance when compared with other global currencies was relatively stable, with a stronger dollar weighing on all major currency pairs. However, towards the end of the year, a reversal in dollar strength and FPI inflows into debt, supported a rally in INR, with the domestic currency recouping as much as 2.4% in a single-month alone.

The coming year is likely to be marked by a period of volatility awaiting clarity on US tariff policies. This will also set the stage for the Fed's rate actions, in turn affecting how the dollar behaves. On the domestic front, INR is likely to find support from improvement in growth prospects, lower inflation and stable external deficits. Overall, we expect INR to trade in the range of 85.5-87.5/$ in FY26.

FY25 was an interesting year for the rupee as it underwent periods of stability, rapid depreciation and consolidation thereafter. While the first 7 months of the year were marked by a largely rangebound currency, the latter part of the year was characterised by wide fluctuations in the rupee movement (Figure 1). Results of the US Presidential elections in Nov'24, was a key catalyst for the global forex market as a win for Republican nominee Donald Trump, casted a shadow of uncertainty over US growth and inflation dynamics. This led to a significant repricing of Fed rate cut expectations, which in turn boosted the demand for dollar. INR's fortune also varied in turn. Between Mar'24 to Oct'24, INR depreciated by just 0.8%, with average daily annualised volatility at multi year lows of just 1.5%.

Figure 1: Movement in global currencies in Feb'25



Source: Bloomberg, Bank of Baroda Research | Note: Data as of 28 Mar 2025

POLICY RATE

02 April 2025

India-US rate differentials through the year

Dipanwita Mazumdar
Economist

As another financial year passes by, we assess how the spread of interest rates in India vis-à-vis the US has played out. This becomes crucial in determining the direction of investment flows besides affecting currency movements. In terms of key policy rate, the differential between India and US has widened as US rate cut cycle began much earlier compared with India. The higher quantum of cuts by the Fed has resulted in this differential increasing. On the other hand, the yield differential (reflective of market rates) between India and US has exhibited some bit of deviation compared to policy differential.

This spread has fallen on account of stickiness in US 10Y yield due to higher debt levels and expectations of high inflation amidst a volatile geopolitical environment. However, going forward, we expect some stickiness in yield differential in favour of India, which will be further supportive of buoyant FPI flows which will aid the rupee.

Policy rate differential

The policy rate differential between India and US underwent some correction in FY25. It started with the easing cycle of Fed which came in earlier compared with India. The turnaround in inflation in favour of the US and weakening growth indicators resulted in the same. This led to increase in policy rate differential between India and US from Sep'24 onwards. The differential widened in Dec'24 with the frontloading of monetary easing by Fed happening at a fast pace. Thus, in the current fiscal, US Fed with a total cut of 100bps compared with RBI's rate cut of 25bps has kept the policy rate differential between India and US slightly elevated compared to FY24.

However, if we compare it to long run averages, the policy rate differential is far lower. Hence mean reversion levels might call for faster pace of easing by Fed compared to RBI. The recent Fed commentaries have also been considerably dovish hinting at inflation bump due to tighter tariff norms being transitory. The Fed projections have priced in two rate cuts of 25bps each this year. We are expecting cumulative cut by RBI of another ~ 50bps, thus policy rate differential is expected to exhibit some bit of firmness in FY26.

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Note: Recommendation structure changed with effect from 21 June 2021

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