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Currency Outlook

INR takes a breather

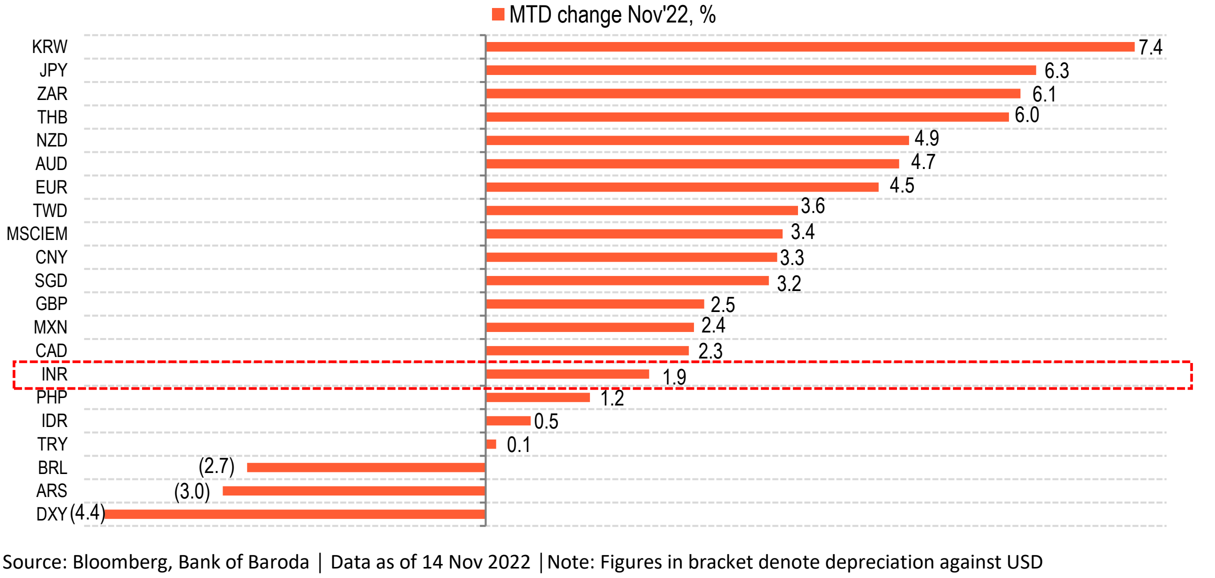
Buoyed by hopes of a likely Fed pivot, global currencies appreciated against the dollar in Nov'22. A softer-than expected US inflation report have led to expectations that the Fed may taper its rate hikes going forward. As a result, the dollar index retreated. In line with its other global peers, INR too appreciated against the dollar and rose by 1.9% in the last fortnight. Lower oil prices and buoyant equity flows also lent support to the INR. A mix of both global and domestic factors will determine the INR trajectory going forward. We expect INR to trade in the range of 80-82/$ till Dec'22.

Currency movement in the last fortnight

In Nov'22 so far, global currencies have registered sharp gains against the dollar. The dollar has been under pressure after the US inflation report showed that US CPI inched down more than expected to 7.7% from 8.2% in Sep'22. This raised hopes that US inflation has likely peaked and hence led to expectations that the Fed may slowdown the pace of future rate hikes. In the immediate aftermath of the CPI report, DXY fell by 2.1%, registering its largest single-day fall since Dec'15. As per the CME FedWatch Tool, probability of a 50bps rate hike by Fed jumped to 85% compared with only 52% before the CPI report. In the last session, DXY has recovered marginally supported by comments from Fed Governor, but it is still down 4.4% in the fortnight.

Easing dollar supported gains in other global currencies. Korean Won (KRW) and Japanese Yen (JPY) were amongst the biggest gainers. Amongst other major currencies, the Euro (EUR) appreciated by 4.5% to a near 4-month high against the dollar. Gains in the pound (GBP) were more modest at 2.5% as investors await the budget announcement. EM currencies gained 3.3%.

Figure 2: Global currencies



Source: Bloomberg, Bank of Baroda | Data as of 14 Nov 2022 | Note: Figures in bracket denote depreciation against USD

Currency volatility:

The last fortnight has also been associated with heightened volatility in the foreign currency markets, when compared with the previous month i.e. Oct'22. While the median volatility in the sample of 19 currencies was 10.1% in Oct'22, it increased to 13.4% in the first fortnight of Nov'22.

Other key observations are:

- Barring Brazilian Real (BRL), volatility in all other currencies increased in Nov'22 vis-à-vis Oct'22. Even so, volatility in BRL continues to remain very high at 23.0%.
- Out of a total of 19, volatility in 12 currencies was in double-digits in Nov'22 compared with 10 in Oct'22.
- Sharpest increase in volatility can be seen in the case of KRW and JPY. In fact, volatility in these currencies increase by more than 10% in the latter period.
- For GBP, volatility has increased from 10.7% to 12.5%. Even for EUR, volatility in the latter period was much higher at 8.8% compared with 6.9% in the period before.
- GBP, AUD, PHP and MYR saw a more than 5% increase in volatility in Nov'22.
- Volatility in INR has also increased from 5% in Oct'22 to 8.7% in Nov'22. However it remains below the median level.

Table 1: Annualized average daily volatility (%)

Annualised daily volatility, %	Oct'22	Nov'22 (upto 15 Nov)
GBP	17.9%	24.2%
KRW	10.2%	23.4%
BRL	24.4%	23.0%
AUD	15.8%	22.0%
JPY	10.1%	20.4%
NZD	14.8%	19.6%
ZAR	15.7%	18.3%
EUR	12.5%	16.1%
THB	11.3%	14.9%
CAD	10.4%	13.4%
PHP	4.8%	11.1%
CNY	7.4%	10.6%
MXN	5.9%	9.7%
SGD	5.7%	9.1%
MYR	3.4%	9.0%
INR	5.0%	8.7%
TWD	4.8%	8.2%
IDR	4.6%	7.0%
TRY	2.5%	5.8%
GBP	17.9%	24.2%

Source: Bloomberg, Bank of Baroda Research | Data as of 15 November 2022

What about INR?

Supported by a weakness in the dollar, INR strengthened and rose to its highest since late Sep'22, before pulling back in the last session. Even so, it has appreciated by 1.9% in the last fortnight. Apart from a weak dollar, FPI flows and lower oil prices also supported gains in the INR.

Outlook for INR

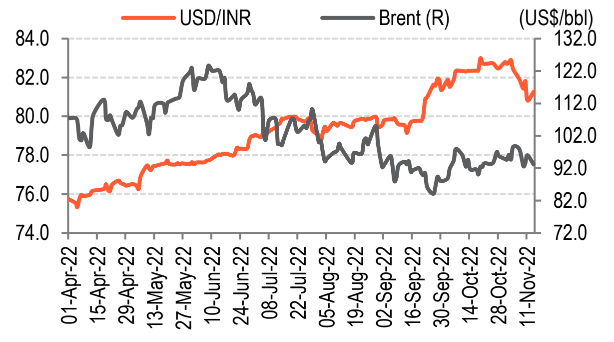
INR trajectory in the future will be dependent on both global and domestic factors. In the last few months, a stronger dollar was the major factor working against the rupee. Hence, the recent bout of weakness in the dollar is a welcome sign. There have been increased expectations of a Fed pivot, which have derailed the dollar rally and a further correction cannot be ruled out. This will be positive for INR. Oil prices have seesawed recently but have remained below the US$ 100/bbl, which will again be favorable for the rupee.

Domestic fundamentals on the other hand are more mixed. FPI flows have turnaround in Nov'22, with inflows of US$ 2.8bn, concentrated primarily in the equity segment. With India being one of the fastest growing major economy in the world, FPIs may continue to prefer investing in the Indian markets as growth elsewhere slows down. Slower pace of rate hikes by the Fed will also be positive for FPI inflows into India.

On the other hand, trade deficit has surged to an uncomfortably high level of US$ 175.4bn in FYTD23 (Apr-Oct'22), putting pressure on the India's external position. With easing global commodity prices, imports may see some moderation. However this is likely to be offset by an even sharper decline in exports as global demand is likely to slow down. Even in Oct'22, while imports fell by US$ 4.5bn on a MoM basis, exports fell by US$ 5.7bn, leading to a wider trade deficit of US$ 26.9bn (compared with US$ 25.7bn in Sep'22).

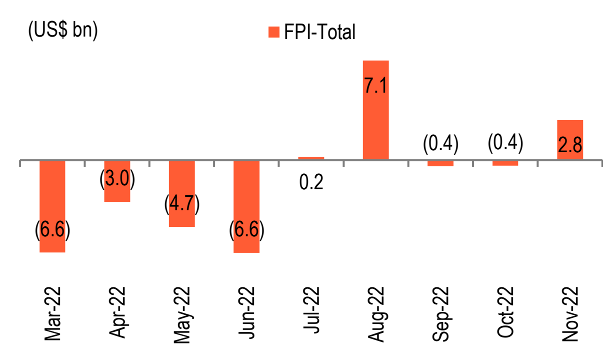
India's foreign exchange reserves too have dipped to US$ 530bn (4 Nov 2022) covering just about 9-months of imports compared with around 19-months at the start of the year. However, with the dollar falling against major currencies, forex reserves may gain due to the revaluation impact which will boost investor sentiments. It will also give RBI room to intervene in the currency market in case there is any sharp moves in INR. Overall, we foresee INR in the range of 80-82/$ till Dec'22.

Figure 2: Lower oil prices to support INR



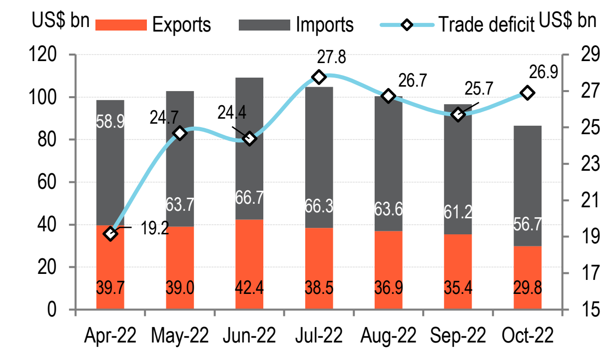
Source: Bloomberg, Bank of Baroda Research

Figure 4: FPI flows have resumed



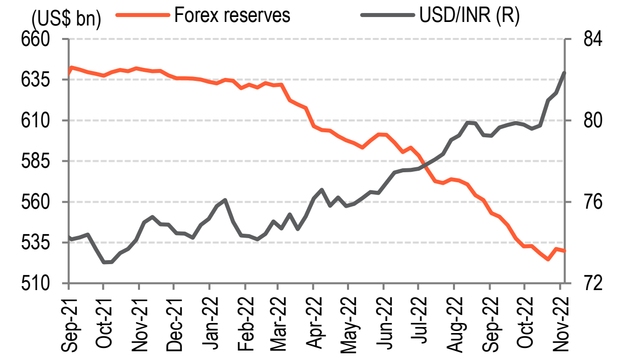
Source: Bloomberg, Bank of Baroda Research | Data as of 11 Nov 2022

Figure 5: Trade deficit remains elevated



Source: Bloomberg, Bank of Baroda Research

Figure 6: Forex reserves have declined



Source: Bloomberg, Bank of Baroda Research

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