

Currency Outlook

Pressure on INR

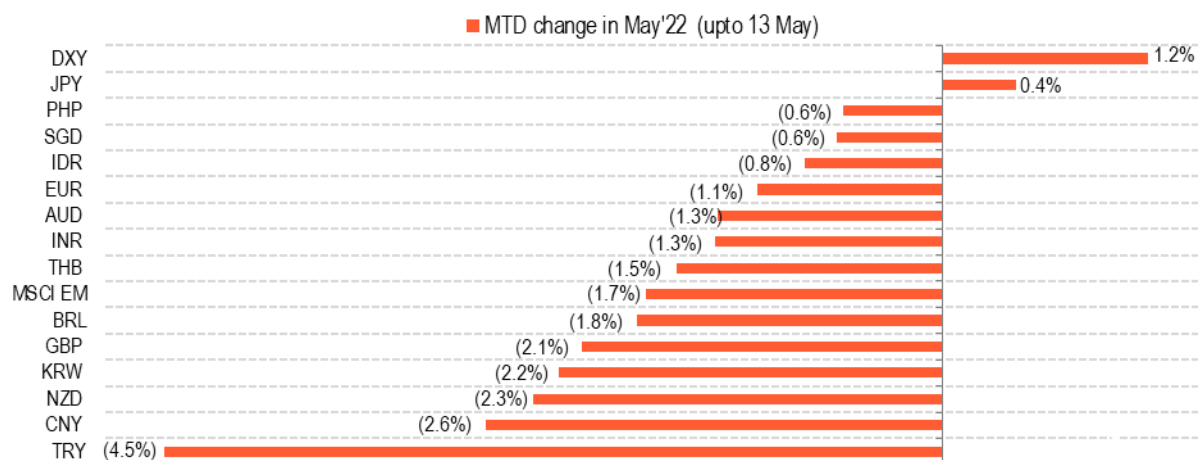
DXY continued to hover around a 20-year high in May'22 amidst safe-haven demand as well as expectations of aggressive rate hikes by Fed. US outlook too remain favorable. Safe-haven flows also helped drive some appreciation in JPY. Other currencies lost ground against the dollar, with EM currencies being the worst hit. High global commodity prices and resultant rise in inflation as well as persistent FPI outflows are hurting EM currencies. Even in India, inflation risks have exacerbated prompting RBI to hike rates. Further, external sector risks have increased amidst elevated oil prices and persistent FPI outflows. We expect INR to remain under pressure in the near-term. INR is likely to trade in the range of 77-78/\$ in the next fortnight with a depreciating bias.

How have currencies fared?

Emerging risks to global growth drove global currencies lower in the last fortnight. On the other hand, safe-haven dollar (DXY index) and Japanese yen (JPY) strengthened. Global outlook has worsened significantly amidst lockdowns in major Chinese cities, Russia-Ukraine war, high inflation and monetary policy tightening across the world. DXY surged to a 20-year high, driven by as expectations of aggressive policy by Fed as well as better growth prospects in the US. Fed hiked rates by 50bps-highest in over 22 years, and indicated 2 more rate hikes of similar magnitude in the next two meetings and also signaled winding down its US\$ 9tn balance sheet. As a result, US10Y yield also shot up significantly to above 3%, for the first time since Nov'18.

Amongst other advanced economies, GBP depreciated sharply by 2.1% on growth concerns. BoE, while raising rates by another 25bps to 1% (highest since 2009), warned against the risk of recession. EUR too depreciated by another 1.1% as EU's proposed import ban on Russian oil imports threatens the economic growth in the region.

Fig: 1: Currency depreciation %



Source: Bloomberg, Bank of Baroda | Data as of 13 May 2022 | Note: Figures in bracket denote depreciation against USD

EM currencies have been most severely hit amidst a broad-based dollar strength. MSCI EM currency index has fallen by 1.7% in this month. Turkish lira (TRY) depreciated sharply by 4.5% this fortnight, led by fears of widening CAD and high inflation. CNY has depreciated sharply by 2.6% as fears of economic slowdown due to stringent and continued lockdowns in several cities weigh on the currency. Macro data showed that China's exports, retail sales and industrial production slowed down in Apr'22. Korean won (KRW) is down by 2.2% and Brazilian real (BRL) has also depreciated by 1.8%. INR depreciated by 1.3% in the last fortnight to a record-low of 77.46/\$ on 9 May 2022. Elevated oil prices, high inflation, persistent FPI outflows as well as a stronger dollar continue to weigh on the rupee.

Currency volatility:

Apart from daily changes in currencies, volatility is also a major factor for the markets. Here, we compare volatility in two periods; 15-29 Apr 2022 and 2-13 Apr 2022. For a majority of the currencies, average annualized daily volatility has increased in the latter period. Some important observations are:

- Median volatility observed in the basket of 20 currencies was 6.8% between 15-29 Apr 2022. This increased to 8.7% in May 2022.
- Even so, volatility in IDR, HKD, MYR, KRW, JPY and BRL decreased in the latter period.
- Despite the reduction in the last fortnight, volatility in BRL was the highest in both the periods.
- Significant increase in volatility was seen in the case of ZAR, AUD, THB, TRY and NZD.
- 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.
- Volatility in INR has also increased from 5% to 8.6%, marginally lower than the median level of 8.7%.

Table 1: Annualized average daily volatility (%)

Annualized daily volatility, %	15-29 Apr 2022	2-13 May 2022
HKD	0.3%	0.2%
IDR	4.6%	2.4%
PHP	4.1%	3.5%
TWD	3.5%	3.9%
MYR	5.4%	3.9%
SGD	4.3%	6.1%
KRW	9.4%	6.5%
CNY	6.6%	7.5%
TRY	2.3%	8.1%
INR	5.0%	8.6%
EUR	6.9%	8.8%
CAD	7.8%	9.0%
JPY	13.2%	9.0%
THB	4.7%	10.6%
MXN	8.7%	11.5%
GBP	10.7%	12.5%
NZD	9.8%	14.9%
ZAR	7.7%	16.8%
AUD	11.2%	18.8%
BRL	24.6%	22.5%

Source: Bloomberg, Bank of Baroda Research | Data as of 13 May 2022

Outlook for INR:

INR has remained under pressure in the last few days. Even today, INR is trading at a record low of 77.57/\$. As outlined above, several factors both domestic and global continue to weigh on the rupee. Global macro backdrop has also changed significantly in the last fortnight. Lockdown in China and EU's proposed ban on Russian energy imports have lent considerable uncertainty to the economic outlook. This has contributed to the dollar strength which continues to hover at a 20-year high (as measured by DXY index). Apart from this, prospects of aggressive rate hikes by Fed have spurred FPI outflows from EMs, including India. As Fed is likely to outpace other major central banks in hiking rates, dollar strength is likely to continue even in the future.

On the domestic side, inflation continues to track higher prompting the RBI to hike rates by 40bps. It is likely to follow with 3-4 more rate hikes in FY23. High inflation along with higher rates will have an impact on consumption and investment demand and hence growth. Apart from this, India's external position is also likely to come under renewed stress amidst elevated oil prices. Trade deficit is likely to rise to ~US\$ 240bn in FY23 compared with US\$ 194.3bn in FY22. This will have a dampening impact on INR. FPI outflows too have remained persistent at US\$ 3.4bn in May'22 so far (12 May 2022) and US\$ 21.3bn in CYTD22. As a result, India's foreign exchange reserves have declined by US\$ 37.7bn this year so far to US\$ 596bn in the week ended 6 May 2022.

Overall, we expect INR to remain under pressure in the near-term and trade in the range of Rs 77-78/\$ in the next fortnight.

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