

Currency Outlook

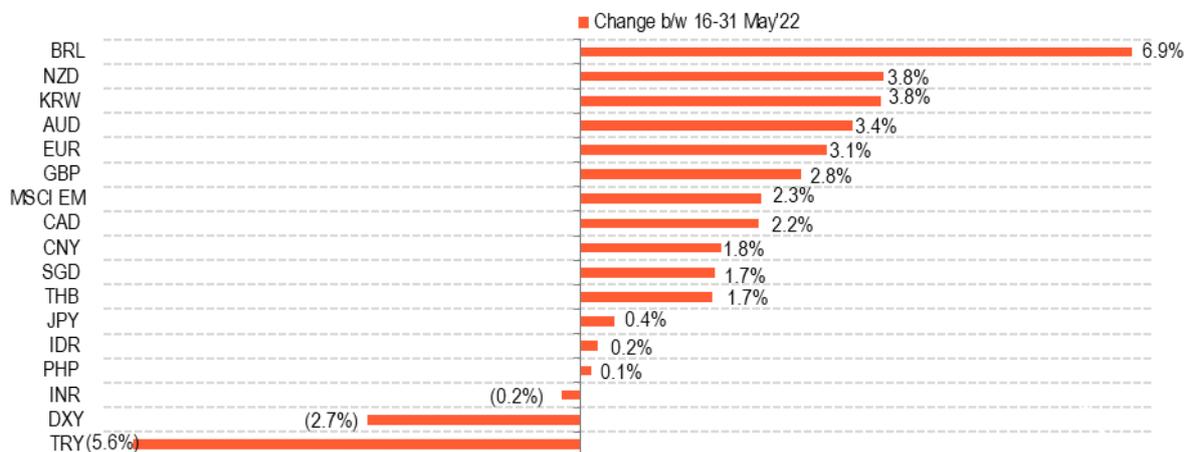
Pressure on INR

With easing lockdown restrictions in China and stimulus measures announced by UK and China, global growth concerns abated. As a result, DXY eased and other global currencies edged up. Investors have also pared back expectations of more than stated aggressive rate hikes by Fed, while ECB is expected to kick-start the rate-hike cycle sooner than expected amidst record-high inflation. In India, INR depreciated to a record-low of 77.73/\$ in the last fortnight but has since found support at the 77.5/\$ level. However, higher domestic inflation, FPI outflows, risks to domestic growth outlook and a widening trade deficit continue to weigh on the Rupee. We expect INR to trade in the range of 77.5-78/\$ in the next fortnight with a depreciating bias.

How have currencies fared?

Improvement in global risk-appetite drove global currencies higher in the last fortnight. Fears of global growth slowdown eased as China ended lockdown restrictions in Shanghai and also announced several measures aimed at supporting the economic recovery. DXY fell by 2.7% as safe-haven demand waned. Further, investors also pared back expectations of aggressive rate hikes by Fed. This was consistent with a decline in US treasury yields.

Fig: 1: Currency depreciation %



Source: Bloomberg, Bank of Baroda | Data as of 31 May 2022 | Note: Figures in bracket denote depreciation against USD

EM currencies rose sharply by 2.3%. Chinese Yuan (CNY) also rose by 1.8%, after declining by 2.7% in the fortnight before. Brazilian Real (BRL) was the highest gainer, appreciating by 6.9% supported by higher global commodity prices. Expectations of further rate hikes by Brazil's central bank also supported gains in the currency. On the other hand, Turkish Lira (TRY) depreciated sharply by 5.6% amidst surging inflation and widening current account deficit. Even so, Turkey's central bank has kept interest rate steady at 14% for the fifth straight month. It must be noted that inflation in Turkey surged to ~70% in Apr'22, much above the central bank's target of 5%.

New Zealand dollar (NZD) too gained by 3.8% as Reserve Bank of New Zealand (RBNZ) raised its official cash rate by 50bps to 2%. This was the second consecutive rate hike by RBNZ. Further, it is estimated that the cash rate is likely to double to 4% over the coming year and stay at that level until CY24. EUR gained by 3.1% as surging inflation in the Euro Area (Euro Zone's inflation soared to a record-high of 8.1% in May'22), led to expectations that the ECB may hike rates sooner than expected. GBP too gained by 2.8% as UK announced a slew of fiscal measures to tide over the cost-of-living crisis.

Currency volatility:

Apart from daily changes in currencies, volatility is also a major factor for the markets. Here, we compare volatility in two periods; 1-13 May 2022 and 16-31 May 2022. For a majority of the currencies, volatility has decreased in the latter period. Some important observations are:

- Median volatility observed in the basket of 20 currencies was 8.4% between 1- 13 May 2022. This declined to 7% during 16-31 May 2022.
- Despite seeing the sharpest reduction, volatility in BRL was the highest in both the periods and continues to remain in double-digits.
- Even for AUD and GBP, volatility remains in double digits despite some moderation in the latter period.
- INR has outperformed other global currencies, with volatility in the last period at just 2.8%.
- Significant decline in volatility was seen in the case of MXN, NZD, THB, CAD and JPY.
- Even so, volatility in TWD, CNY, EUR, IDR, KRW, TRY and ZAR increased in the latter period.

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 depreciated to a record-low of 77.73/\$ on 19 May 2022, and has continued to trade above 77.5/\$ in the period thereafter. Expectations of aggressive rate hikes by Fed and persistent FPI outflows, continue to weigh heavily on the domestic currency. Furthermore, oil prices remain elevated above US\$ 110/bbl, and have shown signs of acceleration in recent days. The relative stability in the exchange rate in the last fortnight, can be attributed to a weakness in US\$ as concerns over global growth outlook have abated. Further, RBI has continued to support INR through FX sales. In fact, RBI's forex reserves have fallen by US\$ 36.1bn since the start of the year (partly due to revaluation too).

However, risks to the INR outlook remain tilted to the downside. First, global commodity prices continue to remain elevated thus putting pressure on India's external balance. Second, FPI outflows have been persistent at US\$ 5.5bn in May'22 (31 May 2022) and US\$ 23.8bn in CYTD22. Third, domestic CPI inflation has been tracking higher. Fourth, downside to growth prospects will also weigh on INR.

Overall, we expect INR to trade in the range of Rs 77.5-78/\$ in the next fortnight.

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