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Currency Market Outlook

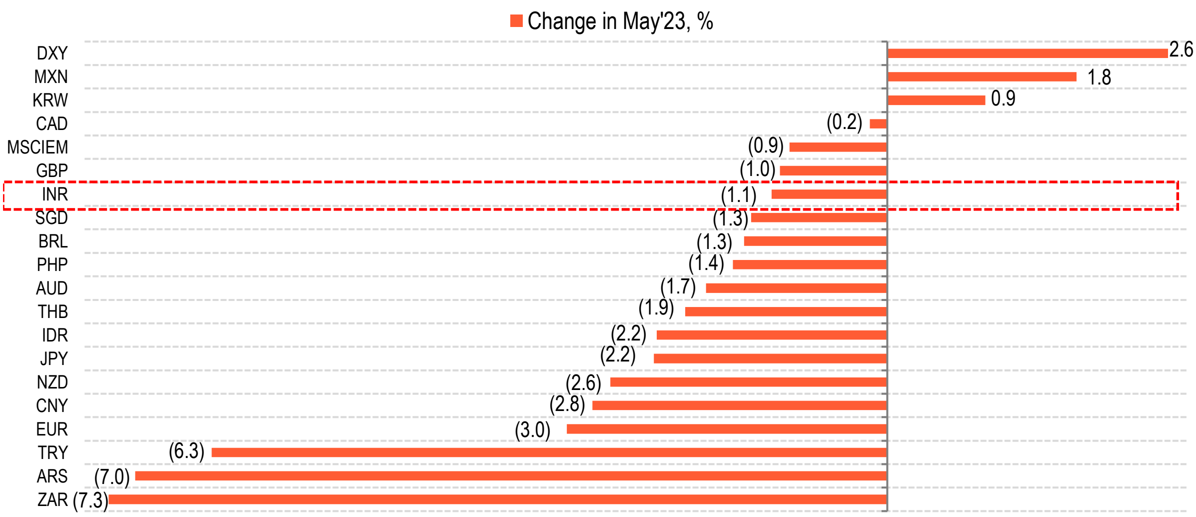
Pressure on INR to be short-lived

INR depreciated in May'23 amidst renewed dollar strength. Safe-haven demand brought on by uncertainty over US debt ceiling buoyed the dollar. However, with the finalization and subsequent approval of the debt-deal market sentiments have settled down. Further denting the dollar's rise were dovish comments from Fed officials which hinted at a pause in Jun'23 meeting. As a result, INR has appreciated by 0.4% as DXY retreated. We believe that range-bound oil prices, FPI inflows as well as lower trade deficit will continue to support INR in the near-term, and any pressure on INR will be only short-lived. Furthermore, RBI has shored up enough forex reserves since the start of the year to help it manage any excess volatility in the exchange rate, if the need shall arise.

Movement in global currencies in May'23

Global currencies once again came under pressure amidst a risk-off sentiment brought about by uncertainty over US debt ceiling and the possibility of a debt default by the US. Investors flocked to the safety of the dollar leading to a 2.6% increase in the dollar index (DXY). Against this backdrop, robust macro data from the US along with mixed signals from Fed officials led to hopes that the Fed may hike rates again in Jun'23. Most global currencies dropped, with EM currencies such as South African Rand (ZAR) and Argentinean Peso (ARS) declining by more than 7% in May'23 alone. Even EUR declined by 3% as weakness in some of the major economies in the region such as Germany, weighed on the currency. JPY too depreciated by 2.2% amidst widening policy divergence between Fed and BOJ. The weakness in JPY prompted the government to step in and caution markets that it would take necessary action to stem the decline in the exchange rate. In China, macro data showed that while inflation has slowed down, economic momentum post the removal of Covid-19 restrictions has fizzled out. CNY slipped and fell below the 7/$ mark, for the first time since Dec'22.

Figure 1: Pressure on global currencies



Source: Bloomberg, Bank of Baroda Research | Note: Data as of 31 May 2023| Figures in bracket denote depreciation against the dollar

How did INR fare?

In line with the pressure seen on other global currencies, INR too depreciated by 1.1% in May’23. INR performed relatively better as the median depreciation in the sample of 17 currencies was 1.9%.

Even in terms of volatility, INR was the least volatile. In fact, the daily annualized volatility in INR has declined from 2.8% in Apr’23 to 2.1% in May’23. On the other hand, volatility in some other Emerging Market (EM) currencies, such as CNY, TWD, and MXN increased in the same period.

Table 1: Annualized daily volatility in major currencies

	Jan'23	Feb'23	Mar'23	Apr'23	May'23
INR	5.1	4.6	4.2	2.8	2.1
IDR	8.3	5.9	5.8	6.3	2.6
TWD	4.4	5.9	4.3	1.8	2.6
CNY	6.4	5.0	7.2	2.7	3.4
SGD	4.4	5.5	5.1	4.0	3.9
MYR	4.1	7.4	6.2	3.1	4.9
EUR	8.0	7.8	9.9	7.0	5.1
PHP	6.6	10.5	4.0	8.2	5.6
GBP	9.2	10.2	10.3	6.7	6.4
KRW	7.8	11.5	14.2	8.5	6.7
THB	9.7	10.2	10.8	7.2	6.8
TRY	1.7	1.5	4.2	1.1	6.9
CAD	8.5	5.7	6.3	5.5	7.0
AUD	12.3	12.6	11.2	10.8	8.8
JPY	12.5	11.2	11.6	9.0	9.1
MXN	7.1	11.2	16.8	6.1	9.3
BRL	17.1	13.0	13.2	13.0	11.4
NZD	10.4	10.8	11.3	10.2	12.2
ZAR	11.4	13.9	13.7	13.4	15.4

Source: Bloomberg, Bank of Baroda Research | Data as of 31 May 2023

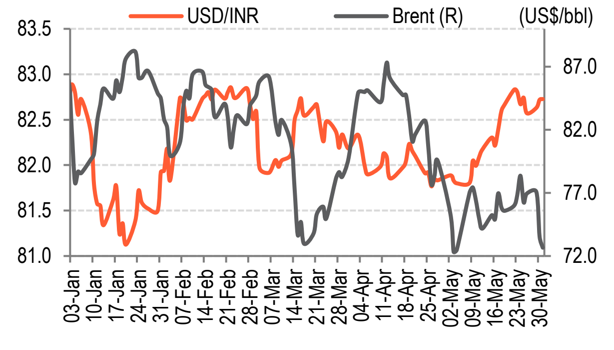
Outlook for INR

Despite a 2.6% increase in DXY, INR depreciated by only 1.1% in May’23. Factors mitigating the impact of a stronger dollar on the rupee included lower oil prices, FPI inflows and lower trade deficit.

In May’23, global oil prices declined by 9.2% amidst concerns over muted demand. Possibility of a debt default by US, uneven recovery in China, mixed comments from OPEC+, amongst others weighed on oil prices. This in turn benefitted INR.

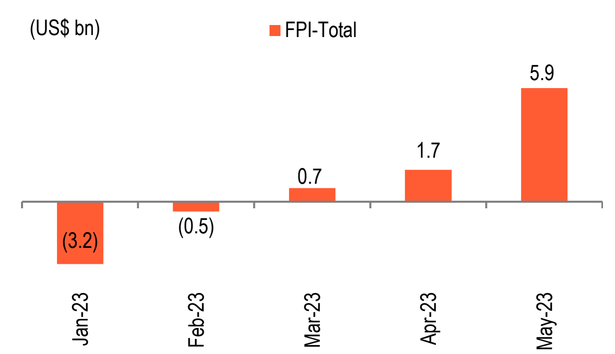
Foreign investors, re-entered the Indian market in full force, after remaining on the sidelines since the last few months. FPI inflows into India surged to US$ 5.9bn, a 9-month high. Most of these were concentrated in the equity segment. India's relative robust growth performance as well as strong domestic fundamentals make it an attractive destination for investors. Also supporting the rupee is an improvement in India's external position. Despite a decline in exports, India's merchandise trade deficit narrowed to a 20-month low in Apr'23. This was due to a much sharper fall in imports amidst normalization in domestic demand as well as lower commodity prices. This is further supplemented by a robust performance on the services front, with services exports expanding at a solid pace even in Apr'23.

Figure 3: Lower oil prices



Source: Bloomberg, Bank of Baroda Research | Data as of 31 May 2023

Figure 4: FPI inflows



Source: CEIC, Bank of Baroda Research | Data as of 31 May 2023

Overall we believe that is likely to trade in the range of 82-83/$ in the next fortnight. The dollar has seen some correction recently amidst dovish comments from Fed Vice Chair designate which have led markets to dial back expectations of a rate hike by Fed in Jun'23. Key drivers for INR in the coming fortnight will come from US jobs and CPI report as well as OPEC+ meeting.

Over the longer term, we continue to believe that INR is likely to strengthen, and trade in the range of 80-82/$ in FY24.

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