Forex update: What the war has meant?

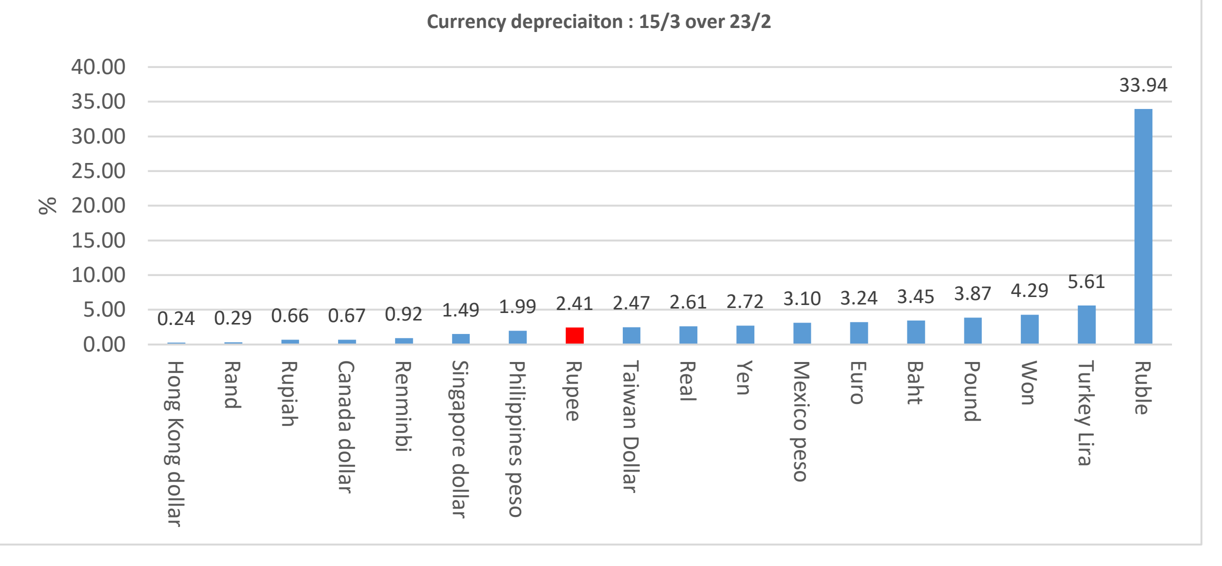
The Ukraine war tended to cast a shadow on the forex market and the tendency was for currencies to depreciate against the dollar. The rupee was under pressure during the first part of the fortnight but recovered with the RBI swap of sell-buy of $ 5 bn was completed. The rupee has ranged between Rs 76-77/$ and would tend to be in this bracket till the month end. The decline in oil prices will help to assuage the currency.

How have currencies fared?

24th February was the turning point when Russia formally invaded Ukraine even while tension has been brewing for some time. The dollar has been strengthening against the euro since then with the appreciation being around 1% till the end of Feb followed by 2.26% in March till 15th. Cumulatively the dollar has gained by 3.24%.

The chart below gives the movement in currencies during the period 23rd February to 15th March in terms of depreciation against the dollar.

Currency depreciation %



Source: Pacific FX database

The chart shows that the rupee has performed relatively well during this period. For the 17 currencies considered here (excluding ruble), the median for the set is 2.47% which was the depreciation witnessed in the Taiwanese dollar. Indian rupee was a wee bit better at 2.41%. Hence there has been some effective intervention by the RBI which has controlled the depreciation. Given that there would be another set of $ 5 bn which will enter the system with the reversal of the 2019 buy-sell swap of dollars which will mature on the 28th, the rupee will hold firm in this range.

Currency volatility

While depreciation/appreciation is a major factor to be looked at in the forex market, volatility is something which the markets are worried about. In this context two periods have been considered-pre-war between January 1 and Feb 24th and from Feb 24 to March 15. As can be seen in the table below the annualized average daily volatility increased for almost all currencies with the highest being for the ruble.

- In case of the Renminbi and Hong Kong dollar the volatility reduced marginally.
- Volatility of the Mexican peso increased almost three times (2.87).
- In case of the rupee volatility rate has doubled. Hence even though during the war phase rupee volatility was lower than the median of the sample currencies, it had increased relative to the pre-war times.
- Doubling of volatility was also witnessed in case of the won.
- Volatility of the euro against the dollar also rose to double digit level of 11.62%

Annualized average daily volatility (%)

	Pre-war	Post war
Canada dollar	6.31	7.92
Euro	6.60	11.62
Pound	5.65	8.27
Yen	5.19	6.42
Real	10.21	16.65
Renminbi	2.67	2.50
Hong Kong dollar	0.69	0.65
Rupee	4.32	8.78
Rupiah	7.50	9.87
Mexico peso	5.37	15.46
Philippines peso	6.33	7.66
Ruble	18.09	164.96
Singapore dollar	3.32	4.60
Rand	12.79	17.67
Won	4.83	9.46
Taiwan Dollar	2.00	4.61
Baht	7.34	10.13
Turkey Lira	13.06	17.69

Source: Bank of Baroda Research

How do the fundamentals look like now?

Forex reserves stand at $ 631.9 bn which is marginally below the Feb 18th balance of $ 632.9 bn. This does show that that reserves have so far stood well during these turbulent times. This is notwithstanding the fact that there have been FPI outflows of almost $ 6 bn - $ 5.4 bn in equity and $ 583 mn in debt. This tendency will continue and the Fed statement to be issued later today will have a bearing on the pace and direction of these flows. The CAD will be pressurized for sure due to higher import bill though the recent change in direction of movement of oil price will temper the overall trade deficit.

We may expect the rupee to remain in the range of Rs 76-77 till end March. The futures contracts on NSE which may be taken to be broadly indicative of expectations of the currency at a later date ranges between 76.48 for March end contract to 77.18/$ for the end-June contract.

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