

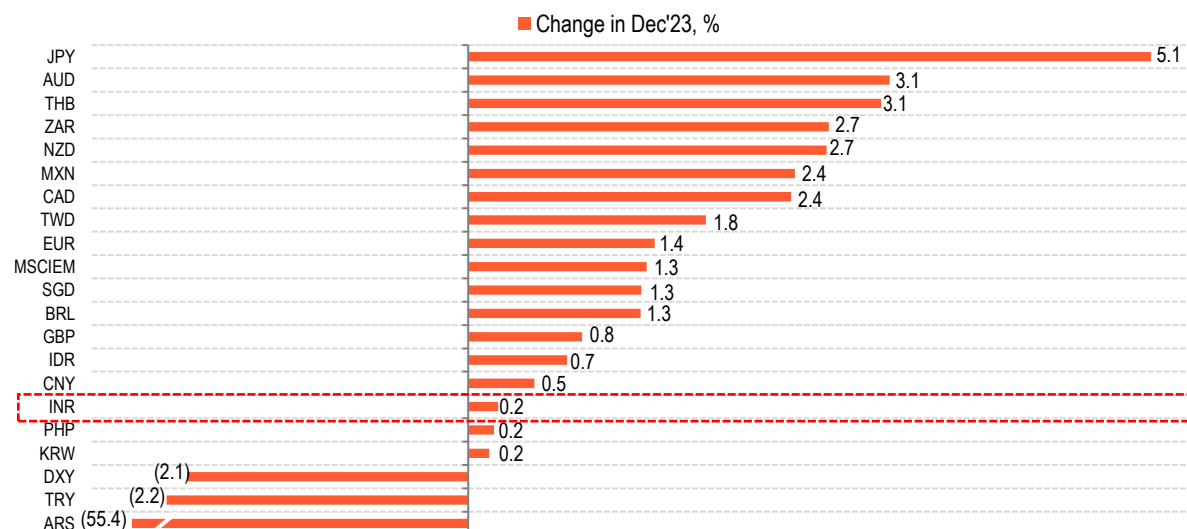
Currency update

Global currencies gained at the expense of the dollar as prospects of looming Fed rate cuts weighed on the greenback. While INR appreciated by 0.2% in Dec'23, it ended 2023 0.6% lower. When compared with a 10%+ depreciation last year, INR's performance was quite remarkable. Apart from a weaker dollar, lower oil prices, strong FPI interest and range-bound external deficits also worked to the advantage of the Rupee. RBI also did a commendable job of managing the currency by limiting volatility. Prospects for INR look bright in the near-term, primarily driven by a weakness in dollar. We expect a range of 83-83.5/\$ in the near-term. For 2024, INR can break past the 83/\$ mark and inch towards 82/\$. However, RBI is unlikely to allow INR to appreciate beyond that given that exports are still facing headwinds due to the uncertain global environment.

Movement in global currencies in Dec'23

The possibility of Fed rate cuts to begin from Mar'24 buoyed investor sentiments globally in Dec'23. Softening labour market conditions along with a moderation in inflation, along with dovish commentary in the last Fed meeting provided the perfect backdrop for lower US rates. This has weighed on the dollar, and in turn worked to the advantage of other global currencies. While DXY was lower by 2.1%, JPY gained as much as 5.1% in Dec'23 alone. Emerging market currencies also gained with the MSCI EM currency index registering a 1.3% gain. In fact, barring Turkey and Argentina, all major EM currencies appreciated against the dollar.

Figure 1: Global currencies in Dec'23

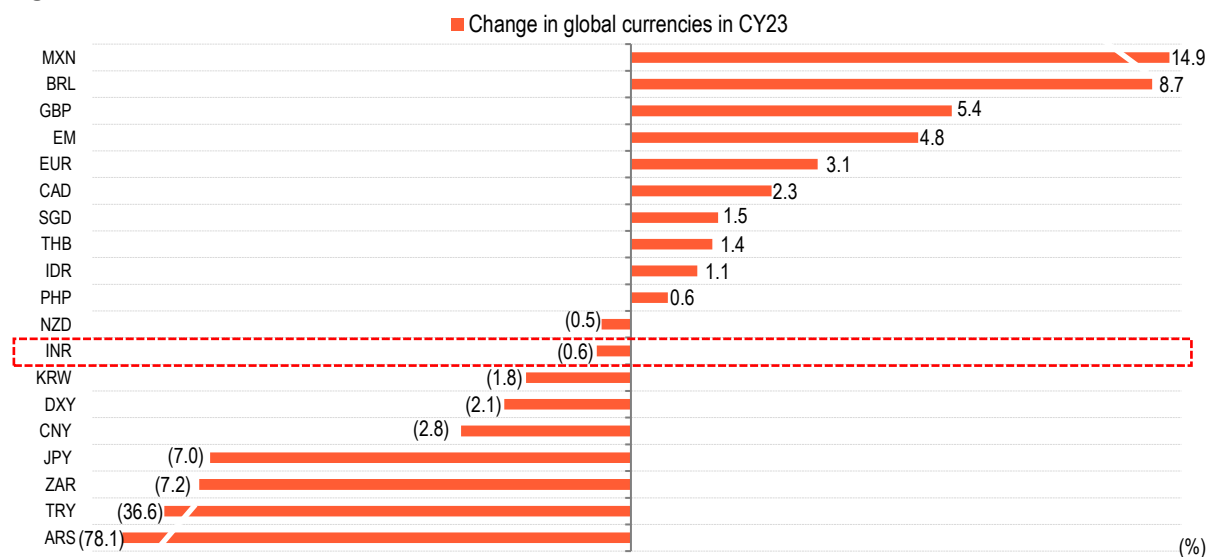


Source: Bloomberg, Bank of Baroda Research | Note: Data as of 29 Dec 2023 | Figures in brackets indicate depreciation against the dollar

Currency movement in 2023

In CY23, DXY declined by 2.1%. This is the first annual decline in the index since 2020, when it declined by 6.7%. The trajectory of DXY has been influenced by the Fed path, which underwent a sharp turn during the course of the year. While the dollar started the year on a somber footing amidst dwindling economic fortunes, a turnaround was visible in the latter part of the year when the US growth outcomes beat all market expectations and tightness in labour market and services inflation remained stubbornly high. This lent support to the Fed’s higher for longer rate narrative which worked in the dollar’s favour. However, with inflation abating and labour market also softening, those expectations subsided and investors now turning their focus on the timing of rate cuts. This was all but confirmed in Fed’s projections, which priced in lower rates in CY24. Since then, the probability of the first rate cut in Mar’24 has increased gradually and stands at ~73% as per the CME FedWatch tool. The impact on dollar has been significant. From a peak of 107 in Oct’23, the dollar has fallen by ~5%. As a result both GBP and EUR have gained, despite being severely handicapped by their respective economic challenges.

Figure 2: Global currencies in Dec’23



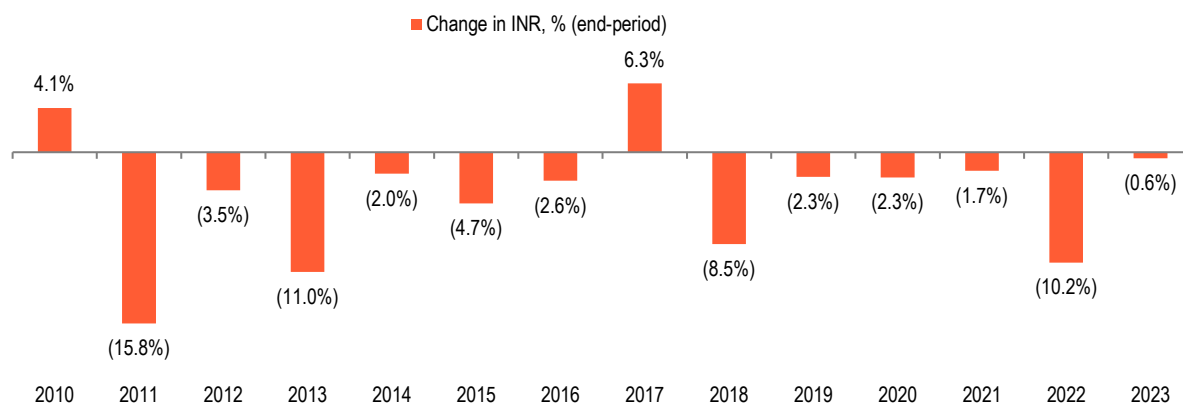
Source: Bloomberg, Bank of Baroda Research | Note: Data as of 29 Dec 2023 | Figures in brackets indicate depreciation against the dollar

How has INR fared?

In Dec’23, INR appreciated by 0.2% buoyed by a weakness in dollar, FPI inflows as well as lower oil prices. Overall, INR ended 2023 just 0.6% lower, compared with a depreciation of over 10% last year. This is especially noteworthy given the fact that INR fell to record low multiple times during the course of the year. FPI inflows of US\$ 10bn in 2023 (US\$ 2.9bn last year), lower oil prices (nearly 17% drop), range bound CAD and a weaker dollar also supported the dollar. Apart from this, RBI’s intervention in

the forex market to curb excess volatility during period of turbulence also helped keeping the exchange rate range bound for most part of the year.

Figure 3: INR performance over the years



Source: Bloomberg, Bank of Baroda Research | Figures in brackets indicate depreciation against the dollar

With the expectations of lower Fed rate in 2024, the prospects of INR look bright. This along with bond index related inflows and range-bound oil prices bode well for the trajectory of INR in the near-term. We expect a range of 83-83.5/\$ for the next fortnight. Beyond that, we expect INR to trade with an appreciating bias in 2024, and see a range of 82-83/\$ for the year.

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