

Currency Outlook

INR expected to trade with appreciating bias

Buoyant FPI inflows and a weaker dollar pushed INR 0.8% higher in Jun'23. Range-bound oil prices also offered some comfort. Uncertainty over the Fed's future course of action amidst moderation in US core PCE and consumer spending led to a fall in DXY in Jun'23. More clarity on Fed's rate action will come from macro data scheduled in the month including PMIs, non-farm payrolls, CPI etc., We expect INR to trade with an appreciating bias in the range of 81.5/\$-82.5/\$. Positive FPI flows as well as weaker oil prices are likely to support INR.

Movement in global currencies in Jun'23

Barring a few exceptions, most global currencies ended higher against the dollar in Jun'23. Rate action by respective central banks and the movement in dollar continued to determine the movement of global currencies in the forex markets. While the Fed projections as well as comments made by Fed officials since the last policy meet have been hawkish, a moderation in core PCE index and an unexpected deceleration in consumer spending have led to expectations of a softer stance from the Fed. DXY has seesawed during Jun'23, but ended the month lower by 1.4% as uncertainty remains over the future course of rate action. This has benefitted EM currencies, with BRL and ZAR gaining the most by 5.6% and 4.7% respectively.

Figure 1: Pressure on global currencies



Source: Bloomberg, Bank of Baroda Research | Note: Data as of 30 Jun 2023 | Figures in bracket denote depreciation against the dollar

Monetary policy divergence was seen across the world. Amongst major central banks, while Fed kept rates steady, both ECB and BoE hiked policy rates during the month. Interestingly, while ECB hiked policy rates by an expected 25bps, BoE surprised markets by an unanticipated 50bps rate hike.

Comments from ECB and BoE suggests more rate hikes are imminent. Bolstering this, data released thereafter showed that inflation in both UK (May'23) and Germany (Jun'23) picked up unexpectedly, after being on a downtrend in the last few months. As a result, both GBP and EUR gained 2.1%.

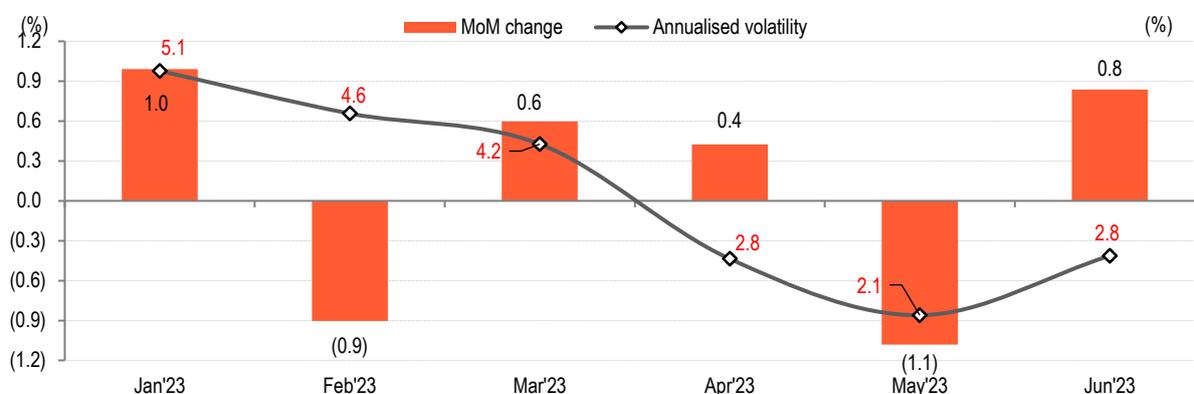
Policy divergence between BoJ and Fed continued to widen as BoJ remained steadfast on its commitment to the ultra-dovish policy. JPY depreciated by 3.4% during the month, even as the government vowed to support the currency from weakening further. Notably, the government had stepped in to buy the currency in Sep'22 when the exchange rate slipped below 145/\$.

CNY depreciated by 2% in Jun'23 as China continued to grapple with its economic struggles. Recent indicators have reinforced views of a patchy recovery necessitating the need for monetary as well as fiscal stimulus.

How did INR fare?

In Jun'23, INR appreciated by 0.8%, after falling by 1.1% in May'23. This was its largest monthly gain since Jan'23, when it gained 1%. Interestingly, INR was able to shake off the weakness in CNY which depreciated by 2% in Jun'23. Even in terms of volatility, INR remained one of the least volatile currency with annualized daily volatility at 2.8% in Jun'23, a tad higher than 2.1% in May'23. However, the median volatility in the sample of 19 currencies was 6.8%. While most EM currencies exhibited lower volatility, advanced economies' currencies saw higher volatility in Jun'23.

Figure 2: INR movement in H1CY23



Source: Bloomberg, Bank of Baroda Research | Note: Data as of 30 Jun 2023 | Figures in bracket denote depreciation against the dollar

Table 1: Annualised daily volatility in major currencies

	Jan'23	Feb'23	Mar'23	Apr'23	May'23	Jun'23
TWD	4.4	5.9	4.3	1.8	2.6	2.4
INR	5.1	4.6	4.2	2.8	2.1	2.8
SGD	4.4	5.5	5.1	4.0	3.9	3.9
PHP	6.6	10.5	4.0	8.2	5.6	4.5
IDR	8.3	5.9	5.8	6.3	2.6	4.5
CNY	6.4	5.0	7.2	2.7	3.4	4.6
MYR	4.1	7.4	6.2	3.1	4.9	5.1

CAD	8.5	5.7	6.3	5.5	7.0	5.2
MXN	7.1	11.2	16.8	6.1	9.3	5.6
THB	9.7	10.2	10.8	7.2	6.8	6.8
JPY	12.5	11.2	11.6	9.0	9.1	7.0
EUR	8.0	7.8	9.9	7.0	5.1	7.0
GBP	9.2	10.2	10.3	6.7	6.4	7.8
NZD	10.4	10.8	11.3	10.2	12.2	9.5
KRW	7.8	11.5	14.2	8.5	6.7	10.0
BRL	17.1	13.0	13.2	13.0	11.4	10.0
AUD	12.3	12.6	11.2	10.8	8.8	10.7
ZAR	11.4	13.9	13.7	13.4	15.4	12.4
TRY	1.7	1.5	4.2	1.1	6.9	29.0

Source: Bloomberg, Bank of Baroda Research | Data as of 30 Jun 2023

Buoyant FPI inflows was the most important factor supporting the strength in INR. In Jun'23, FPI inflows accelerated to a 10-month high of US\$ 6.8bn. India's strong macroeconomic fundamentals have been driving FPI equity flows in recent times even as growth elsewhere remains on a shaky ground. Apart from this a weaker dollar and lower oil prices also supported INR.

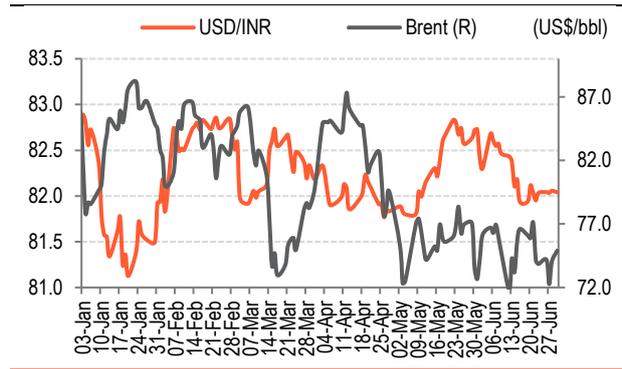
Outlook for INR

We believe that INR is likely to see further appreciation. FPI inflows may see further momentum, as India remains the fastest growing economy in the world. Oil prices have remained range-bound amidst increasing risks to global growth and hence demand. More importantly, China's growth concerns are weighing on oil prices. Further, India's CAD narrowed in Mar'23 amidst a dip in trade deficit. With global commodity prices easing further, CAD is expected to narrow in FY24, which is also positive for INR in the medium to long-term.

However, risks to INR remain from an uptick in dollar due to Fed's aggressive rate stance. Fed's own projections as well as market expectations are tilting towards two more rate hikes this year, with the probability of a rate hike in Jul'23 at more than 80% (CME FedWatch Tool). Rate cuts in this year, have been essentially ruled out. Nevertheless, considerable uncertainty remains around the Fed's future course of action which has kept DXY grounded in the last few sessions. Incoming data will be key, and hence the path ahead for DXY looks muddy.

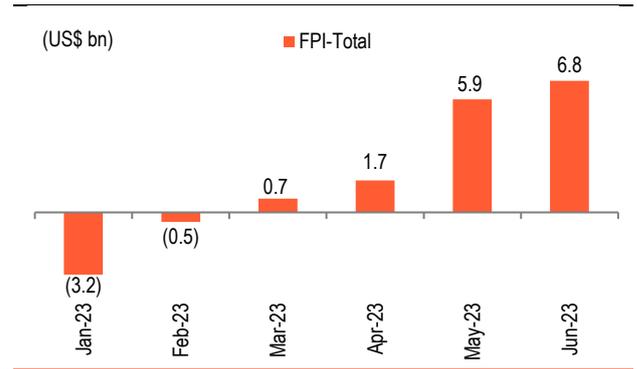
With RBI's foreign exchange reserves looking robust at US\$ 593.2bn, INR is likely to sail through a period of market volatility without any harsh swings on either side. USD/INR NSE futures are pricing in a range of 81.85/\$-81.9/\$ in Jul'23. We expect INR to remain strong and trade in the range of 81.5/\$-82.5\$ in the next fortnight.

Figure 3: Oil prices range bound



Source: Bloomberg, Bank of Baroda Research | Data as of 30 Jun 2023

Figure 4: FPI inflows accelerating



Source: CEIC, Bank of Baroda Research | Data as of 30 Jun 2023

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