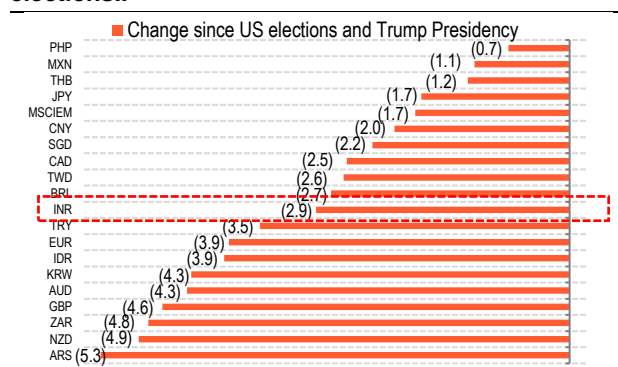


Currency update

After touching record lows at the start of Feb'25, INR made a steady recovery in the last week. INR has been under pressure ever since the US elections, as US policies, particularly on tariffs and taxes, supported a stronger dollar. In the initial phase of the US President's second term, global markets experienced heightened volatility. The impact was felt on EM currencies including INR. INR fell to a record low of 87.58/\$ of 6 Feb 2025, but recovered quickly in the period thereafter as US tariff stance softened. Going ahead, INR's trajectory is likely to be determined by the movement in dollar. Escalation in global tariff war and a change in US Fed stance can once again put INR under pressure. RBI's intervention is likely to be limited going ahead given the tight domestic liquidity situation. We expect INR to trade in the range of 86.5-87.5/\$ in the near-term.

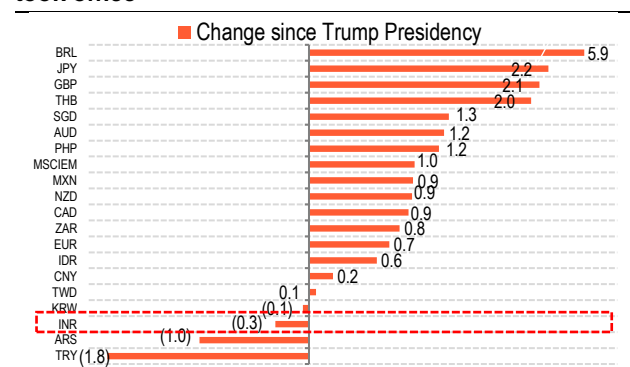
Global markets have seen sharp gyrations ever since the US elections. The period since the US elections can be roughly divided into 2 parts to understand the movement in global currencies. The first period was after the US elections and before the period that Donald Trump took office, which was marked by wild swings in global currencies amidst uncertainty over US policies. In this period, the median depreciation in a basket of 20 global currencies was 2.8%, while the DXY rose by 4.9%. In the same period, INR depreciated by 2.9%. The second period, which started after the US President assumed office, was marked by relative calm in the currencies market as the US adopted a more benign stance on its tariff policies. Movement in global currencies diverged, however, broadly there was a tendency for global currencies to appreciate. However, despite a 2.4% decline in the DXY index, INR depreciated by 0.3%.

Figure 1: INR depreciated by 2.9% after the US elections..



Source: Bloomberg, Bank of Baroda Research | Note: Change between 31 Oct 2024 and 20 Jan 2025 | Figures in brackets indicate depreciation against the dollar

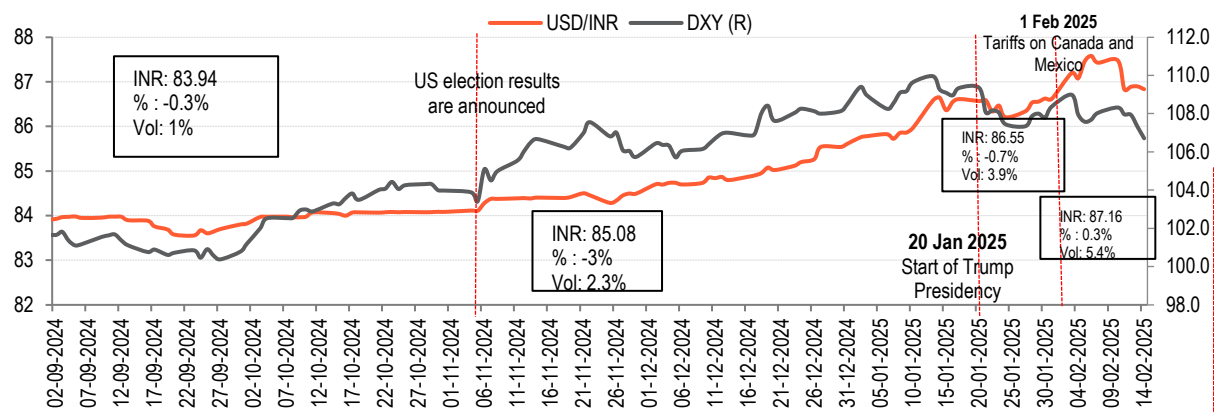
Figure 2: .. and further by 0.3% since Donald Trump took office



Source: CMIE, Bank of Baroda Research | Note: Change between 20 Jan 2025 and 14 Feb 2025 | Figures in brackets indicate depreciation against the dollar

Figure below breaks out the movement in INR since Sep'24. Between Sep-Oct'24, INR was relatively stable and depreciated only marginally by 0.3%. Volatility in the period was also muted at just 1%. However, volatility in INR surged since Nov'24, after the US election results. In this period, INR depreciated by ~3%.

Figure 3: Charting the movement in INR



Source: Bloomberg, Bank of Baroda Research | Note: Data as of 14 Feb 2025 | INR: Average USD/INR, %: Refers to % change in USD/INR, Vol: Average annualised daily volatility

Since then, there has been a further increase in INR volatility, with average annualised daily volatility rising to 3.9% between 20 Jan 2025 to 1 Feb 2025, and further to 5.4% in the period thereafter. While uncertainty over US tariff policies and the resulting strength in DXY kept INR under pressure in the beginning of this month, the fears have largely subsided now. In fact, INR depreciated sharply to a record low of 87.58/\$ on 6 Feb 2025, before recovering to trade around 86.8/\$ currently. This can be explained by a retreat in the value of DXY, however, news reports also point to suspected RBI intervention.

Apart from global headwinds, continued weakness in domestic equities as well as a sombre economic outlook is also weighing on the rupee. There are also expectations that the RBI is likely to allow the currency to depreciate more freely, given that domestic liquidity conditions have remained tight. RBI also lowered its policy rate after a long gap of 5 years, and more rate cuts are expected. This comes at a time when the probability of more rate cuts by the Fed have faded. Based on current market expectations, the policy rate differential between India and US is expected narrow, which can lead to more outflows. Since Sep'24, India has seen FPI outflows to the tune of ~US\$ 23bn.

However, on the positive side, India's growth is likely to have bottomed out which should help in a recovery in investor confidence. Corporate profitability is noting a patchy but steady recovery, which bodes well for growth. Agricultural prospects have improved, and inflation risks have subsided. The Budget provided a much-needed boost for consumption, even as the government's capex push continued. External deficits remain largely in check, despite an unfavourable global environment, with significant support coming from services exports and remittance inflows. This is further supported by robust foreign exchange buffers which stand at US\$ 638bn, sufficient to cover over 10-months of imports.

Overall, the movement in INR is likely to be determined by how the dollar moves which in turn depends on US tariff rhetorics. In the coming days, US decision on postponing tariffs on Mexico and Canada will also be tested. As of now, status quo is likely to prevail in the global markets as the US President has refrained from going ahead with his decision of universal tariffs which has kept the DXY in check. We expect INR to trade in the range of 86.5-87.5/\$ in the near-term.

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