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Currency update

INR depreciated by 0.3% in the first fortnight of Oct'24. This is led by a concomitant of factors at play. Dollar firmed up in the same period led by anticipation of staggered monetary policy easing as major macro fundamentals in the US bears the testimony of the same. FPI flows in the equity segment have exhibited aberration led by risk off sentiment. Volatility in oil prices was also an added headwind. However, in terms of depreciation observed in major EM peers, INR was largely capped. This may be attributable to RBI's continued intervention amid favourable domestic liquidity conditions. On external front, some moderation in export cycle is likely to continue with weakening demand from China, import may also face some risks of higher commodity prices. However, RBI will ensure volatility of rupee to be largely contained. We expect rupee to remain range bound at 83.9-84.1/USD in Oct'24, with a depreciating bias.

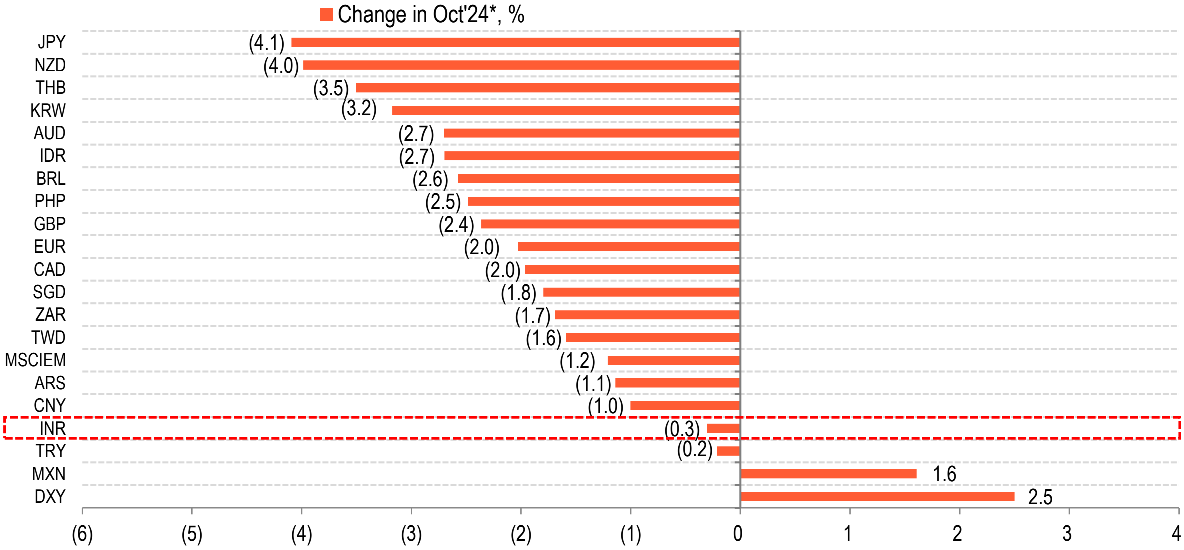
Movement in global currencies in Oct'24

In the 1st fortnight of Oct'24, major global currencies depreciated against the dollar. The rhetoric of 'too far or too fast' about monetary policy easing globally have impinged on dollar. DXY firmed up by 2.5% amidst repricing of a staggered neutral policy stance by Fed, going forward. This comes in the wake of recent macro prints in the US which hinted at economic resilience. Labour market conditions remained stable with JOLTS data, ADP employment change and the official BLS employment summary, reflecting the same, barring some seasonal fluctuations witnessed lately. US CPI continued to overwhelm especially sticky services inflation, which is also reflected in the firming up of wage data. Some de-anchoring of inflation expectation for the near term (1-year ahead) is also seen in the data. Fed officials have also called for modest cut moving at a deliberate pace. Investors are gradually paring down expectations of larger cut by Fed going ahead. We believe it would be more of a cautious data dependent approach without pushing the pedal of monetary easing too hard. This is likely to keep currency pairs of major EMs to trade with a depreciating bias.

Asian currencies likely to remain bearish triggered by risk off sentiment with more alignment towards sovereign debt assets. Further, weaker China data (trade and inflation data) would also contribute towards tight range of currency pairs. Earlier stimulus response from both fiscal and monetary authorities of China has not been reflected much in terms of improvement in macro numbers. However, in the past few announcements, a more holistic policy response has been incorporated. The new range of measures from planning to inject capital in larger banks, ploughing the unused quota for special long term government bonds and additional issuance of local bonds, all speak of indirect ways to finance the increased spending to prop up demand of the economy. CNY is expected to get some support amid this backdrop. JPY is expected to soften and would be more contingent on movement of DXY as no more normalisation in policy by BoJ is expected this calendar year. EUR USD pair weakened as high frequency indicators of both growth and inflation showed slowdown. This has raised hopes of more monetary stimulus. In UK, better than reported retail sales, well balanced employment and growth figures highlight some delay in the policy response by BoE. Thus, some tightness in its trading range may be witnessed in the coming days.

Going forward, DXY is expected to trade with an appreciating bias. Labour market is still resilient to some degree, demand indicators are also gaining ground as services inflation is also not capped. So durable alignment of disinflation in line with FOMC projections remains crucial for any monetary policy response, going ahead. This is likely to put downside pressure on major currency pairs in the remaining fortnight.

Figure 1: Movement in global currencies in Oct'24 (till 14 Oct)



Source: Bloomberg, Bank of Baroda Research | Note: Data as of 14 Oct 2024 | Figures in brackets indicate depreciation against the dollar

Performance of rupee

In contrast to most global currencies, depreciation in INR USD pair was capped. This was supported by RBI's intervention. Adequate foreign exchange reserves amid supportive domestic liquidity conditions acted as a deterrent in INR's further downward arrest in the first fortnight of Oct'24. It outperformed MSCI EM, which fell at a sharper pace by 1.2% in the same period. It hovered on an average at 83.98/$, shying off its lifetime low of 84.07/$. Amongst major EM peers, rupee's performance has been relatively stable while the depreciation in Thailand Baht (-3.5%), Indonesian Rupiah (-2.7%) and Brazilian Real (-2.6%) were much sharper. Some of the volatility in rupee is also attributable to fluctuations in international oil prices which went up by 7.9% in the same fortnight. The correlation between INR and International Crude prices has been strong in FYTD25 at -0.68. FPI flows have exhibited aberration especially equity flows on account of Fed's cautious rhetoric. However, debt flows remained supportive with FAR flows coming in at US$ 0.4bn in the first fortnight of Oct'24. More sentiment driven flows are expected with improvement of the liquidity of the FAR securities.

Outlook

Going forward, the rupee is expected to witness bit of consolidation. Export cycle might exhibit some cyclical drift as global demand is under pressure with weakening data in China. Continued inflationary pressure also pose risk of imported inflation going ahead. All these are major headwinds. Risk off sentiments have also impacted equity driven FPI flows. Debt inflows will be supportive. The second half generally exhibit pressure on domestic liquidity on account of festive demand and activity post sowing and increased momentum of government spending. Thus, pressure on INR cannot be ruled out along with some hawkish bias for dollar. We expect rupee to remain range bound at 83.9-84.1/USD in Oct'24, with a depreciating bias.

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