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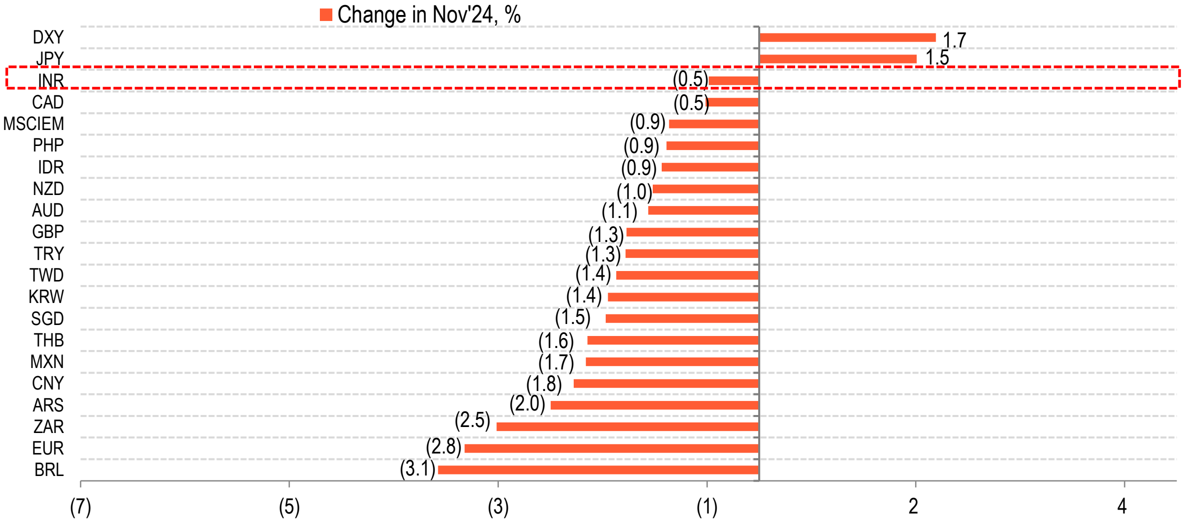
Currency update

INR continues to remain under pressure and traded at record low in Nov'24. It depreciated by 0.5% last month, following 0.3% decline in Oct'24. It has started Dec'24 also on a weaker note, as it has fallen even lower to 84.7/$ mark. Stronger US$ has been the key driver of this trend. In Nov'24 alone, DXY rose by 1.7%, following 3.2% rise in Oct'24. Significantly elevated US yields are supporting dollar strength. Even though US10Y yields cooled off a bit towards the end of the month, they still remain much above the 4% mark. Further, there appears to be increased likelihood that Fed will opt for gradual rate cuts in 2025, against the backdrop of President-elect Trump's continuous threats of tariff hikes for China, Mexico, and Canada (accounting for ~43% of US imports). All major currencies globally have been hit as a result. In comparison to this, INR has held ground and has depreciated the least. Slowdown in FPI outflows in Nov'24 compared with Oct'24 also helped. Investors will now focus on high frequency indicators to gauge prospects of growth in Q3. We expect the currency to trade in the range of 84.2-84.7/$ in the near-term.

Movement in global currencies in Nov'24

Global currencies continued to depreciate in Nov'24 (till 29 Nov), as US$ strengthened further. DXY index, which measures the dollar's value against a basket of currencies rose by 1.7% in Nov'24, after climbing 3.2% in Oct'24. With this, the index touched its highest level since last November. Continued strength comes from elevated US treasury yields and divergent global monetary policies. In the US, 10Y yield after jumping by 50bps in Oct'24, eased by only 4bps at the end of Nov'24. It continues to hover above 4% mark (4.24%), as markets expect slower rate cut momentum from Fed in the coming months. Recent PCE inflation data shows that, while headline numbers came in line with expectations (0.2% MoM and 2.3% YoY in Oct'24), core inflation edged up (0.3% from 0.2% in Sep'24). Services inflation rose notably, while goods inflation fell. Personal income also jumped by 0.6%, higher than estimated 0.3%. Market participants are now expecting ~66% chance of a 25bps Fed rate cut in its meeting this month. In 2025 as well, pace of cuts is expected to be shallower, as President-elect Trump plans aggressive tariff hikes on nearly 43% of US' imported goods (coming from China, Mexico and Canada). This is set to add pressure on domestic inflation. In the recent minutes released by Fed, members have cautioned against cutting rates too fast, in view of slow deflation process and relatively strong labour market. JPY was the only currency which held ground against the US$, as it benefitted from safe haven demand (amidst prospects of tariff hikes by US) and hopes of rate hike by BoJ in its Dec'24 meeting. Recent bump up in inflation in Japan has fuelled hopes of ~57% chance of a 25bps hike this month. In contrast, EUR and GBP noted significant depreciation in Nov'24.

Figure 1: Movement in global currencies in Nov'24



Source: Bloomberg, Bank of Baroda Research | Note: Data as of 29 Nov 2024 | Figures in brackets indicate depreciation against the dollar

Performance of rupee

Towards the end of Nov'24, INR touched another record low of 84.5/$. However, when compared to other currencies, its performance has been relatively stronger. Compared with a median depreciation on 1.4% in the sample of 20 currencies, INR depreciated by only 0.5%. Even though US$ continued to strengthen further, it did so moderately. The relatively better performance was supported by slower outflows of FPIs. FPIs recorded a net outflow of US$ 2.54bn in Nov'24 compared with an outflow of US$ 11.47bn in Oct'24. Continued decline in India's forex reserves is reflective of central bank intervention in the forex market to tame rupee's decline. FX reserves in Oct and Nov alone have declined by US$ 48.3bn. Reserves currently stand at US$ 656.6bn as of 22 Nov 2024 compared with US$ 704.9bn as of 27 Sep 2024.

Outlook

Indian rupee is likely to remain under pressure in the near-term. This will be owing to continued US$ strength and FPI outflows. Fed in its minutes has signalled that the central bank may be more inclined towards reducing rates more gradually. President elect Trump has repeatedly warned that his administration is likely to announce substantial tariff hikes on imports from China, Mexico and Canada. US imports ~43% of its total imports from these countries. As a result, the impact of tariff hikes on domestic inflation is also expected to be significant. In addition, personal income and spending indicators are holding steady. Thus, investors now believe shallow Fed rate cuts in 2025, which in turn will be positive for USD. On the domestic front, with a setback to growth in Q2FY25, investors will now monitor high frequency indicators for Q3 to gauge if growth has rebounded. With monsoon retreating and festive season falling in Q3 this year, consumption indicators appear to have improved. Slack in government spending (centre and states) remains a risk to growth. Given the above backdrop, we expect INR to trade in the range of 84.2-84.7/$ in the near-term.

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