16 May, 2024

Aditi Gupta
Economist

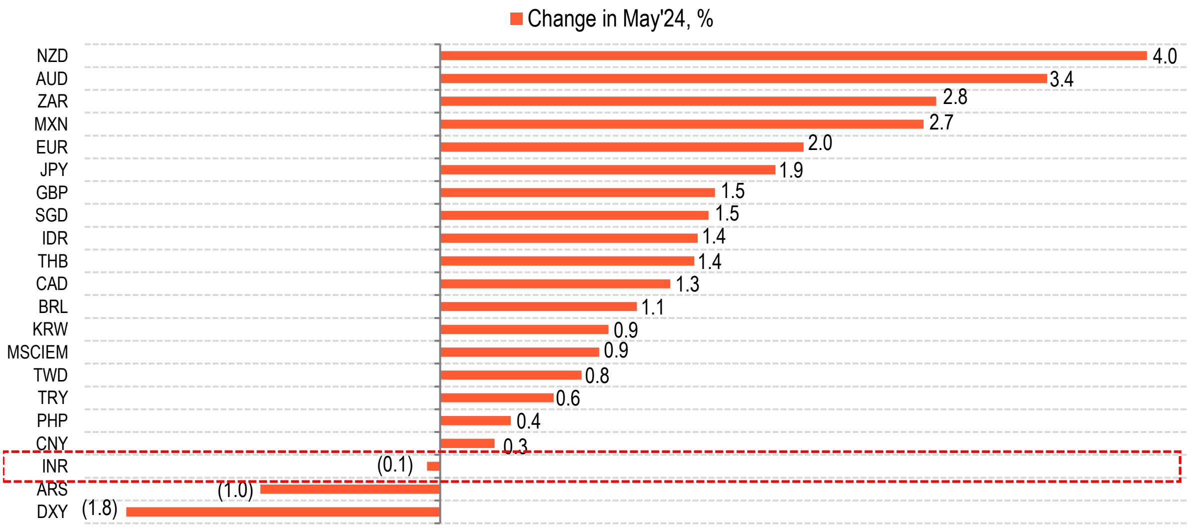
Currency update

INR traded in a thin range in May'24 and depreciated marginally by 0.1%. This was notwithstanding a drop in DXY as well as lower oil prices. Outflows from domestic equities fueled by uncertainty over the outcome of general elections weighed on the domestic currency. However, RBI efficient management ensured that stability in the currency was maintained with a trading range of 83.43-83.53/$. In the next fortnight, we expect weakness in INR to continue amidst FPI outflows, with an expected trading range of 83.25-83.50/$. However, FPI inflows are likely to resume following the election results and we continue to expect INR to end FY25 marginally stronger.

Movement in global currencies in May'24

In May'24, major global currencies appreciated against the dollar. The rally in global currencies was led by a weakness in dollar. DXY index, measuring the dollar's value against a basket of currencies is 1.8% lower in May'24, reversing the 1.7% gain it made last month. The dollar's misfortune can be attributed to a significant repricing of investors' rate cut expectations based on incoming data. Macro data suggests a somber start in Q2, setting up the stage for the start of Fed's rate cut cycle. Labour market conditions showed signs of relenting with non-farm payrolls increasing at the slowest pace in the last 6-months. Wage pressures too eased with increase in hourly earnings falling below 4% mark for the first time in nearly 3-years. Consumer demand too witnessed a sharp slowdown, as retail sales decelerated sharply in Apr'24. On the other hand, inflationary pressures seem to be abating. CPI inflation in the US moderated more than expected in Apr'24, after remaining elevated in Q1 CY24. Given the fact that Fed officials, including the Fed Chair have advocated a data dependent approach, the macro prints so far look encouraging and may tilt the Fed towards monetary policy easing. Hence, the probability of a rate cut in Sep'24 has increased significantly to 54% currently from just 38% as of 30 Apr 2024, as per the CME Fed Watch Tool which is weighing on the dollar.

Figure 1: Movement in global currencies in Apr'24



Source: Bloomberg, Bank of Baroda Research | Note: Data as of 15 May 2024 | Figures in brackets indicate depreciation against the dollar

Performance of rupee

While most global currencies gained against the dollar, INR depreciated by 0.1% in May’24. Even EM currencies appreciated by 0.9%, as oil prices on average were lower. The weakness in INR stemmed from a sharp pullback in FPIs from the domestic market. In May’24, FPI outflows from India totaled US$ 3.1bn, concentrated majorly in the equity segment. Uncertainty over the general elections has led to increased volatility in the domestic equity markets, which has also been compounded with a mixed corporate performance of India Inc in the final quarter of FY24. Apart from this, investor interest in China has returned leading to a diversion of foreign inflows from India. Higher bond yields in US also attracted investors amidst an anticipated delay in Fed rate cut cycle. Interestingly, USD/INR remained in a narrow range of just 10 paise in May’24, and traded just shy of a lifetime low of 83.54/$ it touched in Apr’24.

Outlook

Pressure on INR is likely to sustain in the near term amidst ongoing volatility in the domestic markets which is likely to keep foreign investors wary of India. On the other hand, a weaker dollar and lower oil prices will lend some support to the domestic currency. At US$ 642bn, India’s forex reserves give RBI more than ample buffer to see through the volatility. On balance, we expect INR to continue to trade in a narrow range of 83.25-83.5/$ in May’24.

Over the medium to long term, we remain optimistic on INR. India’s macro fundamentals remain strong with moderating inflation, high growth, manageable twin deficits and expansive forex reserves. Further, we expect FPI inflows into Indian equities to stage a comeback post the election results. This will be supplemented by India’s inclusion in global bond indices which is likely to bring in about US$ 25-30bn inflows into the debt segment. Hence, we continue to see an appreciating bias for INR in FY25.

Disclaimer

Visit us at www.bankofbaroda.com

For further details about this publication, please contact:

Economics Research Department
Bank of Baroda
+91 22 6698 5143
chief.economist@bankofbaroda.com
aditi.gupta3@bankofbaroda.com