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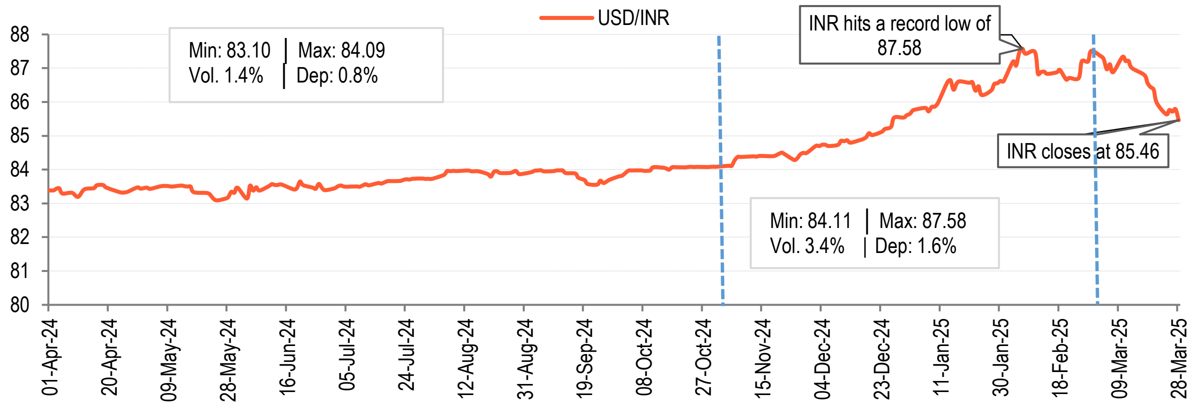
Currency market update FY25

INR depreciated by 2.4% in FY25, after falling by 1.5% in FY24. The depreciation pressure on INR manifested largely after the US elections results, with the domestic currency falling by close to 4% in a span of 4-months. This was also exacerbated by persistent FPI outflows, particularly from the domestic equity markets. Despite this, INR's performance when compared with other global currencies was relatively stable, with a stronger dollar weighing on all major currency pairs. However, towards the end of the year, a reversal in dollar strength and FPI inflows into debt, supported a rally in INR, with the domestic currency recouping as much as 2.4% in a single-month alone.

The coming year is likely to be marked by a period of volatility awaiting clarity on US tariff policies. This will also set the stage for the Fed's rate actions, in turn affecting how the dollar behaves. On the domestic front, INR is likely to find support from improvement in growth prospects, lower inflation and stable external deficits. Overall, we expect INR to trade in the range of 85.5-87.5/$ in FY26.

FY25 was an interesting year for the rupee as it underwent periods of stability, rapid depreciation and consolidation thereafter. While the first 7 months of the year were marked by a largely rangebound currency, the latter part of the year was characterised by wide fluctuations in the rupee movement (Figure 1). Results of the US Presidential elections in Nov'24, was a key catalyst for the global forex market as a win for Republican nominee Donald Trump, casted a shadow of uncertainty over US growth and inflation dynamics. This led to a significant repricing of Fed rate cut expectations, which in turn boosted the demand for dollar. INR's fortune also varied in turn. Between Mar'24 to Oct'24, INR depreciated by just 0.8%, with average daily annualised volatility at multi year lows of just 1.5%.

Figure 1: Movement in global currencies in Feb'25



Source: Bloomberg, Bank of Baroda Research | Note: Data as of 28 Mar 2025

Post the US elections, there was a sharp turnaround in INR's performance. INR depreciated rapidly, touching a record low of US$ 87.58/$ on 6 Feb 2025. A sudden and sharp rally in the dollar, largely explained the decline in the domestic currency. Threats of higher US tariffs, and fears of a global trade war spooked investors leading to a capital flight from risky assets towards traditional safe havens such as the dollar and gold. At the same time, the perceived inflationary impact of higher tariffs on US inflation and growth dynamics, also led to a rejig in investors' assessment of the path of future Fed policy, leading to growing expectations of fewer rate cuts. This also benefitted the dollar.

India also a sharp pullout in foreign investments in the months succeeding the US elections. In fact, between Nov'24 to Feb'25, foreign portfolio outflows totalled a little over US$ 11bn. However, it must be noted that outflows from domestic market had already started even before this, with sharp withdrawals seen in the equity segment. Concerns over domestic growth and corporate performance were primarily cited as the reasons for the same. In the same period, India also witnessed a sharp depletion of its foreign exchange reserves. India's forex reserves rose from US$ 645bn at the end of Mar'24, to a record high of US$ 705bn by Sep'24, before falling to US$ 624bn in Jan'25. Since then, there has been some recovery in forex reserves, mainly on account of RBI's forex swap auctions.

In the third and final phase which started roughly from the start of Mar'25 saw a correction in dollar value which in turn benefitted INR. Between Feb'25 to Mar'25, INR appreciated by 2.4%, marking its largest monthly increase since Nov'18. In the same period, DXY declined by 3.2%. This was attributed to increasing growth concerns in the US amidst a slew of disappointing data. Further, expectations that the proposed tariff policies of the US President could be detrimental to growth prospects also dented the demand for dollar. US monetary policy expectations also shifted due to the increased uncertainty on inflation and growth trajectory. Domestically as well, growth prospects improved, amidst a pickup in GDP growth in Q3 FY25. Robust government finances, marked improvement in domestic liquidity, range bound oil prices, robust forex buffers as well as manageable external deficit aided the climb in the rupee.

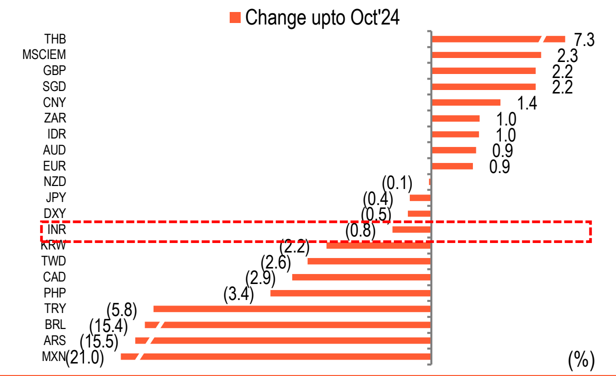
INR performance vis-à-vis other currencies:

Movement in global currencies including INR in each of the above 3 phases has been presented in the figures below. It can be seen that INR has performed relatively well compared to its peers in each of the three phases. In the first phase spanning between Mar'24 to Oct'24, INR depreciated by 0.8%, even as the median depreciation in the sample was 2.7%. However, the MSCI EM index rose by 2.3% in this period, led by gains in currencies of China, Singapore and South Africa.

In the next phase i.e. after the US election, when there was renewed pressure on all global currencies, INR depreciated by 3.9%, only marginally higher than a median depreciation of 3.8%. In this period, DXY rose by 3.5%. EM currencies depreciated by 1.2%. However, other currencies such as EUR, AUD and KRW depreciated by much more.

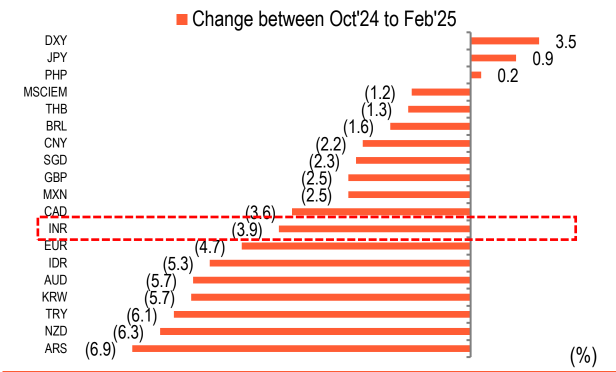
In Mar'25, there was a sharp correction in global currencies, led by a retraction in dollar strength, INR appreciated by 2.4%, much higher than a median appreciation of 1.1% seen in other currencies. The only currencies which appreciated more than INR in this period were GBP, BRL and EUR.

Figure 2: Change in global currencies between Mar'24 to Oct'24



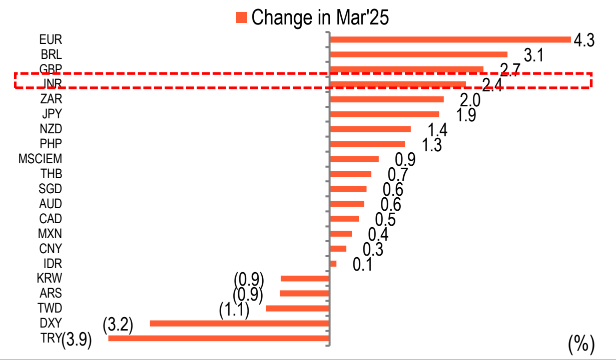
Source: Bloomberg, Bank of Baroda Research

Figure 3: Change in global currencies between Oct'24 to Feb'25



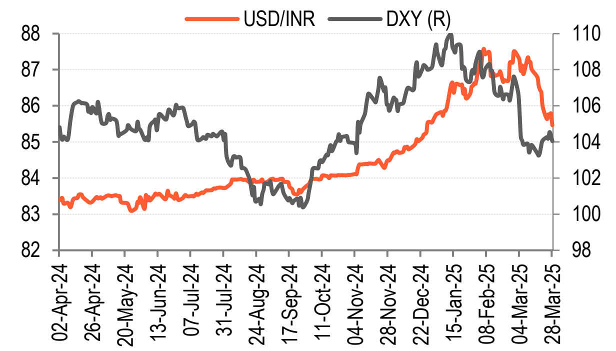
Source: Bloomberg, Bank of Baroda Research

Figure 4: Change in global currencies between Feb'25 to Mar'25



Source: Bloomberg, Bank of Baroda Research

Figure 5: INR and DXY



Source: Bloomberg, Bank of Baroda Research

Outlook:

FY25 was a tumultuous year for the INR. While strong domestic fundamentals underlined a period of stability in the currency in the first part of the year, changing global landscape played an important role in the domestic currency's performance in the latter part of the year. Going ahead, US tariff stance will play a critical role in the movement in global currencies. After some upheaval, markets have largely taken US tariff actions in stride, however, the balance will once again be tested. With the US President's 2nd Apr deadline looming, markets await more clarity on the extent and scope of US reciprocal tariffs. INR's fortunes are likely to remain tied to how these global factors play out. On the domestic side, conditions remain favourable for INR, which should lend support to the domestic currency amidst mounting external challenges. Overall, we expect the currency to trade in the range of 85.5-87.5/$ in FY26. There will be sporadic exogenous shocks, which are likely to be managed by the RBI through timely intervention.

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