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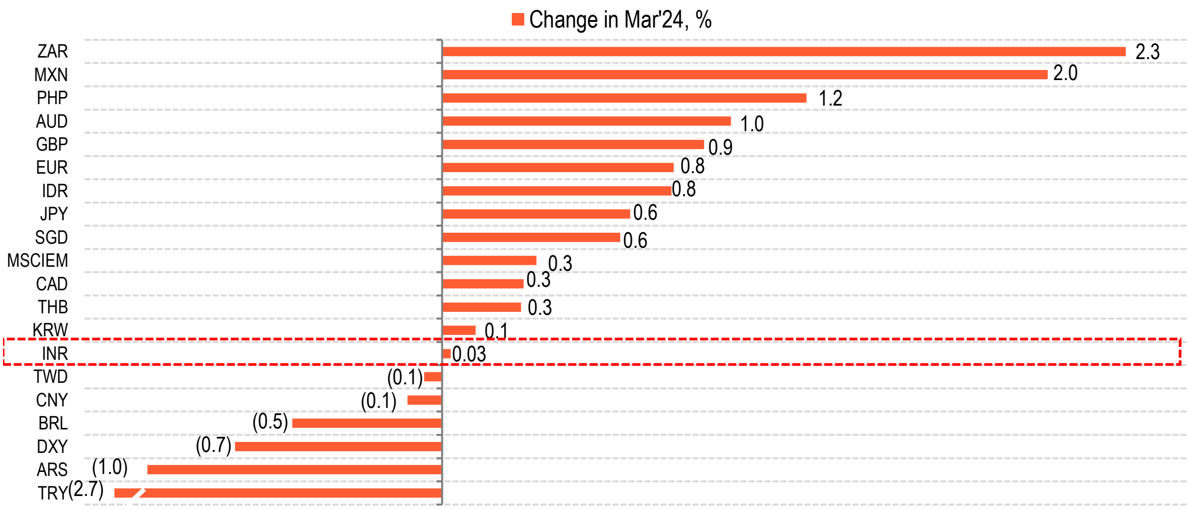
Currency update

INR continued to trade in a narrow trading range in Mar'24 and has noted a modest gain of 2paise over Feb'24. In 2024 so far, it has strengthened by 0.4%. We expect INR to remain resilient in the near to medium term supported by robust domestic fundamentals. Range bound oil prices, buoyant FPI inflows and comfortable external deficits bode well for INR's outlook. We expect INR to trade in a narrow range of 82.75-83.00/$ in Mar'24.

Movement in global currencies

In Mar'24 so far, global currencies have broadly appreciated against the dollar. DXY index is 0.7% lower in the month, as investors assess the Fed rate path. The Fed Chair alluded to the possibility of rate cuts in his testimony to the Congress but continued to bat for a data dependent approach. Macro data has been mixed, with both retail and producer price inflation exhibiting some level of stickiness. This has lent a degree of uncertainty to the timing and quantum of rate cuts, which led to volatility in markets. Markets are widely pricing in a rate cut in Jun'24 as most likely, given that the economy is also appearing to lose steam. Other major central banks such as the European Central Bank (ECB) and the Bank of England (BoE) too are also likely to follow the same timeline as the Fed. The only exception would be Bank of Japan (BoJ) which is widely anticipated to end its long held negative interest rate regime amidst a spiraling of inflationary pressures in the economy. This has been fueling the recovery in JPY.

Figure 1: Movement in global currencies in March 2024



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

How has INR fared?

USD/INR traded in a thin range of 82.77-82.91/$ in the first fortnight of March 2024. The annualized daily volatility in INR remained moderated further to 0.8% in Mar'24 compared with 1.2% in Feb'24.

So far in March its gains have been modest at 0.03% or 2 paise. This is relatively muted compared with other EM currencies. INR's relative underperformance can be explained by the increase in oil prices as well as a weakness in domestic equity markets in major part of the month. However, INR is likely to reverse these losses in the coming days.

Outlook for INR:

Trade deficit in FYTD24 (Apr-Feb'24) is tracking lower at US$ 225.2bn compared with US$ 245.9bn in the same period last year. This is because imports have fallen at a faster rate than exports. Apart from this, despite headwinds, net services receipts have been much higher at US$ 315bn this year, compared with US$ 294.9bn in Apr-Feb'23. A lower merchandise deficit along with higher services receipts is likely to push CAD lower than last year. We expect India's CAD to moderate to below 1% of GDP in FY24, which is lower than our earlier estimates of CAD between 1.2-1.5% of GDP.

On the funding side, capital account picture also looks positive. While FDI inflows have been nascent this year, it has been compensated by buoyant FPI inflows as well as ECBs. Net FDI inflows into India are trailing at just US$ 9.7bn in the first three-quarters of the year, compared with US$ 21.6bn during the same period last year.

On the other hand, FPI inflows into India have been buoyant, led by both equity and debt inflows. Up to 15 March 2024, India has received inflows of US$ 40.9bn. Segment wise, equity inflows have dominated at US$ 25.9bn, inflows into debt have been steadily rising this year and stand at US$ 14.2bn so far. India's inclusion into JP Morgan's bond index (scheduled to start from Jun'24) and Bloomberg EM Local Currency Index (scheduled to start from Jan'25) has buoyed foreign investors' interest in the domestic bond market. This can be gauged from the fact that debt utilization by FPIs in some FAR securities has increased to over 10%. In fact, a total of 4 securities out of the total 35 FAR securities have debt utilization of over 10%. Compared with this, as on 31 March 2023, the maximum debt utilization in a single FAR security stood at only 5.39%.

ECB approvals also have been much higher than last year. ECB approvals by RBI have surged to US$ 38.7bn in FYTD24 (Apr-Jan'24) compared with US$ 21.2bn in the same period last year. NRI deposits too have shown momentum and are likely to contribute positively to the capital account.

With the above backdrop, it is unsurprising that INR has been appreciating against the dollar in the last few months. The trend is unlikely to reverse in the near term. Apart from robust domestic fundamentals, the global macro landscape is also supportive of a stronger INR. Despite mixed macro readings, the US economy is in better shape than what was estimated at the beginning of the year. This suggests that a Fed rate cut is just lurking around the corner and by market estimates, a Jun'24 rate cut is most likely. This will provide further impetus to INR.

Further tailwinds for the INR will come from benign oil prices. Despite the war in Eastern Europe as well as Middle East, oil prices have not increased materially. Though there has been some upward momentum lately, it is highly unlikely that international crude prices could rise to the levels seen during the Russia-Ukraine war. Further, at US$ 636bn, RBI's foreign exchange reserves will provide the necessary cushion to cover against any adverse external shock.

Overall, we expect INR to trade with an appreciating bias and estimate a range of 82.75-83.00/$ in the near term.

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