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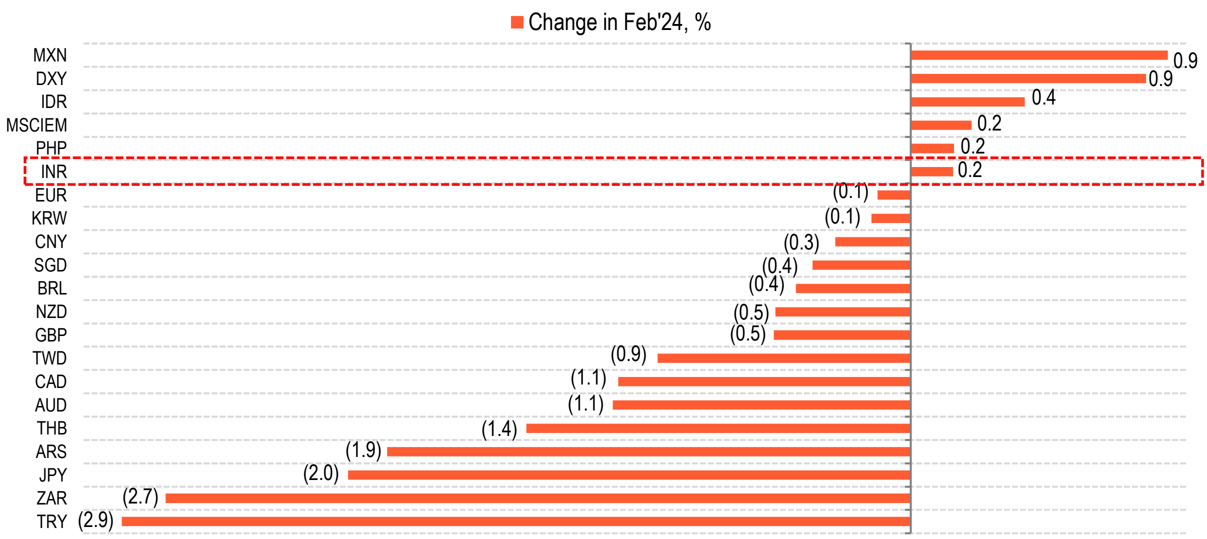
Currency update

INR has remained on a strong footing in Feb'24, appreciating by 0.2%. With this, INR has now appreciated for 3 months straight, despite a resurgence in dollar strength. Resilient domestic growth along with manageable trade deficit has been underpinning the strength in INR. This is being supplemented by robust foreign inflows, particularly in the debt segment. We believe that this trend is likely to continue in Mar'24 as well. INR is expected to trade in a narrow range of 82.85-83.00/$ in Mar'24. Risks remain from a repricing of Fed's rate trajectory and increase in oil prices.

Movement in global currencies

Global currencies were mostly lower in Feb'24, as dollar gained strength. DXY rose by 0.9% as Fed's rate cut expectations have been pushed back to Jun'24 amidst a sustained momentum in the US economy. Investors have also dialed back expectations of aggressive rate cuts, with most analysts now expecting only a smaller magnitude of rate cuts in 2024. This has been helping dollar which has risen by 2.8% in 2024 (upto 29 Feb 2024). As a result, other currencies have depreciated. Amongst major currencies, GNP has depreciated by 0.5% and EUR by 0.1%. It is interesting to note that rate cut expectations in both Eurozone and UK have also been pushed back even as economic activity remains on a fragile ground. JPY depreciated by 2%, as BoJ's policy divergence weighed on the currency.

Figure 1: Movement in global currencies in Feb 2024



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

How has INR fared?

Continuing with the trend in the last few months, INR traded in a narrow trading range in Feb'24 as well. In Feb'24, INR appreciated by 0.2%, taking its gains in CY24 to 0.4%. The stability in the exchange rate despite adverse headwinds from a stronger dollar and escalated geo-political tensions in the Middle-East is underpinned by India's robust macro fundamentals. Domestic growth remains on track with FY24 GDP expected at a robust 7.6%. Government's astute fiscal discipline along with lower commodity prices has ensured that the twin-deficit remains in check. FPI inflows remain buoyant, with debt inflows witnessing strong momentum. In fact, FPI inflows into India have been accelerating since the last 5-months to US$ 2.7bn in Feb'24 (79-month high).

Going ahead, we believe that INR is likely to trade with an appreciating bias. A key risk can emerge from a change in market expectations of Fed's rate cut trajectory. As of now, the first rate cut has been priced in in Jun'24. If the possibility of the rate cut is pushed back further, it can leave INR vulnerable. Further, while oil prices have remained largely range-bound despite the Red-Sea embargo, any escalation and resulting increase in oil prices can unhinge India's external macros and hence put pressure on INR.

Apart from this, supply demand dynamics also need to be watched carefully. RBI has been accumulating forex reserves to prepare for the eventuality of heightened volatility ahead of India's inclusion in the JP Morgan bond index. India's forex reserves have surged to US$ 619bn, but are still below the peak of US$ 642.5bn in Sep'21. It will also be interesting to see if the RBI decides to take the US$ 5bn swap maturing on 11 March 2024. If it does, the supply of INR will increase by as much as Rs. 40,000 crore which will weigh on INR. Given that domestic liquidity conditions have been tight in the past few months, this possibility seems most likely. The increased supply of INR might put some intermittent pressure on the currency. However, this should be offset by higher inflows ahead of the end of the fiscal year. Historically, INR has closed March stronger in 7 out of the last 10 years.

Overall, we expect INR to trade in the range of 82.85-83.00/$ in the near-term. The appreciating bias is likely to persist in FY25 as well.

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