

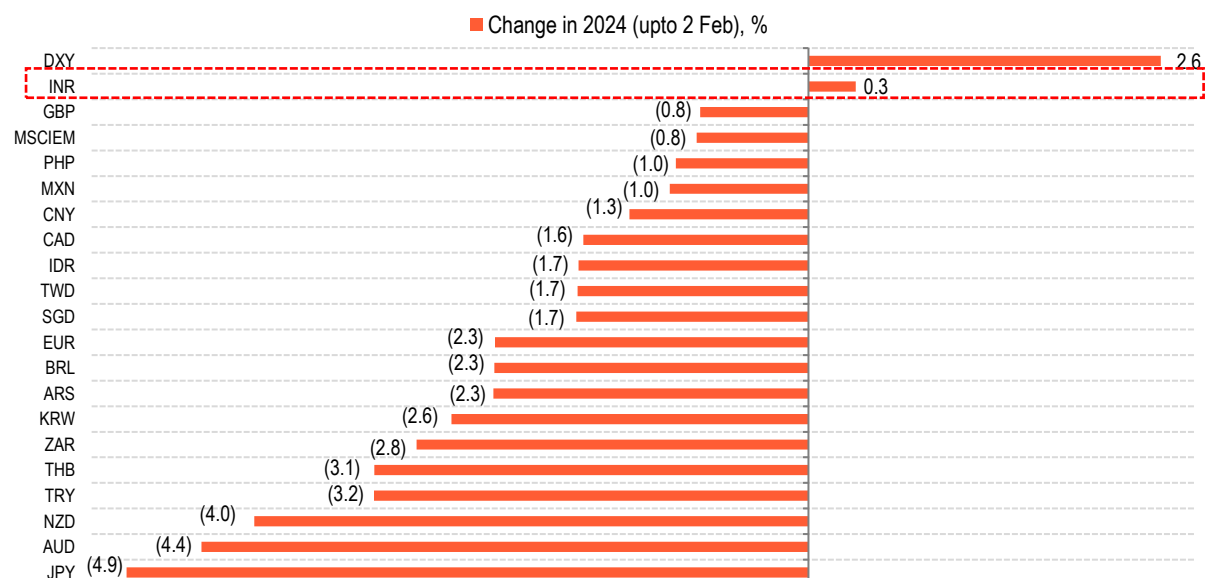
Currency update

INR has strengthened by 0.3% in 2024, consolidating a gain of 0.2% it made in 2023. This is significant, as the rupee's gains came against the backdrop of a stronger dollar. In fact, INR is the best performing major currency against the dollar this year. India's resilient growth story along with a comfortable external position, along with RBI's intervention have kept INR mostly range-bound in the last couple of months. While the macro backdrop is highly favourable for the rupee, we believe that the appreciation in the domestic currency is expected to be gradual. RBI is likely to absorb foreign inflows to build up its buffers to cushion against the eventuality of sudden capital outflows, amidst India's increased interconnectedness in the global financial system. Based on this we anticipate a range of 82.5-83/\$ in the next fortnight. For 2024, we believe INR to trade with an appreciating bias and slowly inch towards 82/\$.

Movement in global currencies

Global currencies depreciated in 2024, as investors pared back expectations of Fed rate cuts in Mar'24 amidst a continued strength in the US economy. While the Fed Chair acknowledged the fact that rates have peaked, he believes that a rate cut in Mar'24 to be premature. As a result, possibility of a rate cut in Mar'24 fell from over 70% at the end of Dec'23 to 38% in Feb'24, as per the CME FedWatch Tool. This helped the dollar to claw back some of its losses and appreciated by 2.6% so far this year (DXY fell by 2.1% in 2023). Amongst major economies, JPY depreciated the most by 4.9%, as BOJ has stuck to its ultra-dovish stance. On the other hand, GBP depreciated the least reflecting in part the view that BoE is likely to lag behind other major central banks in cutting rates.

Figure 1: Global currencies in 2024



Source: Bloomberg, Bank of Baroda Research | Note: Data as of 2 Feb 2024 | Figures in brackets indicate depreciation against the dollar

How has INR fared?

INR is the only currency amongst the basket of currencies under consideration, to have appreciated this year. It has appreciated by 0.3% in 2024. This is in stark contrast to other major EM currencies, which have shed anywhere between 1% - 3.4% so far this year. Notably, in the 23 trading sessions this year, INR has appreciated in 17 of these days. This is somewhat perplexing given that the factors working in favour of INR have mostly reversed this year. To put this in perspective, INR had closed 2023 strong, appreciating by 0.2% in Dec'23, mainly led by a weaker dollar, lower oil prices and robust FPI inflows. This is in contrast to the situation right now. Dollar, which fell sharply amidst expectation of monetary easing in the US towards the end of 2023, has once again regained some of the lost ground, as investors have pushed back expectations of rate cuts to begin from Mar'24. Oil prices saw heightened volatility resulting from disturbances in the Red Sea region. FPIs were also net sellers in the domestic market in Jan'24.

Rupee's relative over performance this year, can hence be attributed to India's strong growth fundamentals. Government estimates peg GDP growth at 7.3% in FY24, which is the fastest amongst any major economy in the World. Apart from this, the Union Budget also reinforced the government's commitment of fiscal prudence without compromising on growth inducing capital expenditure. Lower market borrowings have also helped to buoy investor confidence. Concurrently, volatility in the currency has been low, hinting at some intervention by the RBI in the currency space.

Outlook

The outlook for INR is largely positive. Budget announcements, coupled with expectations that India will outperform other major economies are expected to draw foreign investors. On the external side, current account deficit is expected to be range-bound as despite the disruptions in the Red-Sea region, commodity prices, especially oil, have largely remained contained. Despite global headwinds, services surplus has expanded and IT companies are anticipating a rebound in demand this year. On the financing side, FPI flows are likely to pick up, with debt inflows continuing to show significant traction ahead of India's inclusion in JP Morgan's global bond index. Even FDI inflows are expected to recover, amidst expectations of a stable political environment.

The above backdrop suggests that INR has the potential to appreciate sharply. However, RBI may continue to absorb the foreign inflows to bolster its forex reserves. This is crucial as India's inclusion in global bond indices also leaves the domestic financial sector vulnerable to external volatility. Hence, we believe that INR is likely to appreciate methodically and continue to trade in a narrow range. We foresee a range of 82.5-83.00/\$ in the next fortnight.

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