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Currency Outlook

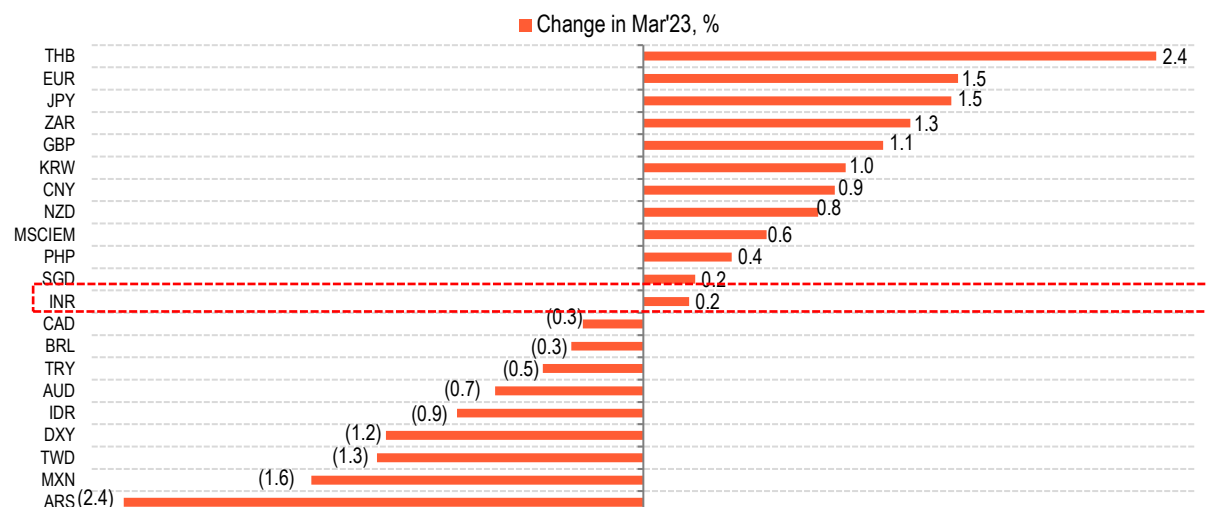
INR is likely to remain range-bound

The recent turmoil in the financial markets has caused an upheaval in global markets and has also changed to an extent the Fed's narrative from aggressive monetary tightening as was initially anticipated to slower pace of rate hikes. Markets have now priced in 25bps rate hike instead of 50bps with fading of hawkish tilt, going ahead. However, the recent US CPI inflation data might keep Fed in predicament over its next course of action. Dollar has changed course and other currencies have appreciated. INR has scope to perform much better than other currencies, given the FPI flows, forex reserves and moderation in oil prices. Improved demand outlook by OPEC for China is expected to lift oil prices. Against the above backdrop, we expect INR to remain range bound and trade in the range of 82-83/\$ in the next fortnight. All eyes on Fed for now.

Movement in global currencies

Global currencies yet again regained strength as dollar came under pressure. In Mar'23, DXY reversed its previous month gains and weakened by 1.2%. Last week, the market witnessed the collapse of the US bank, second largest failure in history, resulting in ripple effects across US and international markets. Fed announced emergency measures in order to curtail the risk and protect depositors. Against such measures, the risk of contagion has somewhat faded. Separately, US headline inflation eased marginally, while core CPI edged upwards at 0.5% in Feb'23 from 0.4% in Jan'23 on MoM basis. On the other hand, US payroll addition strengthened rising by 311,000 against the expectation of 225,000 in Feb'23. Though, wage growth slowed and unemployment rate rose. Against this backdrop, all eyes would shift towards Fed as it is confronted with multiple challenges of elevated inflation, strong labor market conditions, weak consumer spending and carefully monitoring stability in the financial system. Analysts have priced in 85% likelihood of 25bps rate hike in the upcoming meet with terminal funds rate peaking to 5.4%.

Figure 1: Global currencies were mostly lower in Mar'23



Source: Bloomberg, Bank of Baroda Research, Data as of 14 Mar 2023 | Note: Figures in bracket denote depreciation against USD

Most of the global currencies appreciated against the dollar in Mar'23. Amongst the major economies, Thai Baht (THB) appreciated the most by 2.4%, EUR and GBP climbed up by 1.3% and 1.1% respectively. Euro zone inflation eased modestly, though it continues to remain elevated (8.5% in Feb'23 from 8.6% in Jan'23). Core inflation inched up to 5.6% in Feb'23 from 5.3% in Jan'23. ECB President had commented rate hikes are 'very very likely' as inflation remain sticky. There is a likelihood of 50bps rate hike in the upcoming meet with the markets pricing in the terminal deposit rate to peak up to 4%. JPY too gained strength and rose by 1.5%. BoJ in the dovish minutes highlighted the ultra-loose monetary policy will continue for a much longer period, in order to achieve the price stability target of 2%.

How did INR fare?

INR appreciated by 0.2% in Mar'23 (up to 14 Mar 2023). Back in Feb'23, INR had depreciated by 0.9%. Apart from dollar weakness, FPI inflow and lower oil prices can explain the strength in INR. Compared to other currencies, INR has remained an underperformer. In fact, when compared with a median appreciation of 1% in the sample of 18 currencies, INR was way behind other currencies in the pack.

Outlook for INR

Markets experienced extreme volatility in the last couple of days amidst the collapse of US bank, bringing the risk of contagion in global markets to the fore and heightened uncertainty in the global financial system. Timely and appropriate responses by Fed has managed to trim down some of these fears. However, they will play a prominent role when Fed decides its next action. Slippage in oil prices have been positive for INR. Although, stronger demand outlook by OPEC on renewed demand from China may push oil prices higher in the coming days. China's retail sales and FAI also posted strong gains, providing support to country's growth outlook. FPI flows remain positive, along with lower trade deficit and RBI's vast forex reserves is expected to support INR. We expect a range of 82-83/\$ in the next fortnight.

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