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Currency Outlook

Surge in oil prices remains key risk to INR

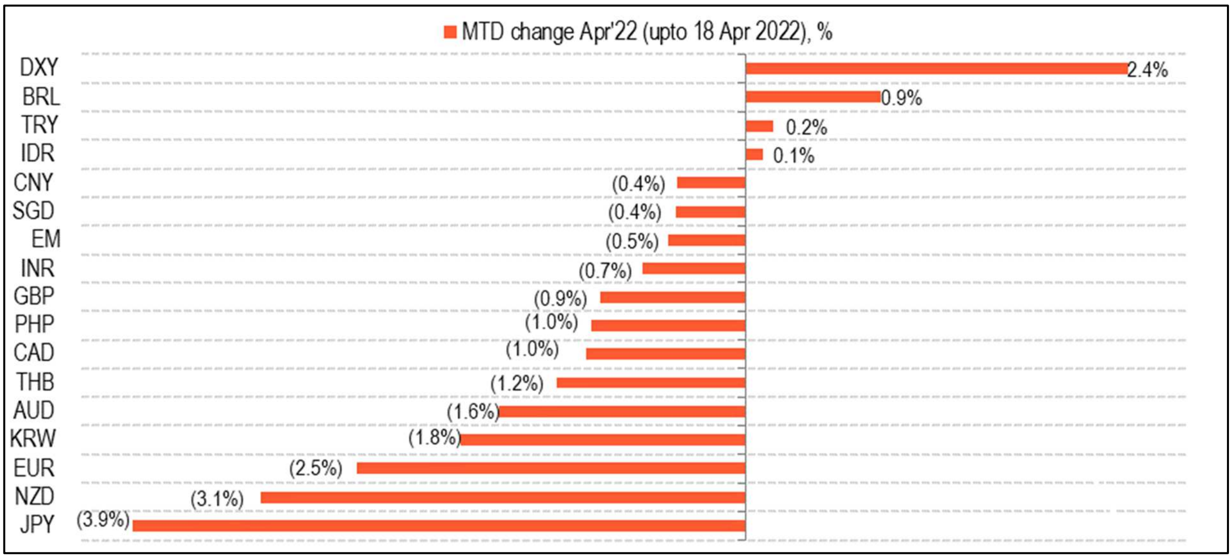
Global currencies closed lower against the dollar. Fed's aggressive policy tightening, rising treasury yields as well as improved US macro data supported gains in DXY. On the other hand, JPY and EUR fell amidst widening policy divergence with the Fed. INR has depreciated by 0.7% in Apr'22, led by a surge in oil prices in the last few days. FPIs outflows have moderated but are likely to remain muted as Fed starts its policy tightening. The rupee is likely to remain in the range of Rs 76-77/$ till the end of the month. A further spike in oil prices may put pressure on INR.

How have currencies fared?

Most global currencies have depreciated against the dollar in Apr'22 (as of 18 Apr 2022). DXY has strengthened, supported by better macro prints, hike in US treasury yields and hawkish commentary by Fed. In Apr'22 so far, DXY has risen by 2.4% to a more than 2-year high. On the other hand, Japanese yen (JPY) depreciated further by 3.9% to a 20-year low, amidst rising yield differentials from the US as well as concerns over rising oil prices and external stability. EUR has also depreciated by 2.4% in the period. This is because of rising policy divergence between ECB and US Fed. Furthermore, risks of stagflation as well as uncertainty over French Presidential elections continue to weigh on the EUR. New Zealand dollar depreciated by 3.1% even as Reserve Bank of New Zealand raised policy rates by 50bps (highest rate hike in 22-years) amidst surging inflation.

On the other hand, currencies such as Brazilian real, Turkish lira and Indonesian rupiah have appreciated against the dollar.

Fig: 1: Currency depreciation %



Source: Bloomberg, Bank of Baroda | Data as of 18 Apr 2022

INR performance:

INR has depreciated by 0.7% in Apr'22 so far. The movement in INR can be traced back to the movement in oil prices. INR depreciated by only 0.2% between 1-11 Apr 2022, when oil prices averaged US$ 103/bbl. In the same period, FII outflows were US$ 5.5bn. Subsequently, oil prices have averaged US$ 109.3/bbl, leading to a 0.4% depreciation in INR. With oil prices on an uptrend again, INR is likely to come under renewed pressure.

Currency volatility:

Apart from daily changes in currencies, volatility is also a major factor for the markets. Here, we have looked at the volatility in two periods; 16-31 Mar 2022 and 1-18 Apr 2022. For almost all currencies, volatility has declined in the latter period. Some important inferences which can be drawn from the table are:

- Despite the depreciation, volatility in JPY has almost halved in Apr'22.
- Even in case of Turkey, South Africa New Zealand and Korea, currency volatility has seen a marked decline.
- On the other hand, for Singapore dollar (SGD), Hong Kong dollar (HKD) and Chinese Yuan (CNY), there has been only a marginal dip in volatility.
- Rupee volatility has also declined, and has remained below the median in the sample in both the periods.
- However, currencies such as Canadian dollar, Brazilian real, Mexican peso and Philippine peso have witnessed increased volatility in the latter period.

Table 1: Annualized average daily volatility (%)

%	16-31 Mar 2022	1-18 Apr 2022
JPY	10.9%	4.1%
TRY	9.4%	4.0%
ZAR	12.5%	7.7%
NZD	9.8%	5.5%
KRW	10.8%	6.7%
THB	7.7%	4.8%
DXY	6.6%	3.8%
EUR	7.9%	5.4%
TWD	6.1%	4.2%
GBP	6.6%	5.5%
INR	4.3%	3.3%
AUD	8.7%	7.6%
IDR	2.0%	1.1%
SGD	3.8%	2.9%
HKD	0.8%	0.3%
CNY	2.5%	2.2%
CAD	4.3%	5.0%
BRL	13.5%	15.7%
MXN	5.8%	9.0%
PHP	3.6%	6.9%

Source: Bloomberg, Bank of Baroda Research

Outlook for INR:

India's foreign exchange reserves have declined to US$ 604bn as of 8 Apr 2022, compared with US$ US$ 622.3bn on 11 Mar 2022. In fact, forex reserves have been declining for 5-straight weeks now. It must be noted that the decline in forex reserves comes despite moderation in FPI outflows. Surging commodity prices and the likely impact on trade deficit, has prompted RBI to intervene in the forex market to support the rupee.

India's trade deficit surged to 6.1% of GDP in FY22 and is likely to remain elevated even in the future as oil prices continue to trade above US$ 100/bbl. Furthermore, with the US Fed now expected to be more aggressive than earlier anticipated, FPIs inflows are also likely to be muted. This will also weigh on the rupee.

We expect the rupee to trade in the range of Rs 76-77/$ till end April. A further surge in oil prices remains a key risk to this view.

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