CURRENCY OUTLOOK

01 April 2022

INR to stabilise at 75.5-76.5/$

After depreciating to a record-low of 76.97/$, INR has stabilised in the last few days. This has coincided with easing concerns over Russia-Ukraine war and moderation in oil prices. FPI outflows too have receded as risk-sentiment has improved. We expect INR to trade in the range of 75.5-76.5/$ in the next fortnight. Sharp jump in oil prices remains a key risk. However, over the medium and long term, Fed tightening might put downward pressure on INR. For FY23, we expect INR to trade in the range of 76-77/$.

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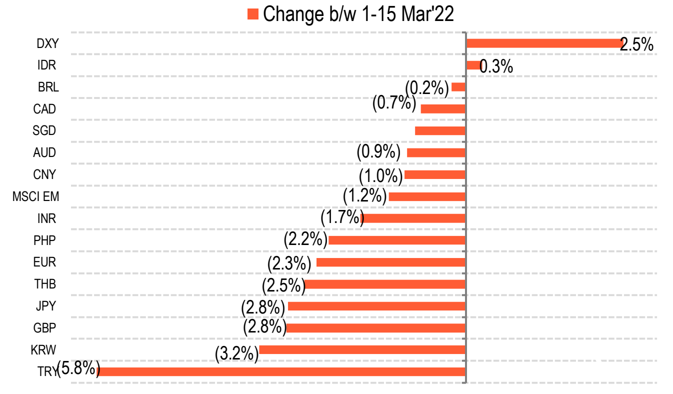
Currency movement: Most global currencies rallied in the second-half of Mar'22 (18-31 Mar'22), as concerns over Russia-Ukraine war stabilised. This led to a risk-on sentiment in the global forex markets. While DXY had strengthened by 2.5% between 1-15 Mar'22, it fell by 0.8% in the latter period. This was notwithstanding Fed's first rate-hike since Dec'18 and rising US 10Y yields. Amongst other advanced economies, EUR rose by 1% after falling by 2.3% between 1-15-Mar'22 as higher than expected inflation in the Eurozone has raised expectations of rate hikes by ECB. On the other hand, JPY has depreciated sharply in both the periods and continues to trade near a 6-year low. JPY's relative underperformance can be attributed to BoJ's dovish commentary and rising yield differential with the US. Further, higher oil prices have raised concerns over external stability and hence weighed on the JPY. However, EM currencies rallied between (18-31 Mar'22), led by Brazilian Real. Higher commodity prices are supporting the rally in most EM currencies.

INR too has moved in tandem with other EM currencies. After depreciating by 1.7% between 1-15 Mar'22, it appreciated by 1.1% in the latter half of the month. This was supported by some correction in oil prices as well as weakness in dollar. Further, while FPI's continued to remain net sellers in the domestic market even in the second half of Mar'22, there was some moderation. FPI outflows totalled US$ 5.6bn between 1-15 Mar'22, compared with outflows of US$ 0.3bn in the second-half. This too supported INR.

Outlook: While, dollar has weakened recently, it is likely to recoup its losses. This is because, Fed is turning increasingly hawkish. The median rate projection for Fed's funds rate of 1.9% for CY22 (in Mar'22 policy meet), was much higher than 0.9% estimated in its Dec'21 meeting. This implies rate hikes in each of the six remaining meetings in CY22. Even in CY23, three more rate hikes are expected, bringing the Fed funds rate to 2.8% (1.6% expected in Dec'21 meeting). This will support DXY. While other global central banks are also likely to embark on the policy tightening cycle, Fed is likely to remain ahead of the curve. This should keep the yield differential in favour of the dollar. US Jobs report due later in the evening will also have a bearing on the outlook for DXY.

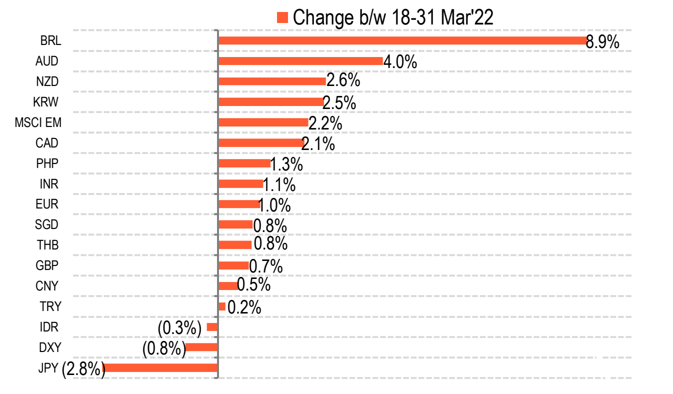
INR to remain range-bound: After depreciating to a record-low of 76.97 on 7 Mar 200, INR has consolidated its losses. In fact, while INR closed at a ~1-month high of 75.79/$ in the last trading session. Notably, India's current account deficit (CAD) expanded to a 13-quarter high of 2.7% in Q3FY22. This is likely to surge further to 3.5% in Q4 led by higher oil prices (brent oil prices averaged US$ 97.9/bbl in Q4 versus US$ 79.7/bbl in Q3). However, the recent correction seen in oil prices will lent support to INR. We expect INR to trade in the range of 75.5-76.5/$ in the next two-weeks. Escalation in tensions between Russia and Ukraine and the resulting increase in oil prices remains a key risk.

Fig 1 – Currency movement between 1 Mar to 15 Mar 2022



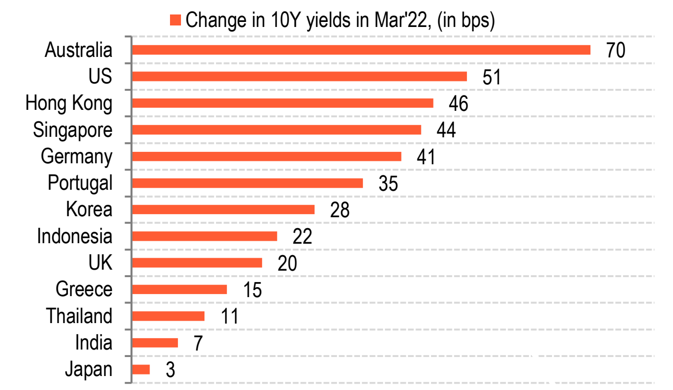
Source: CEIC, Bank of Baroda Research

Fig 2 – Currency movement between 18 Feb to 31 Mar 2022



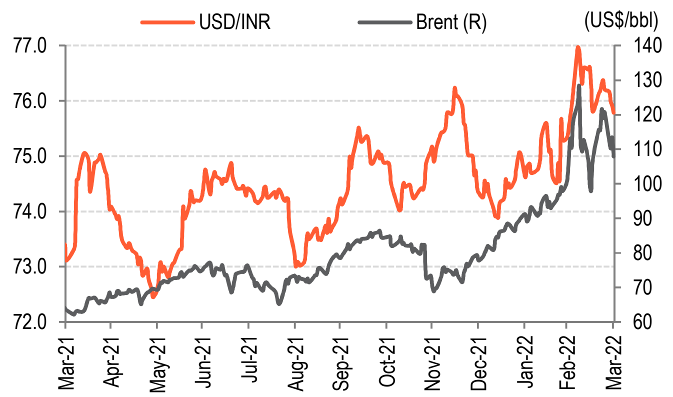
Source: CEIC, Bank of Baroda Research

Fig 3 – Global yields have risen, led by US



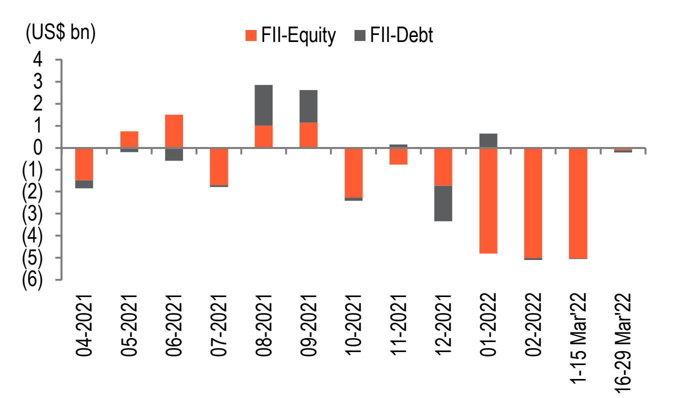
Source: CEIC, Bank of Baroda Research

Fig 4 – INR and Oil prices



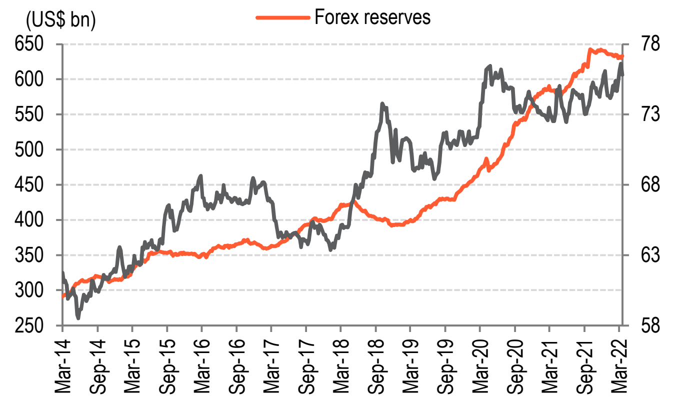
Source: CEIC, Bank of Baroda Research; Data as of 31 Mar 2022

Fig 5 – FPI outflows have eased



Source: CEIC, Bank of Baroda Research; Data as of 29 Mar 2022

Fig 6 – Forex reserves stand at US$ 619.7bn



Source: CEIC, Bank of Baroda Research; Data as of 18 Mar 2022

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