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# Currency Outlook

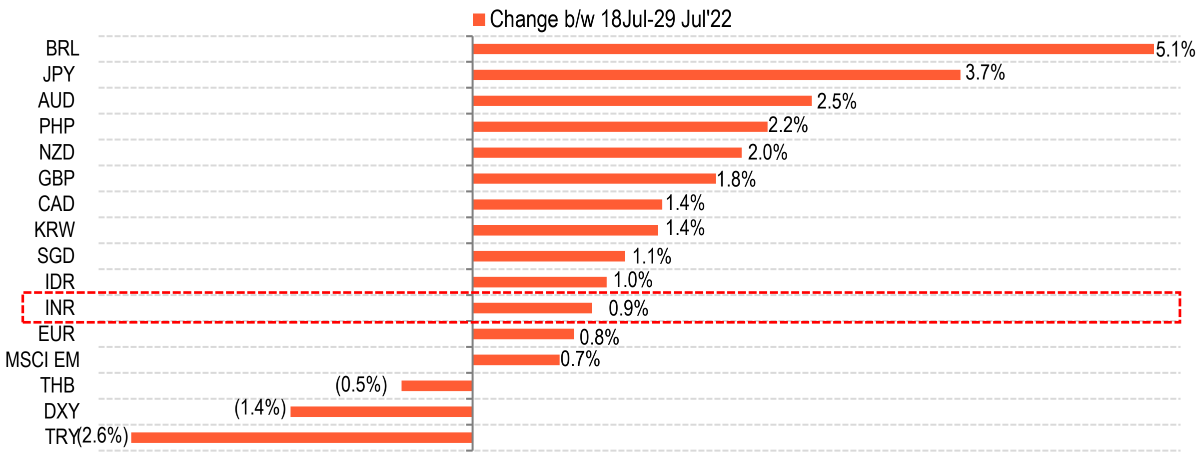
## INR stages a comeback

*Global currencies edged up against a weaker dollar. DXY index fell amidst expectations that the Fed may slow down the pace of monetary policy tightening going forward. JPY, GBP and EUR strengthened against the dollar. INR too ended the fortnight higher by 0.9% after depreciating to a fresh record low. A weaker dollar and revival in FPIs supported gains in USD/INR. Apart from the RBI policy meet, US CPI and jobs report will guide the trajectory of INR in the coming two weeks. We expect, INR to trade in the range of 79.15-79.75/$ in the next fortnight.*

## How have global currencies fared?

Most global currencies edged higher in the last fortnight against a weak dollar. DXY retreated even as Fed raised policy rate by another 75 bps, taking the cumulative rate hikes to 225 bps this year. However, comments from Fed Chair were less hawkish than earlier, suggesting that the pace of rate hikes may slow down going further. A higher than expected contraction in US GDP in Q2CY22 also bolstered the case for slower policy tightening. However, a further surge in US PCE price index may change this view and the future trajectory of the Fed will depend on incoming data before it meets again in Sep'22.

**Figure 1: Currency movement**




Source: Bloomberg, Bank of Baroda | Data as of 29 Jul 2022 | Note: Figures in bracket denote depreciation against USD

Brazilian Real (BRL) has strengthened most sharply and rose by 5.1% led by higher iron ore prices. Further, Brazil posted only a small CAD (lowest in 5-years) in Mar'22 which also supported BRL. JPY too rose by 3.7% to a ~6-week high, against the weaker dollar. It was further supported by better than expected exports, PMI and industrial production data. BoJ restarted its ultra-accommodative stance while raising the inflation forecast upwards and growth forecast downwards. Amongst advanced economies, British pound (GBP) has gained 1.8% in the fortnight as surging inflation in the UK (40-year high), has led to expectations of a 50 bps rate hike by Bank of England (BoE). Further, flash PMIs suggest an improvement in economic activity, lending support to the currency. EUR rose by 0.8% as European Central Bank (ECB) increased policy rates by a higher-than-expected 50bps-its first rate hike in 11 years. Further, data showed that the Euro Area's GDP expanded more than expected in Q2CY22.

INR has strengthened by 0.9% in the last fortnight, outperforming the MSCI EM index (increase of 0.7%). However, when compared with the median of 1.4%, the appreciation in INR is relatively smaller.

**Currency volatility:**

Volatility in most global currencies showed a decline when compared with the fortnight ending 15 Jul 2022. Some important observations are:

- Median volatility observed in the basket of 20 currencies was 7.3% between 1- 15 July 2022, higher compared with 5.7% observed between 18-29 July 2022.
- Significant reduction was seen in the volatility of Mexican peso (MXN), Australian dollar (AUD) and Turkish lira (TRY).
- On the other hand, volatility in Philippine peso (PHP), Indonesia Rupiah (IDR), and JPY increased in the latter period.
- Despite some moderation, volatility in BRL and ZAR (South African Rand) remains in double digit in both the periods.
- Volatility in INR rose marginally to 3.3% from 3%. However, it remains below the median volatility seen in the sample.

**Table 1: Annualized average daily volatility (%)**

| Annualized daily volatility, % | Vol. 1-15Jul | Vol. 18 Jul-29Jul |
|---|---:|---:|
| HKD | 0.1% | 0.1% |
| TWD | 1.9% | 0.9% |
| MYR | 1.5% | 1.5% |
| CNY | 3.5% | 2.3% |
| TRY | 8.4% | 3.0% |
| SGD | 5.4% | 3.2% |
| INR | 3.0% | 3.3% |
| IDR | 1.7% | 4.4% |
| THB | 5.1% | 5.5% |
| MXN | 12.7% | 5.6% |
| CAD | 9.7% | 5.8% |
| GBP | 9.9% | 6.2% |
| NZD | 9.0% | 6.8% |
| KRW | 7.0% | 6.9% |
| AUD | 13.2% | 7.3% |
| EUR | 10.4% | 8.8% |
| JPY | 7.6% | 9.4% |
| PHP | 5.7% | 9.7% |
| ZAR | 14.4% | 13.4% |
| BRL | 18.3% | 17.6% |

Source: Bloomberg, Bank of Baroda Research | Data as of 29 Jul 2022

**INR performance and outlook:**

After depreciating to a record-low of 79.99/$ on 20 Jul 2022, INR has closed the fortnight stronger by 0.9%. Apart from a weaker USD, a reversal in FPI outflows has also helped in supporting INR. FPIs which remained net sellers in the domestic markets for the past 9-months, invested US$ 239mn in the Indian markets in Jul'22. Although small, this suggests an improvement in investor sentiment which should support INR going forward. Further, active intervention by RBI in the foreign exchange market has also ensured an orderly movement in the exchange rate. It must be noted that RBI's foreign exchange reserves have fallen to a near 20-month low of US$ 571.6bn as of 22 Jul 2022. In FY23 so far, foreign exchange reserves are down by US$ 46.1bn.

On the flip side, India's external position still remains tenuous. Trade deficit continues to track at record-high which will put pressure on the balance of payments. Imports may see some moderation aided by softening global commodity prices. However, exports too will be muted amidst a fall in demand in key markets such as US and Europe. RBI and government measures announced earlier should help ease some concerns on this front.

Overall, we expect INR to trade in the range of 79.15-79.75/$ in the next fortnight, supported by positive global cues.

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