

Rupee Ruminations

Resilience Fuels Optimism for Appreciation

The Indian Rupee (INR) has demonstrated remarkable resilience, hitting a perceived bottom of 83.5 against the US Dollar and now showing signs of a structural uptrend. Factors such as narrowing CAD, robust FX reserves, and favourable inflation disparities support this trajectory. While RBI intervention aims to maintain stability, the overall outlook suggests a potentially appreciating INR in the years ahead, with projections of USD/INR reaching 78 by FY2026.

Current Account Trends: Driving Forces Behind INR's Strength: A pivotal factor in bolstering the INR is the narrowing of the Current Account Deficit (CAD), expected to transition into a modest surplus within the next two years. This shift is propelled by governmental initiatives incentivizing outbound shipments, targeting a combined US\$2 trillion value in merchandise and service exports by FY30.

FX Reserves and Inflows, Safeguarding India's Economic Position: India's burgeoning Foreign Exchange (FX) Reserves serve as a protective barrier against external vulnerabilities, ensuring adequate coverage for external debt obligations. Additionally, continuous inward remittances strengthen the nation's Balance of Payments position.

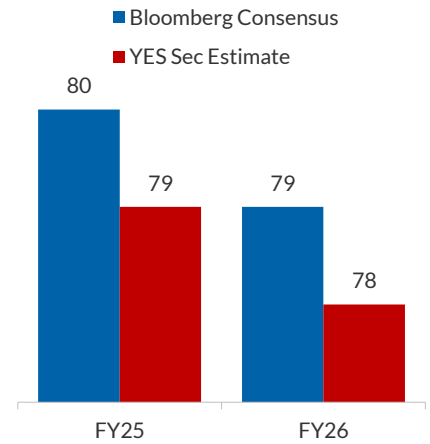
Market Dynamics: Foreign Capital Inflows to unlock upside potential for INR: Indian Debt Markets are poised to attract substantial foreign capital inflows, projected at USD 100 billion over the next three years. Despite potential volatility risks, low Foreign Institutional Investor (FII) ownership of Indian Sovereign Debt mitigates concerns. Similarly, India's Equity Markets, although not yet experiencing peak FII inflows observed in the early 2000s, offer significant potential for increased portfolio investments.

FDI and Domestic Manufacturing: Catalysts for Economic Growth: India's focus on domestic manufacturing aims to draw more foreign direct investments, particularly with the global value chain moving towards Re-Shoring. This trend is expected to drive Foreign Direct Investments as a percentage of India's GDP higher.

Inflation Dynamics and Monetary Policies: Influences on INR Stability: Historically, INR trends have been shaped by inflation disparities between India and the US. However, with narrowing differentials and Indian inflation rates falling below the global average, the scope for INR depreciation diminishes. Furthermore, a probable alignment among major central banks on the reversal of hawkish monetary policies is anticipated to maintain stability in sovereign yield spreads, curbing significant USD upside against major currencies.

RBI Interventions, Balancing INR Appreciation: Reserve Bank of India (RBI) interventions play a crucial role in shoring up FX reserves to counter INR appreciation. Nonetheless, lower forward premia contribute to reduced INR volatility, fostering stability in the currency market.

USD/INR Currency Estimates



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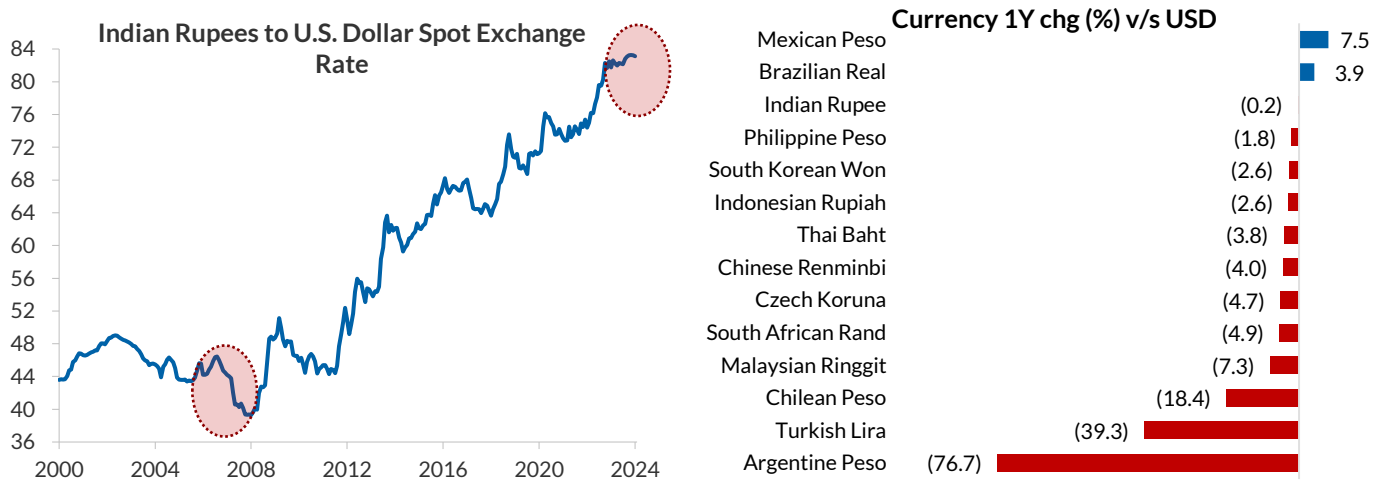


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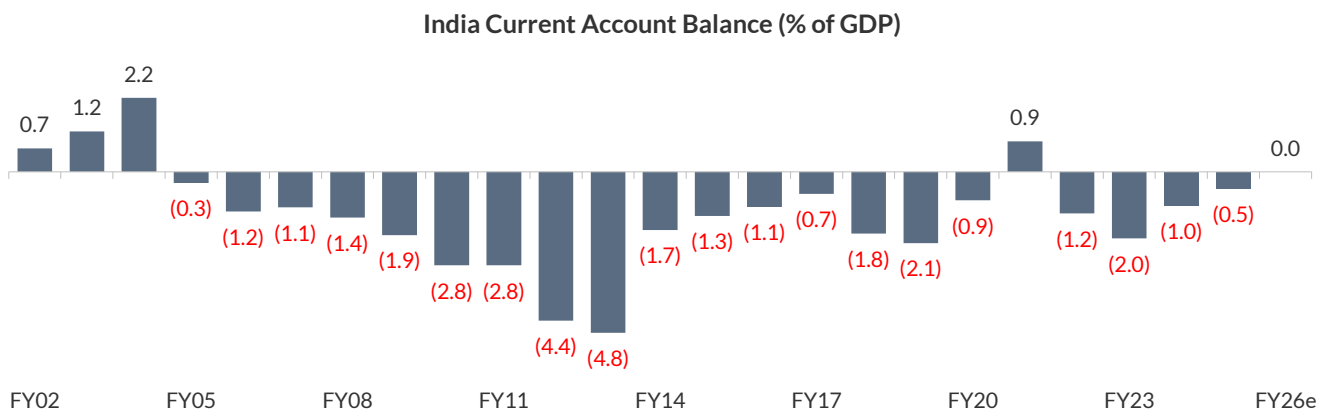
KEVAL SHAH, Associate

Exhibit 1: The Indian Rupee seems to have bottomed around 83.5 against the USD and is due for a structural uptrend, reflected by the resilience in the currency over the past 12 months



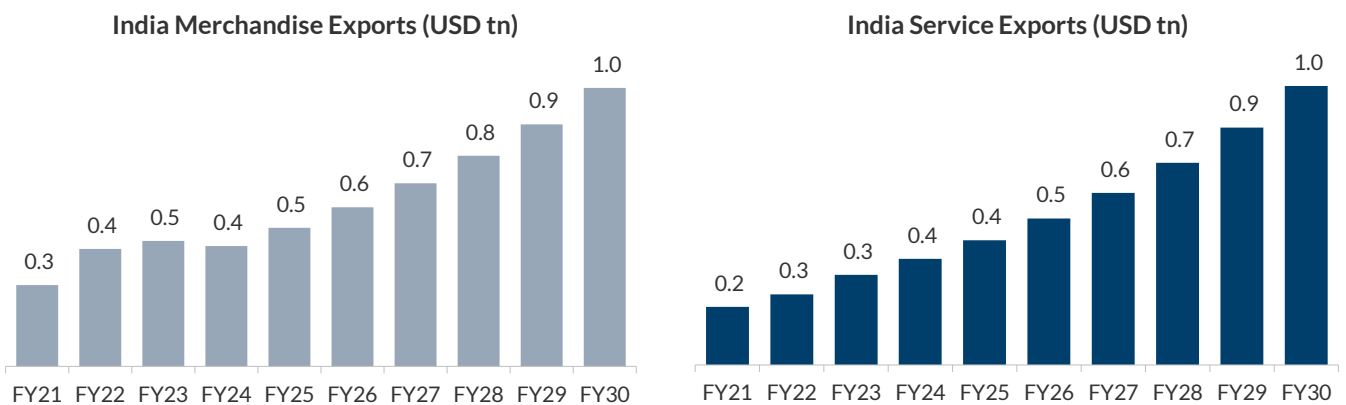
Source: Bloomberg, YES Sec

Exhibit 2: Narrowing CAD has proven to be supportive for INR, with visibility of the Current Account turning into a modest surplus over the next two years



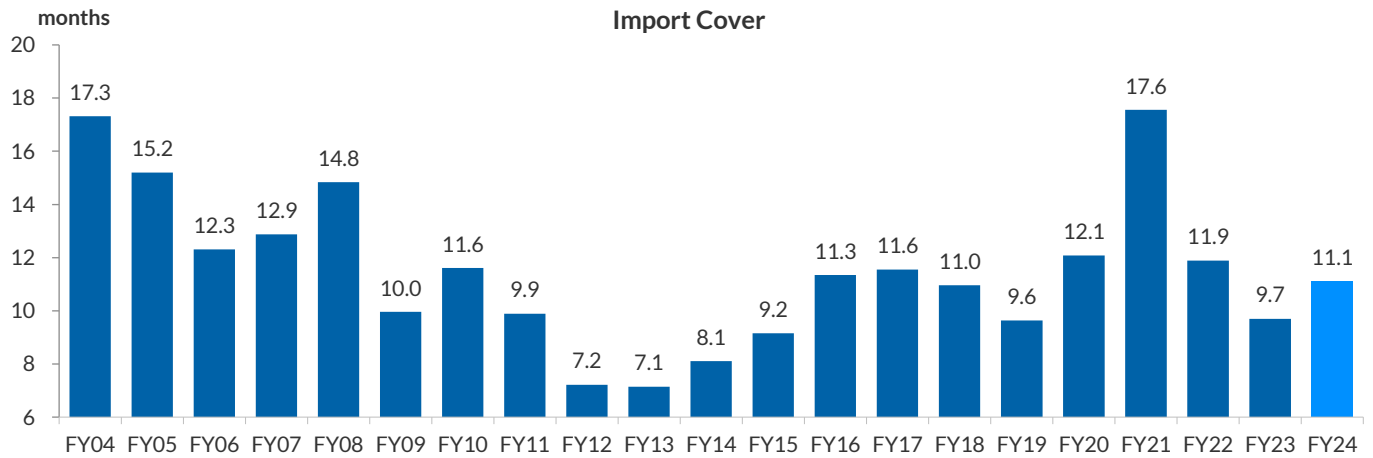
Source: Bloomberg, YES Sec

Exhibit 3: India's Government is incentivizing the expansion of Outbound shipments, with Merchandise and Service Exports seen totalling US\$2 trillion by FY30



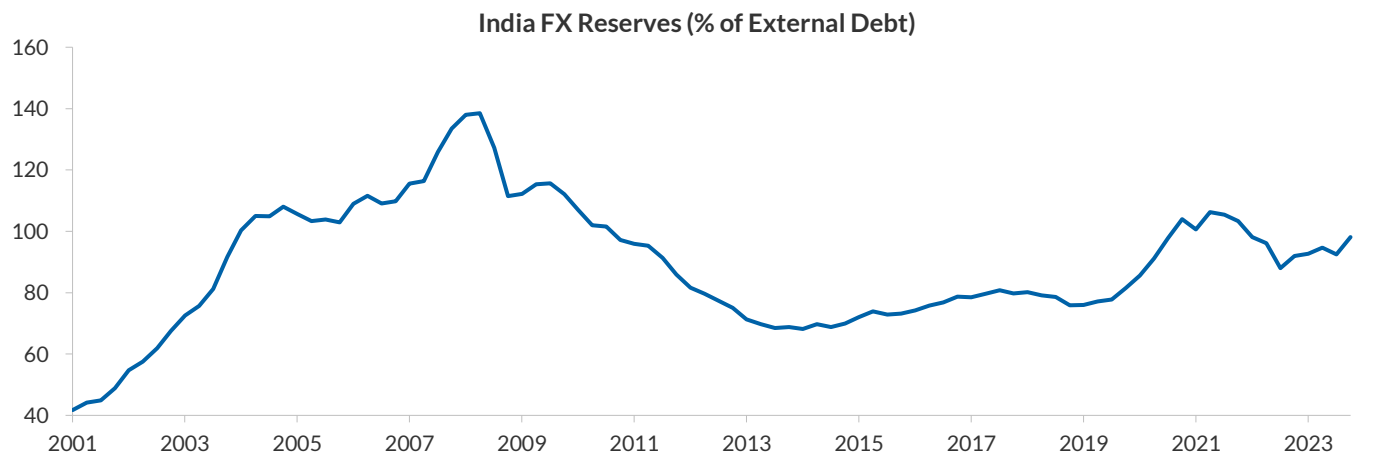
Source: Bloomberg, YES Sec. Note: Projections for FY24-30

Exhibit 4: Growing FX Reserves and augmenting domestic manufacturing will ensure that India's import cover remains within comfortable levels...



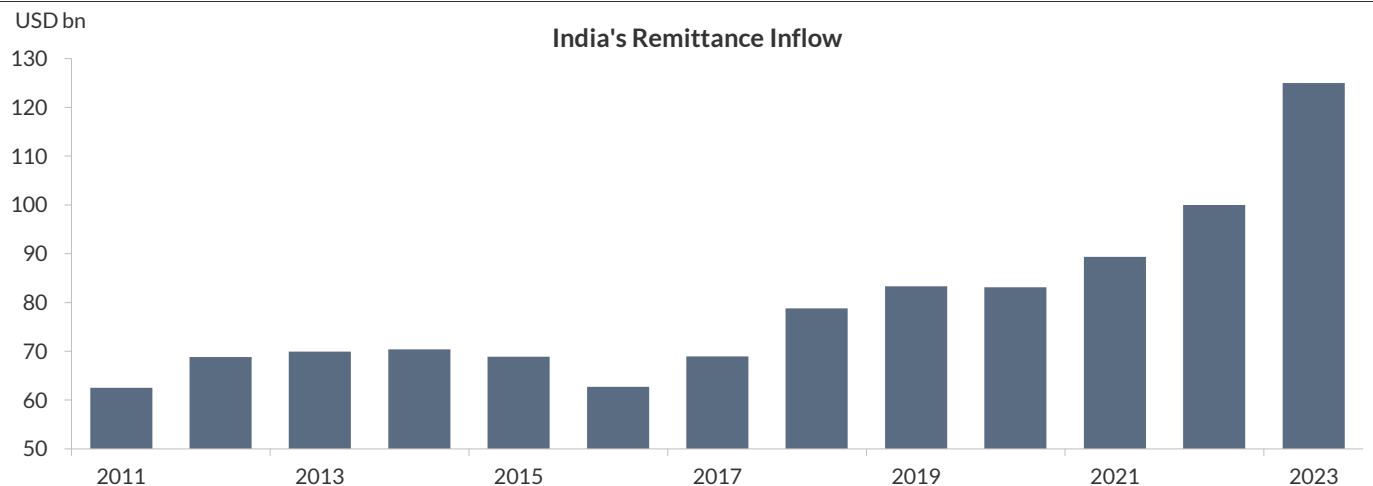
Source: Bloomberg, YES Sec

Exhibit 5: ...FX Reserves are at adequate levels to cover External Debt



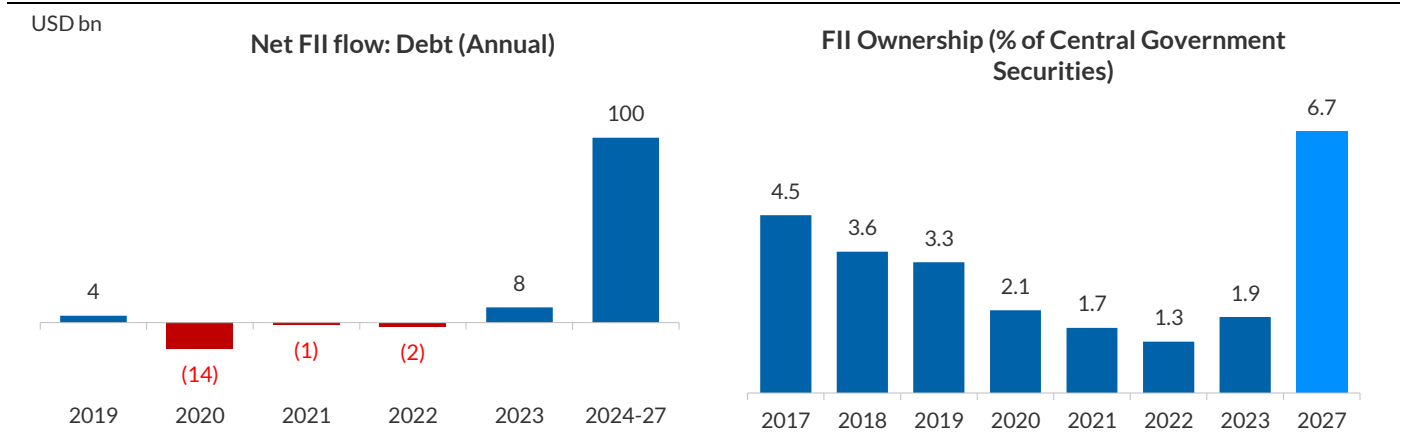
Source: Bloomberg, YES Sec

Exhibit 6: Inward Remittances continue to swell, adding to the Balance of Payments



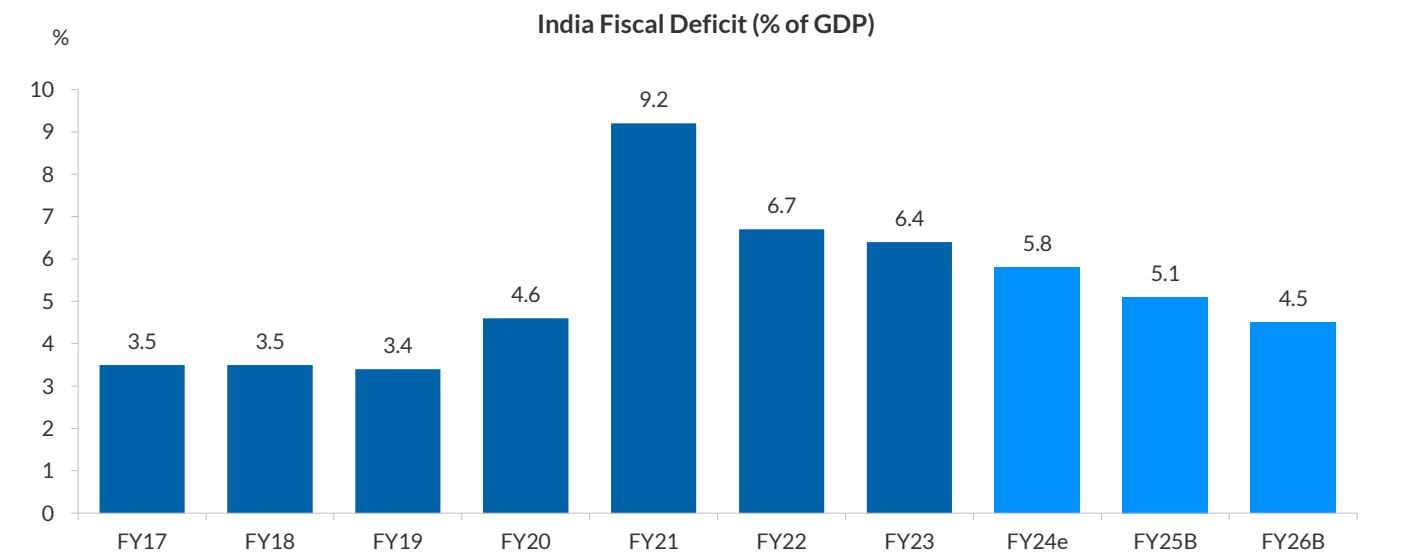
Source: Bloomberg, YES Sec

Exhibit 7: Indian Debt Markets are seen receiving foreign capital inflows worth USD 100bn over the next 3 years. Notwithstanding the hefty inflows, FII ownership of Indian Sovereign Debt will be low, which will avert the risk of high volatility



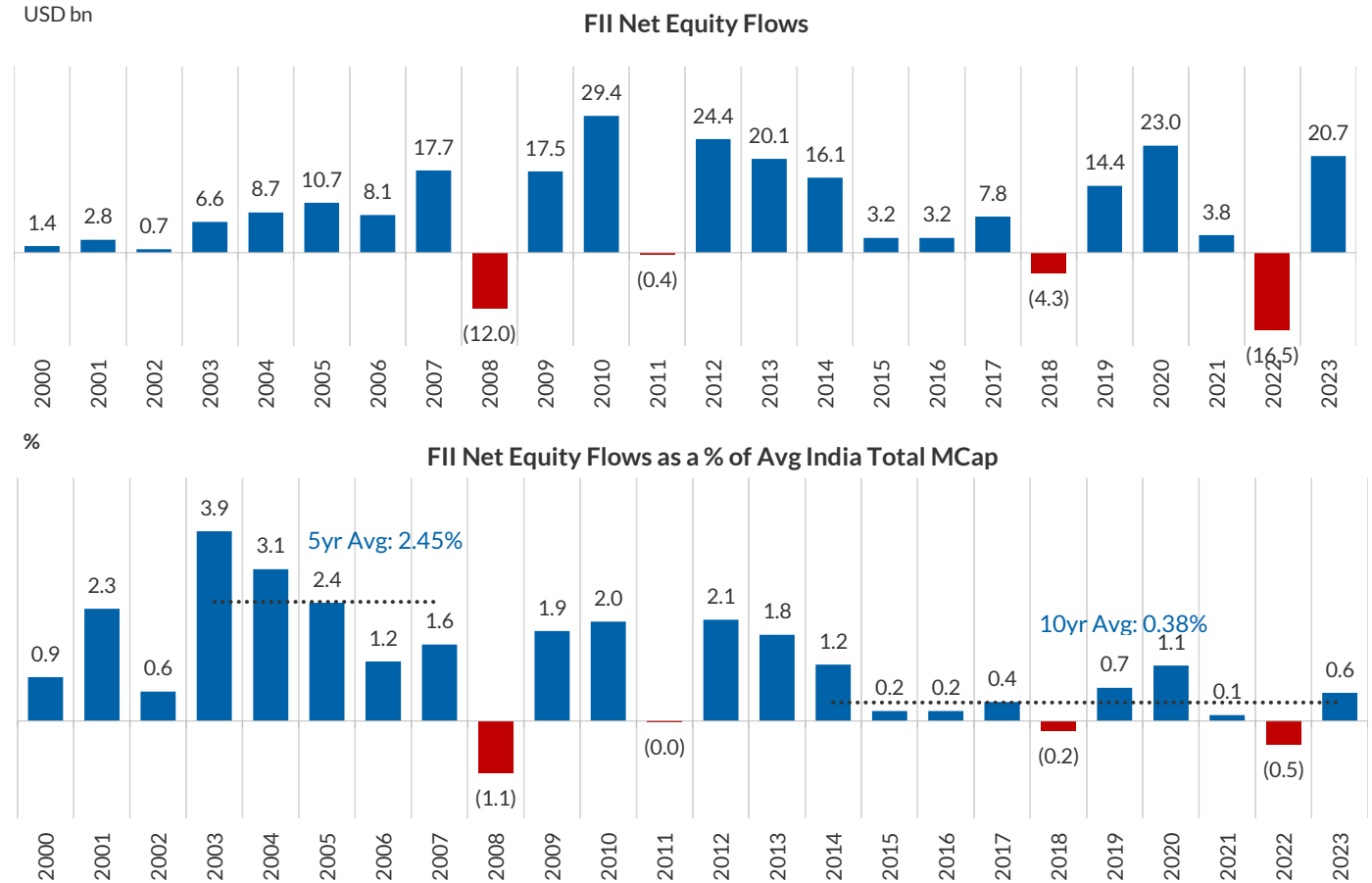
Source: Bloomberg, YES Sec. Note: Projections for Calendar Year 2024-27

Exhibit 8: India's Fiscal Roadmap augurs well for the foreign capital inflows in Debt markets



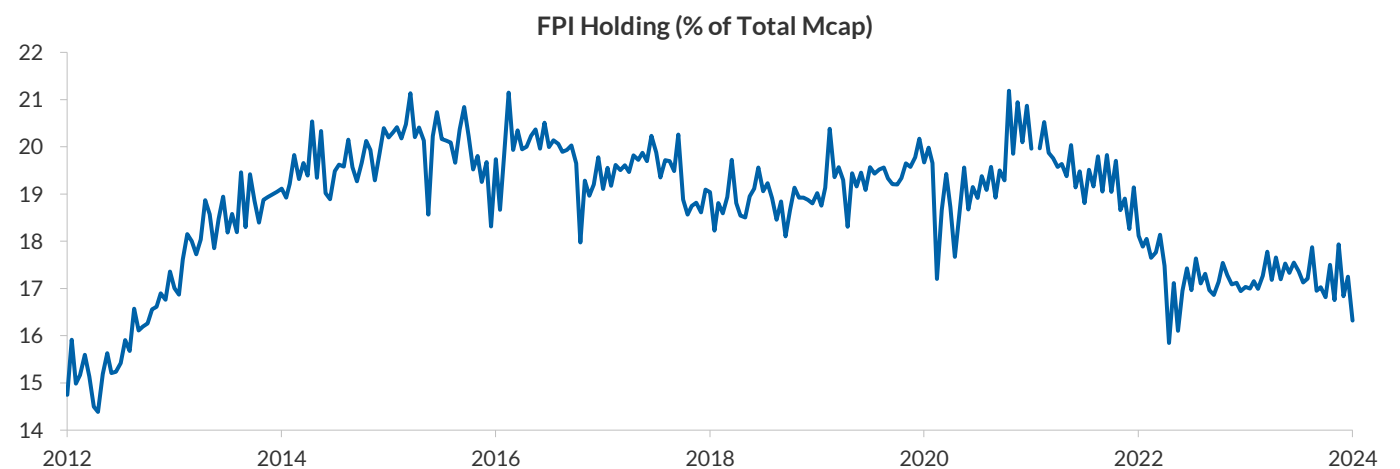
Source: Bloomberg, YES Sec. Note: B implies Budgeted projections

Exhibit 9: India's Equity Markets have not yet seen the same magnitude in FII inflows when compared with the 2003-07 period. The best is yet to come given that FII Net Equity Flows as a percentage of Market Capitalization over the last ten years have averaged well below 0.5%, much lower than the 2003-07 average of 2.5%



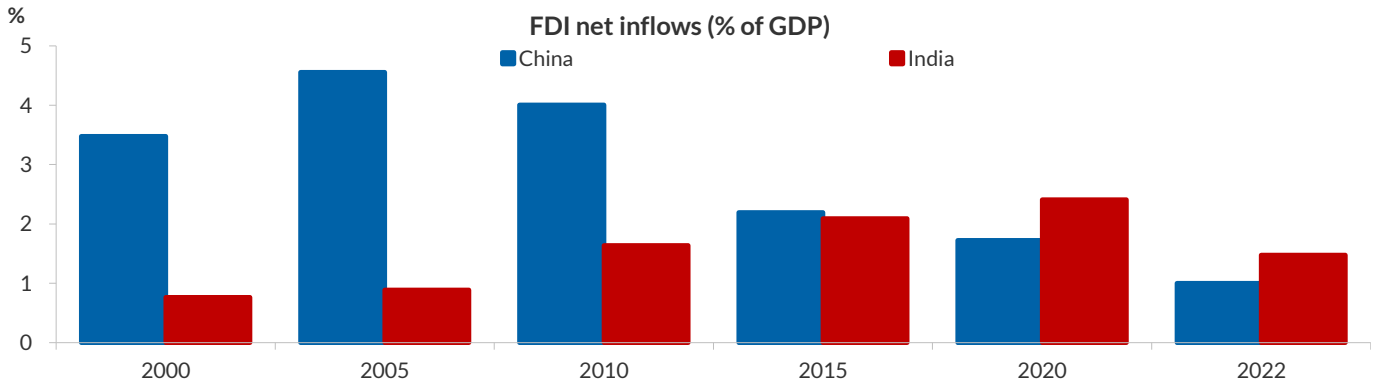
Source: Bloomberg, YES Sec

Exhibit 10: Foreign ownership of Indian Equities remains low, implying ample scope for higher portfolio inflows



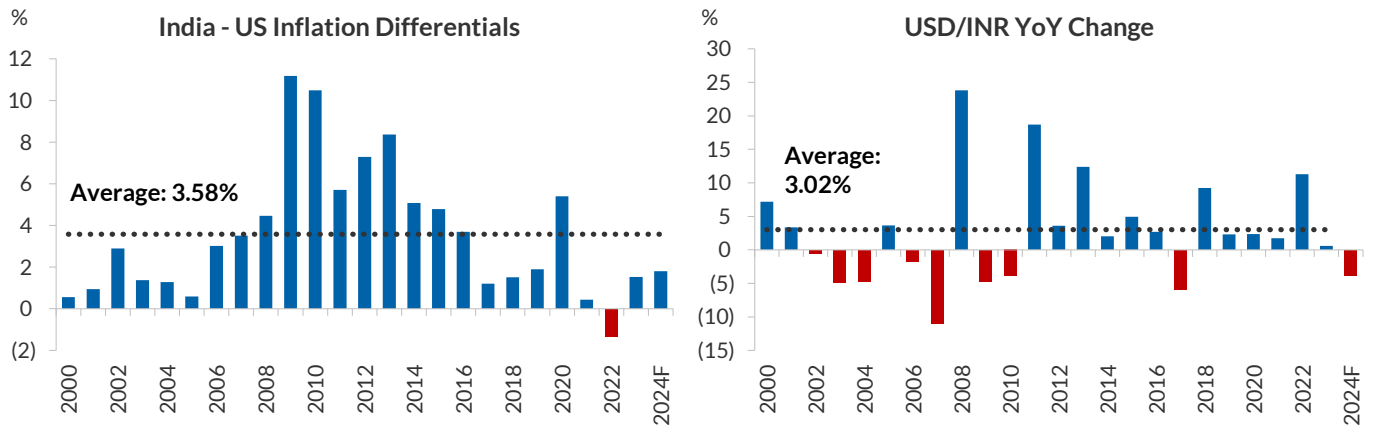
Source: Bloomberg, YES Sec

Exhibit 11: Indian FDI as % of GDP is now higher than China's, unlike 10 years ago. Indian Government's Emphasis on domestic manufacturing will continue to lure Foreign Investments



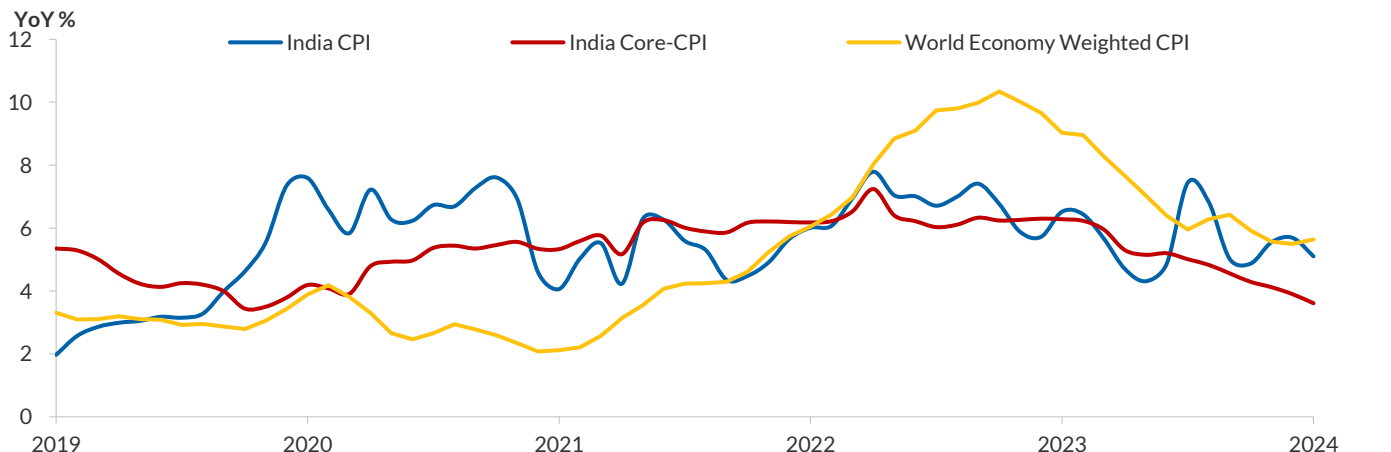
Source: Bloomberg, YES Sec

Exhibit 12: The broader Trend in the Indian Rupee has largely been driven by inflation differentials between India and the US. An average 3.5% inflation differential has resulted in an average 3% annual depreciation in Indian Rupee over the last 2 decades. However, the inflation differential has narrowed and is projected to stay well below the historical average, underpinning the Indian Rupee...



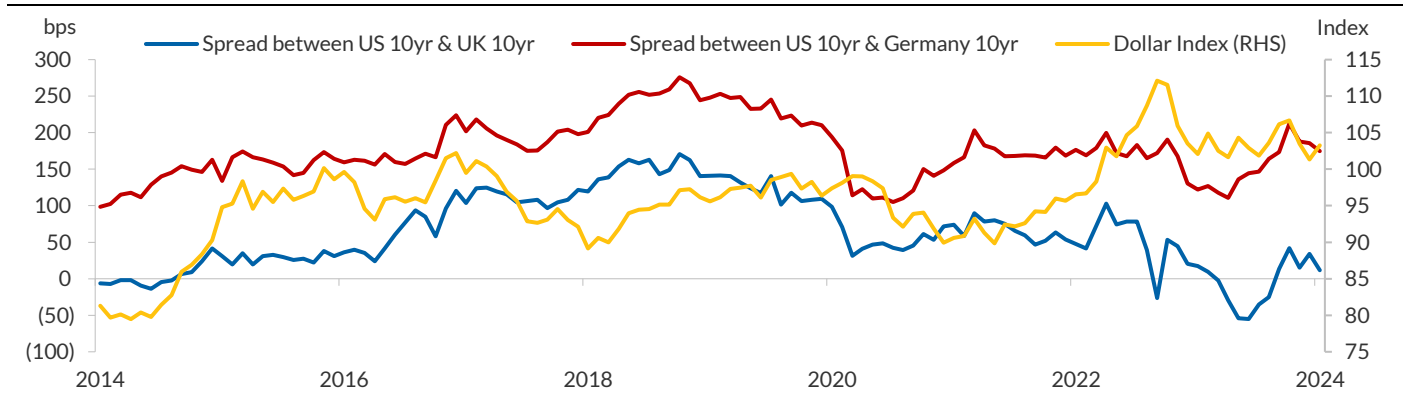
Source: Bloomberg, YES Sec

Exhibit 13: ...India's Headline and Core Inflation have moved below the Global average, ensuring less scope for depreciation in the Rupee



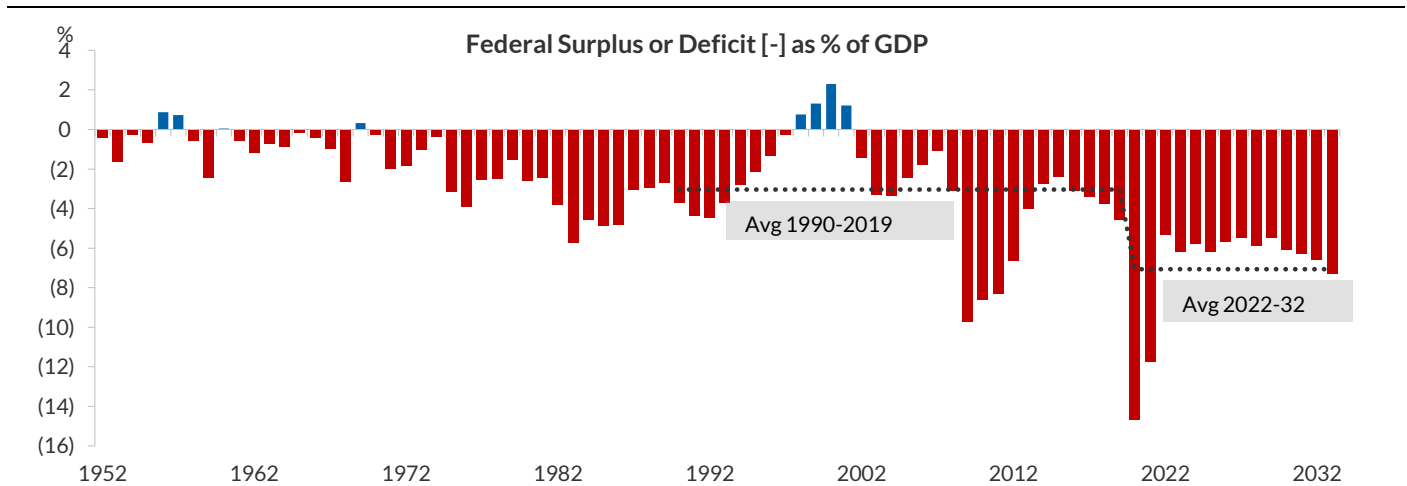
Source: Bloomberg, YES Sec

Exhibit 14: Hawkish Monetary policies have narrowed the spread between the yields on the US Treasury and German Bunds/ UK Gilts. BoE and ECB are likely to synchronise the reversal of their monetary policies with the Fed, keeping the spread with the US Treasury in a familiar range, which does not justify any strong upside in the Greenback against major currencies...



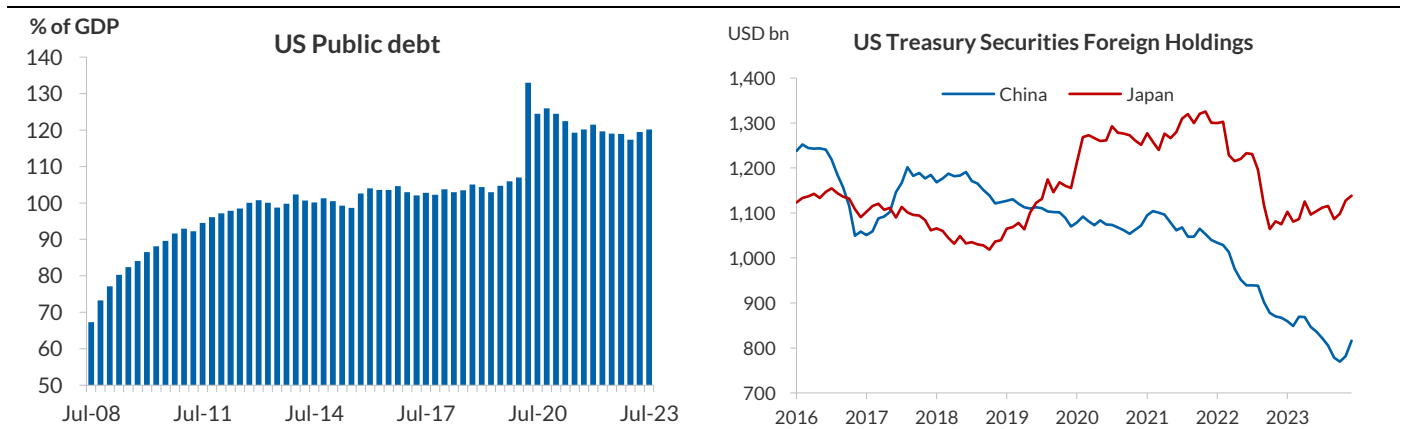
Source: Bloomberg, YES Sec

Exhibit 15: ... a wider US Fiscal deficit cannot justify a stronger US dollar. US Fiscal shortfall is seen averaging 7% over the next ten years when compared with the average of 3% during the last 3 decades...



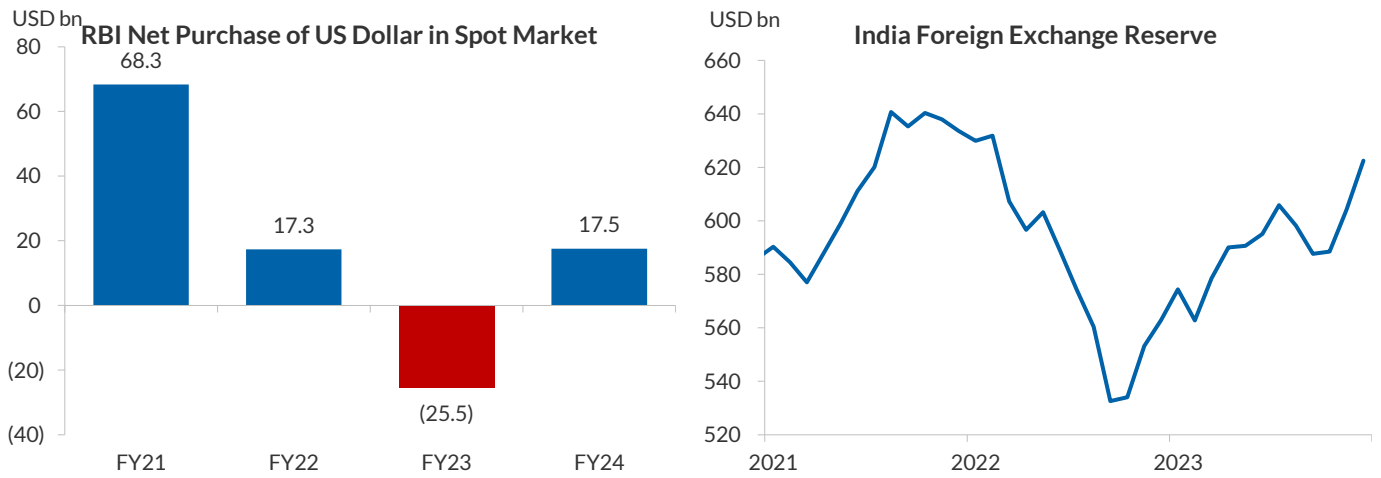
Source: Bloomberg, YES Sec. Note: Projections from 2023 onwards

Exhibit 16: ...while Rising US Government Debt accompanied by falling foreign ownership of US Treasuries takes away the impetus for a Stronger US dollar



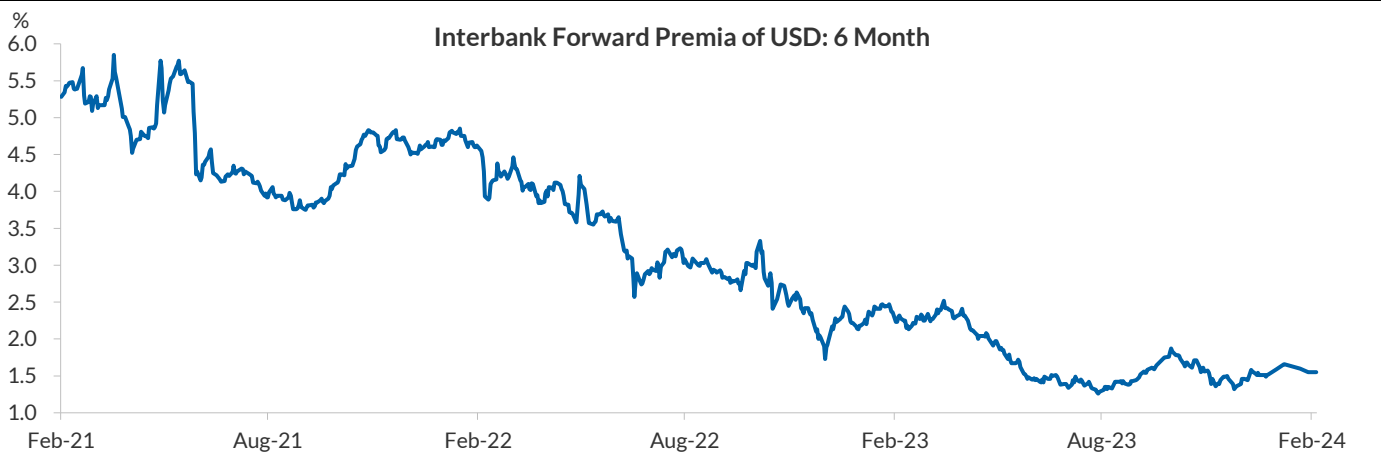
Source: Bloomberg, YES Sec

Exhibit 17: Persistent interventions by the Reserve Bank of India to build FX reserves are restricting the appreciation of the Indian Rupee...



Source: Bloomberg, YES Sec. Note: FY24 data covers April - December 2023 period

Exhibit 18: ...though Lower forward premia translates into stable trajectory for INR



Source: Bloomberg, YES Sec

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