

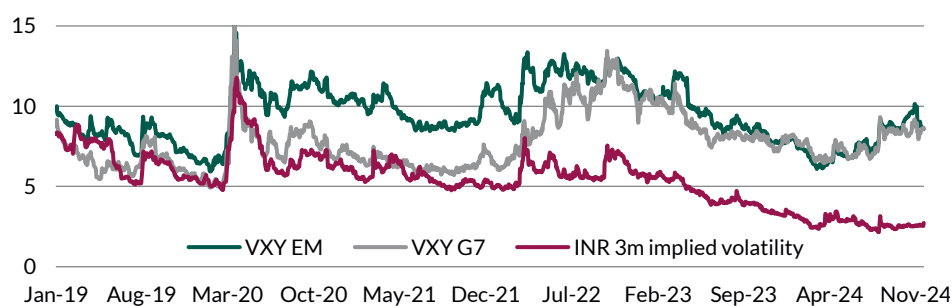
INR: A steady increase of volatility appears likely

The INR has become one of the most stable currencies globally due to extensive RBI intervention. While this has its rewards, it has resulted in weak hedging by businesses/investors. While the RBI has sufficient reserves (even adjusting for forward shorts), the balance-of-payments position has deteriorated due to EM outflows, end of FPI bond buying and steady VC/PE repatriation. Given the expected volatility in currency markets globally going forward (uncertainty on tariffs, CNY, US rates and oil prices, among others), it may be prudent to shift some risk back to businesses through a gradual rise in INR volatility. We expect the USDINR trading range to widen in the coming months.

December 02, 2024

INR update

Exhibit 1 - INR volatility - is it time to finally reconverge with global trends?



Source: Axis Bank Research

INR has among the most stable currencies, helped by extensive intervention

The INR has become one of the most stable currencies globally over the past 12 months. Both implied (Fig 2) and realised volatility (Fig 3) metrics are now much lower than peer currencies as well as its own volatility in the past. This has been accomplished by extensive RBI intervention on both sides – the volatility of the INR has been replaced by the volatility of intervention (Fig 4). Thus far, given the positive balance-of-payments, this meant a relatively steady rise in FX reserves (Fig 5), and the only cost to the economy was weaker seigniorage, as returns are lower on foreign assets than domestic ones.

Side effects of low volatility are now showing up

A stable currency signals macroeconomic health, and some also see central banks incurring such costs like public service, reducing uncertainty for businesses and investors. However, limited volatility over long periods of time has reduced corporate hedging (Fig 8), increasing the reliance on RBI to suppress volatility. Further, the Balance of Payments (BoP) is now shifting, with the index-inclusion-driven FPI bond buying over, a stronger DXY driving EM fund outflows, and high FDI repatriation as VC/PE funds book gains on prior investments (Fig 6). Despite a low CAD due to a slow economy (Fig 7), adjusted for reported onshore forwards and estimated offshore activity, BoP is no longer in a comfortable surplus (Fig 9).

Higher volatility might alleviate stress, and help INR find its right level

With ~USD 655 bn in FX reserves, even adjusted for forward shorts, the RBI has the ability to defend the INR for long periods (Fig 9). However, given uncertainty on tariffs, US rates, CNY, commodity prices (especially oil) and global risk appetite, it is reasonable to expect elevated volatility in global currency markets in the coming quarters. It appears prudent to shift some of the currency risk back to businesses and investors via a gradual rise in volatility, one that does not cause panic in unhedged parties and force intervention once again. The March quarter, seasonally strong for BoP, could be a good period to establish this trend. We watch for gradual widening of the intraday and overnight ranges allowed by the RBI.

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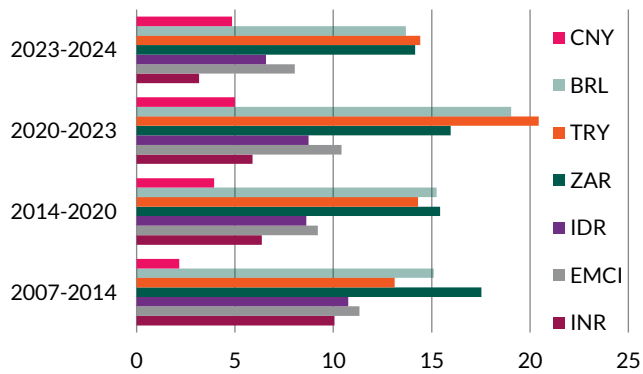
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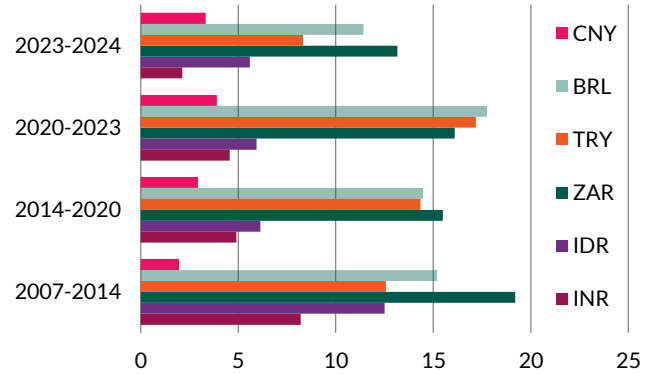
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Exhibit 2 - INR implied volatility lower than peers and lower than in the past



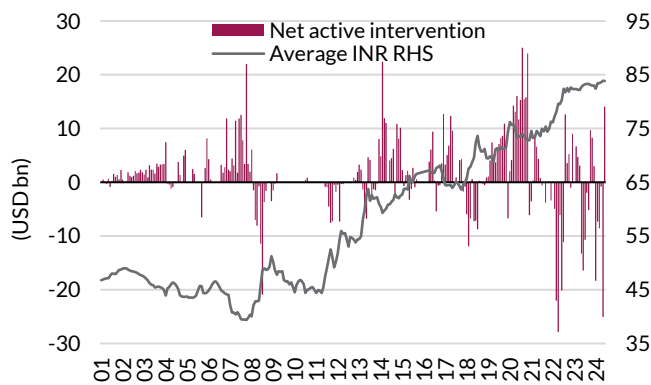
Source: Bloomberg, Axis Bank Research

Exhibit 3 - INR realized volatility is also lower than peers and lower than in the past



Source: Bloomberg, Axis Bank Research

Exhibit 4 - Volatility in INR replaced by that in intervention since late 2022



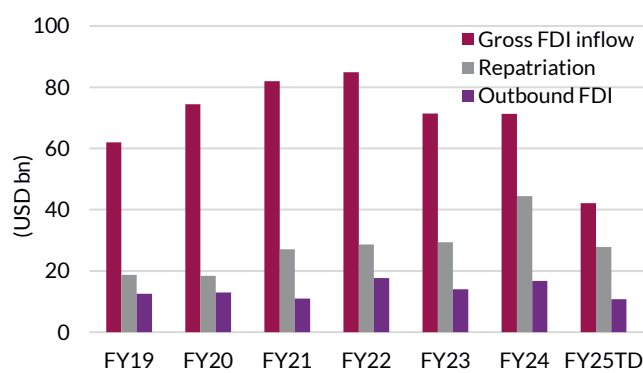
Source: RBI, Bloomberg, Axis Bank Research

Exhibit 5 - India FX reserves are healthy, given the positive BOP position for the last few years



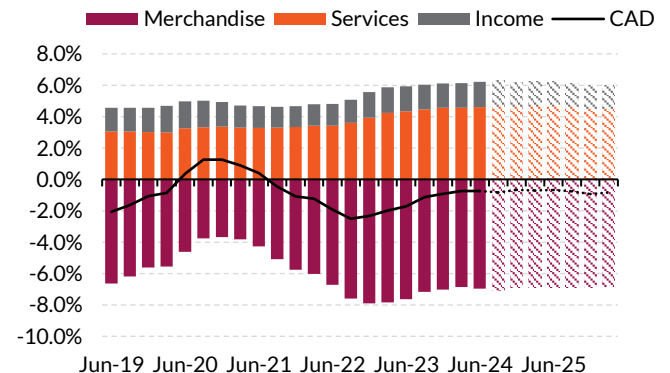
Source: RBI, Axis Bank Research

Exhibit 6 - FDI inflows - pickup in repatriations has dulled impact of inflows



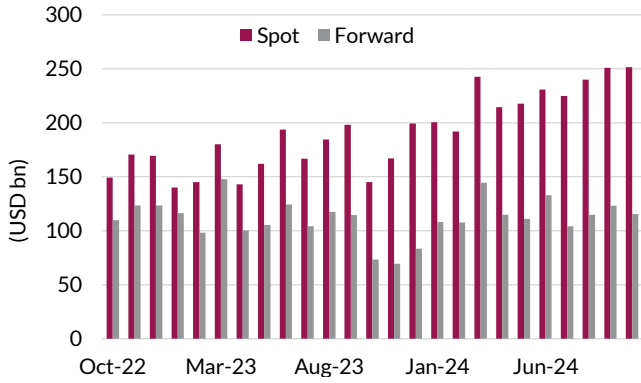
Source: RBI, Axis Bank Research

Exhibit 7 - Current account deficit trends - barring a strong recovery in growth, CAD will remain muted



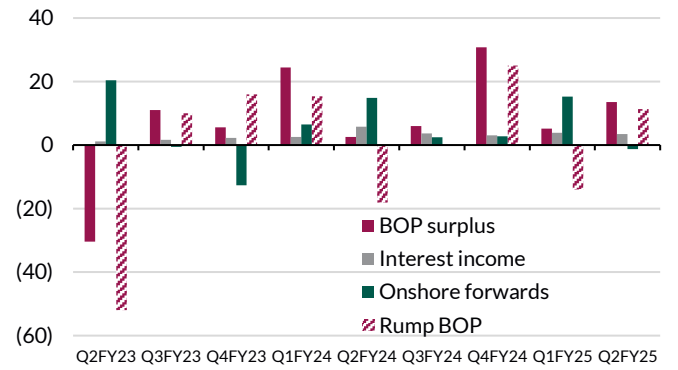
Source: RBI, Axis Bank Research

Exhibit 8 - Low volatility is driving flows away from hedging (forwards) to concurrent (spot)



Source: RBI, Axis Bank Research

Exhibit 9 - BOP excluding interest income and onshore forwards has been mixed over 12 months



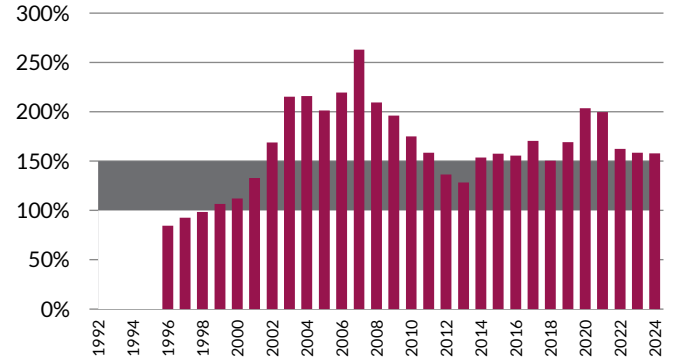
Source: RBI, Axis Bank Research

Exhibit 10 - FX reserve metrics (in months) – import and external debt cover both at comfortable levels



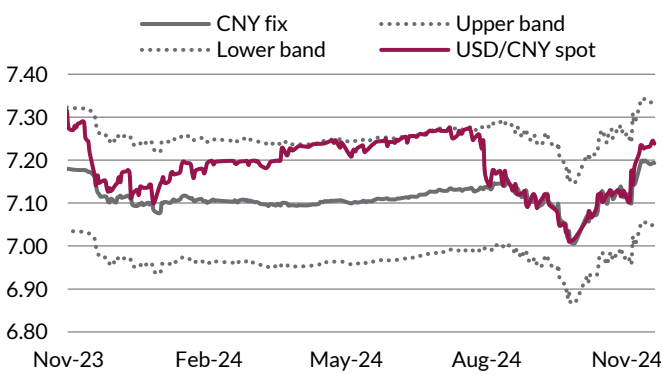
Source: RBI, DEA, Axis Bank Research

Exhibit 11 - IMF ARA – reserves as % of ARA metric still above recommended levels



Source: IMF, Axis Bank Research

Exhibit 12 - CNY – authorities are now fighting depreciation, but can be lumpy given US negotiations



Source: Bloomberg, Axis Bank Research

Exhibit 13 - Watch for gradual widening of near-term movements in INR allowed by RBI



Source: Bloomberg, Axis Bank Research

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