# FX Insight

# INR: Election Pressures Fade, RBI Supportive of Carry

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## Election Pressures Fade, Favourable Environment for Carry

We explore the implications of the Indian elections and the most recent RBI decision on the INR. We examine RBI actions to hold the INR steady, look at the results in terms of reduced INR volatility and suggest that RBI will continue to hold the INR steady, and this will provide a favourable environment for carry trades which could provide tailwinds for the INR.

## Pressure on the Rupee Capped by RBI

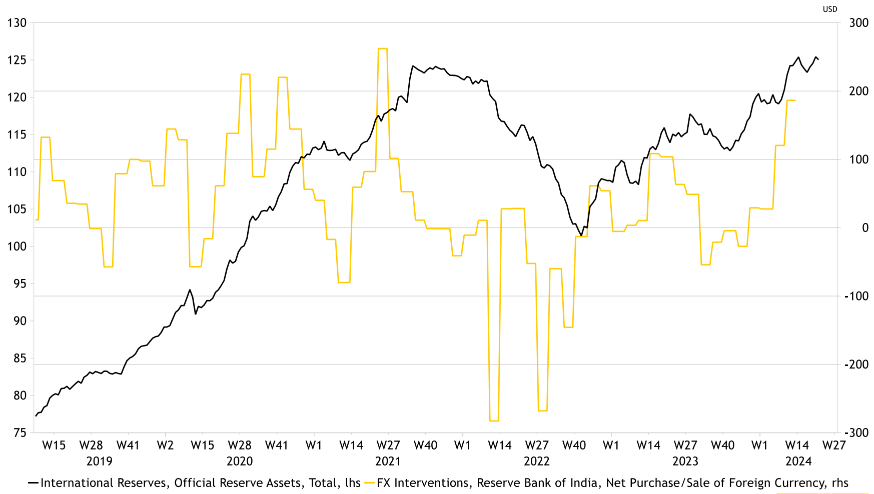
India's historic elections concluded on 4 Jun, and the results showed that the incumbent Bharatiya Janata Party (BJP) failed to achieve its expected majority. This came in stark contrast to both exit polls, which showed that the majority would be intact and Modi's own ambitious election targets of 370/543 seats in Lok Sabha. Actual results showed that BJP only won 240 seats, losing 63 seats, while rival Indian National Congress (INC) won 99 seats, a gain of 47 seats. The NIFTY index lost as much as 8.20% intraday, and the INR similarly came under pressure on the release of the actual results. Clearly markets did not take too kindly to BJP losing seats, although it would be key to note that under Modi's watch, the Indian economy has flourished, to understand why markets initially took the loss of seats in the election badly.

USDINR traded up to +1.70% higher intraday on 4 Jun or about 3.4 standard deviations (a high of 84.75), a move that is rather uncharacteristic for the INR. This was quickly arrested by what we think was RBI intervention as the pair quickly moved lower to trade at 83.64 levels. Upon news that Modi has tentatively formed a government USDINR has further stabilized around 83.50 levels. Both the ability and willingness of the RBI to intervene to stabilize the INR are unquestionable. Foreign reserves of about US$647b are near their all-time highs (US$649b) and the INR is among the most stable currencies. The latest statistical bulletin showed that RBI bought a net of US$13.25b in spot in Mar (Feb: US$8.56b). Meanwhile net outstanding forward book grew to US$23.60b in Mar (Feb: US$9.69b). Both spot and forward purchases increasing indicates that RBI intervened more heavily in Mar, where interestingly USD traded weaker in the earlier part of the month but climbed to finish the month higher. USDINR moves broadly followed this trend in USD, albeit at a much smaller magnitude compared to other currencies as USDINR hit a low of 82.65 and closed the month very near highs of 83.45. In comparison, the DXY index hit a low of 102.358 and closed the month near highs of 104.727. We suggest that RBI is looking to accumulate reserves when it can, so that it can employ them to stem currency volatility in times of stress, such as on 4 Jun where the release of election results injected fresh volatility into the USDINR.

## India's Reserves Position is Healthy and Strengthening

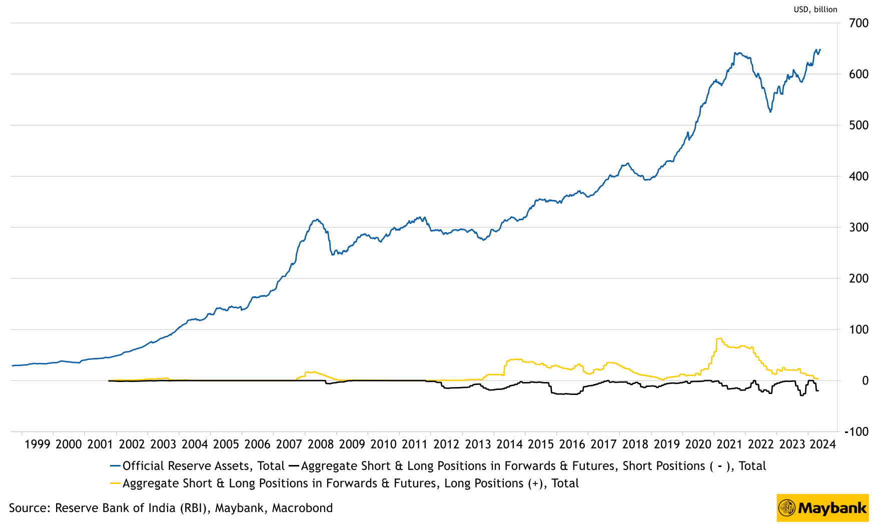
Chart 1 shows that on net, RBI interventions have contributed to roughly a 25% increase in India's foreign reserves since 2020 (and a 67% increase since 2019). For central banks looking to manage their currencies, the size of reserves is crucial since it essentially dictates how much firepower they have to defend their currency against depreciating pressures. Chart 2 shows that India's reserves have grown to a sizeable US$647b. Since 2020, India's declared net purchases are at an average of +US$1.4b monthly. The maximum drawdown on reserves in a month was -US$20b in Mar 2022 and the maximum increase was +US$18b in Jun 2021. Current levels of reserves implies that India should be able to withstand about 32 consecutive months of the maximum drawdown in reserves, which is an extremely unlikely case considering that reserves have been steadily growing. We do not think that the weaker BJP mandate will fundamentally change the economic drivers for India and certainly should not lead to outsized outflows that will necessitate a larger or more sustained drawdown in reserves. Hence, RBI has the wherewithal to back up its preference to moderate INR volatility.

**Chart 1: RBI Interventions are increasing the Size of Reserves (Indexed to 2020)**




Source: Reserve Bank of India (RBI), Maybank, Macrobond

**Chart 2: Growth in India's Foreign Reserves**

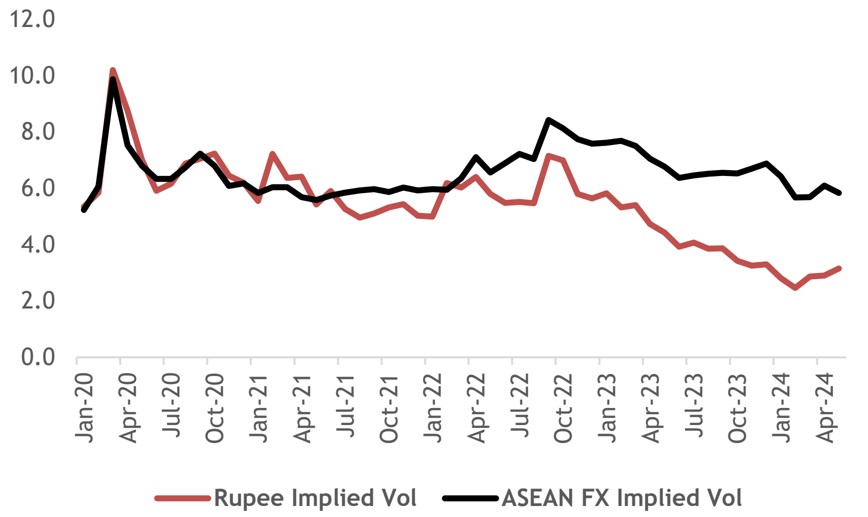



Source: Reserve Bank of India (RBI), Maybank, Macrobond

### Low Volatility Provides for a Favourable Carry Trade Environment

We observe that INR volatility has been low relative to other currencies. Even against an average of ASEAN currencies (which should theoretically have lower volatility) INR volatility is lower. We suggest that this provides a favourable environment for carry trades, since the risk of a sudden move in spot that wipes out carry gains is lowered.

**Chart 3: Rupee Volatility Low Relative to ASEAN FX**




*Source: Bloomberg, Maybank FX Research and Strategy*

Moreover, INR-based carry trades are at historically favourable levels both against itself and across currencies. In some sense, this implies that risk-adjusted returns for carry trades should be favourable, since volatility is low and carry returns are at historical high levels. This should provide some tailwinds for INR, which the RBI could lean against as well.

**Charts 4: Rupee Carry at Historically Favourable Levels across Currencies**

**Chart 4A: XXXUSD 3M Carry**

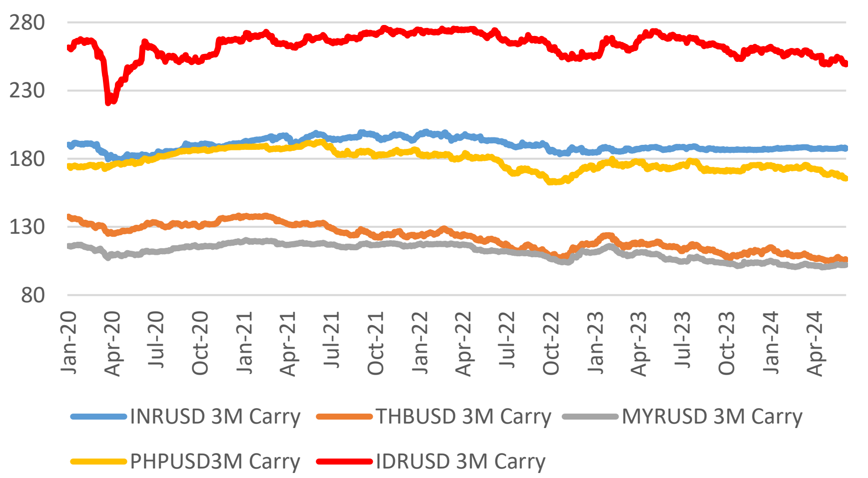


Chart 4B: XXXJPY 3M Carry

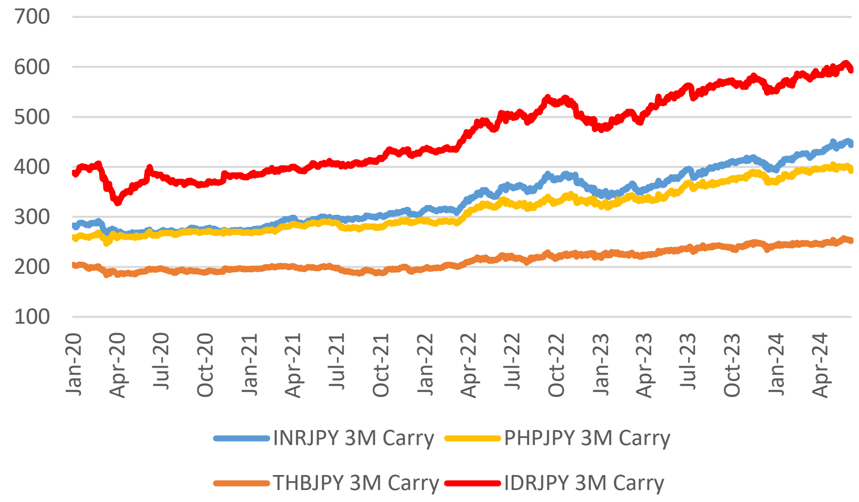
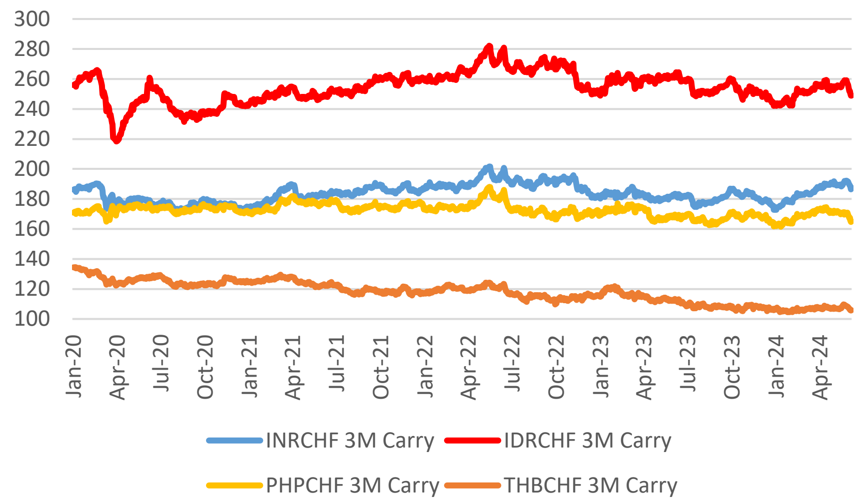



Chart 4C: XXXCHF 3M Carry




*Source: Bloomberg, Maybank FX Research & Strategy Estimates*

*Note: Carry is reflected as a result indexed to 1 Jan 1999 i.e. a reading of 100 implies that carry is identical to carry on 1 Jan 1999 and 200 implies a carry of 2 times carry on 1 Jan 1999. Computed based on borrowing USD, JPY or CHF, placing it in at the XXX three month deposit, and selling XXX in three months based on the forward rates on the day to unwind.*

**RBI Decision and Outlook**

The RBI kept rates on hold today at 6.50% in a 4-2 split (prev: 5-1 split) in favour of accommodation withdrawal. RBI also raised India's growth view through March 2025 to 7.2% (prev: 7%) and maintained its inflation forecast at 4.5% (within 2% to 6% target range). Our view for 2024 is that the RBI will keep rates on hold (or at least while the Fed remains on hold) while most other global central banks are more at risk of cutting. Growth has been healthy in India, is likely to continue to flourish and inflation is also within target, so the RBI is in no hurry to slash rates to be more growth supportive. In addition, there could be concerns about INR-weakness should it cut ahead of the Fed and while this should be a secondary consideration for the central bank, RBI can also afford not to cut rates early. When considered in totality, this is also likely favourable for long-INR carry trades. The yield differential is more likely to widen further in favour of the INR, and this should be beneficial for carry returns, In addition, the RBI keeping the INR steady will be beneficial from the perspective of lowering the risks of INR weakening and weighing on carry returns.

**Risks to our View**

Key risk would be the sudden tanking of global growth and widespread fear that may jeopardize our outlook for the INR. However, this looks unlikely at the moment and our base case is for the US economy to fade, but not tank, and for the rest of the world to catch up to the US, in essence a global soft landing. There are nascent signs of this happening with Eurozone growth improving and the ECB starting to cut rates, although it may do so at a more measured pace than the market expects. India is also expected to do well and could benefit from foreign flows as investors de-risk from China as the US and its allies ramp up on China hawkishness.

Another risk would be if RBI elects to stop leaning against the wind and supporting the INR. However this risk is unlikely as leaning against the win when the INR is generally strengthening allows them to build their reserves for future usage when the INR comes under pressure. As long as this narrative continues to apply, it is unlikely that the RBI suddenly decides to materially change its stance on leaning against the wind to stabilize the INR.

**Hold our INR Forecasts**

We think that the RBI will continue on its stance of leaning against the wind and this provides an environment of low volatility that is favourable for carry trades. Against a backdrop of a Fed that could also cut rates later this year and a RBI which does not have much of a reason to cut rates, INR assets look even more attractive. We also maintain our forecasts for USDINR for the four quarters ahead, which imply a positive outlook on the belief that the USD will weaken as US economic exceptionalism fades and the Fed cuts rates (which should further improve INR carry). Forecasts are as set out in Table 1.

**Table 1: USDINR Forecasts**

| Forecast | 2Q 2024 | 3Q 2024 | 4Q 2024 | 1Q 2025 |
|---|---|---|---|---|
| USD/INR | 83.50 | 82.50 | 82.00 | 81.00 |

*Source: Maybank FX Research & Strategy Estimates*

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