panorama

March 2025

Key Insights:

INR depreciation primarily driven by external shocks and aggravated by internal vulnerabilities

- Sharp depreciation in the INR has primarily been driven by external shocks like Fed rate hikes, pandemic etc.
- However, domestic vulnerabilities like elevated CAD, financial stress or weak growth have also contributed
- Recent INR depreciation stems from USD strength and domestic concerns like weak growth and rich valuations
- INR driven more by growth-sensitive (FPI equity and FDI) than interest rate-sensitive flows (FPI debt, ECB etc.)
- INR’s correlation with growth-sensitive flows at -0.39, compared to -0.17 with interest rate-sensitive flows

At present, both external shocks and domestic vulnerabilities have diminished

- DXY has corrected from the peak levels, CAD remains contained and economic growth has bottomed out
- Net FDI flows to India have declined substantially because of higher depreciation/repatriation
- However, the recent market corrections should temper repatriations and improve net FDI
- INR forward premium has declined substantially on account of lower interest rate differential and INR stability
- The RBI's FX reserves meet the IMF's ARA framework but fall short after adjusting for the forward book

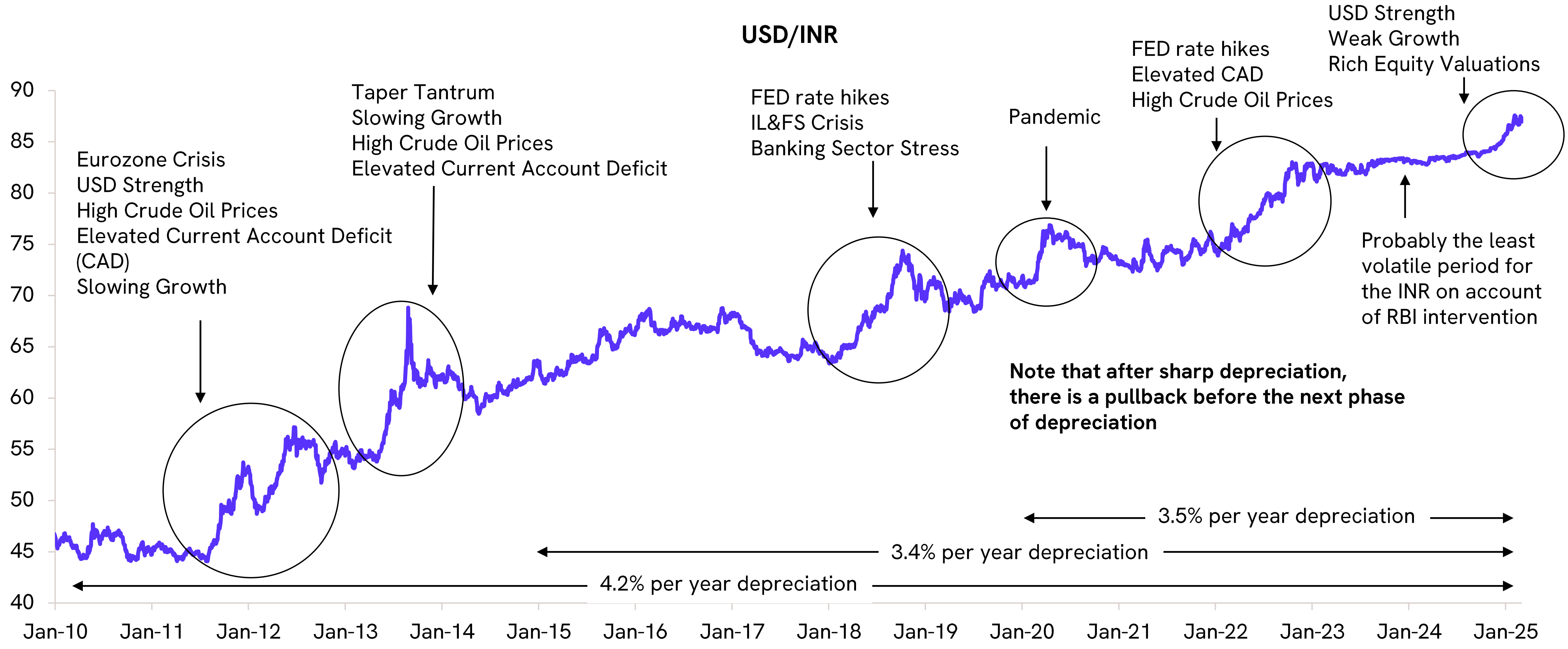
Weaker-than-expected earnings in December 2024 lead to further earnings downgrades

- Sales remained muted in Dec'24 for BSE500 companies, but profit growth improved due to better margins
- Beats-to-misses ratio improved for large caps but declined for mid-caps and even more for small caps
- Consequently, EPS downgrades accelerated, becoming more pronounced as market capitalisation declined

INR Drivers & Outlook

Sharp depreciation in the INR has primarily been driven by external shocks

However, domestic vulnerabilities like elevated CAD, financial stress or weak growth have worsened the currency stress

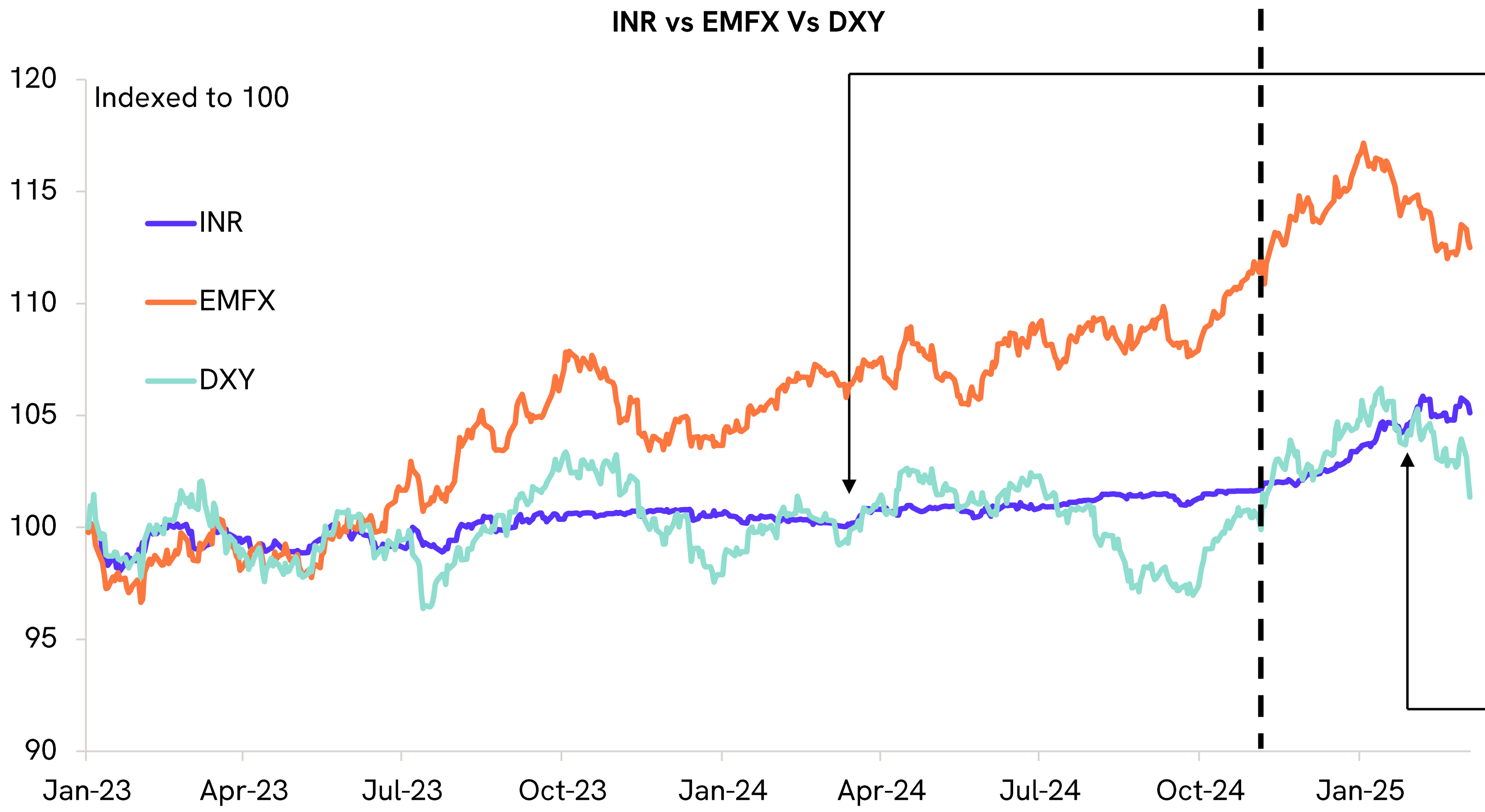


Currency Stress = f(external shock, domestic vulnerability)

Source: Bloomberg, 360 ONE Asset Research

INR underwent a regime shift from October 2024 onwards

RBI allowed sharper depreciation of the INR as the USD strengthened; however, the INR failed to recover even as the DXY corrected



INR remained extremely stable from Jan-23 to Oct-24, even as the broader emerging markets currency index (EMFX) depreciated and remained volatile

This stability was due to heavy RBI intervention during this period

Post-October 2024, RBI allowed sharper INR depreciation as the US Dollar (DXY) strengthened and EMFX weakened

The US Dollar (DXY) topped out in mid-Jan, and emerging market currencies started appreciating

However, no reversal was witnessed in INR due to domestic vulnerabilities such as weak growth, earnings downgrades, and rich equity valuations

Source: Bloomberg, 360 ONE Asset Research

Note- EMFX: JP Morgan Emerging Market Currency Index (inverted), DXY: US Dollar Index

INR driven more by growth-sensitive than interest rate-sensitive flows

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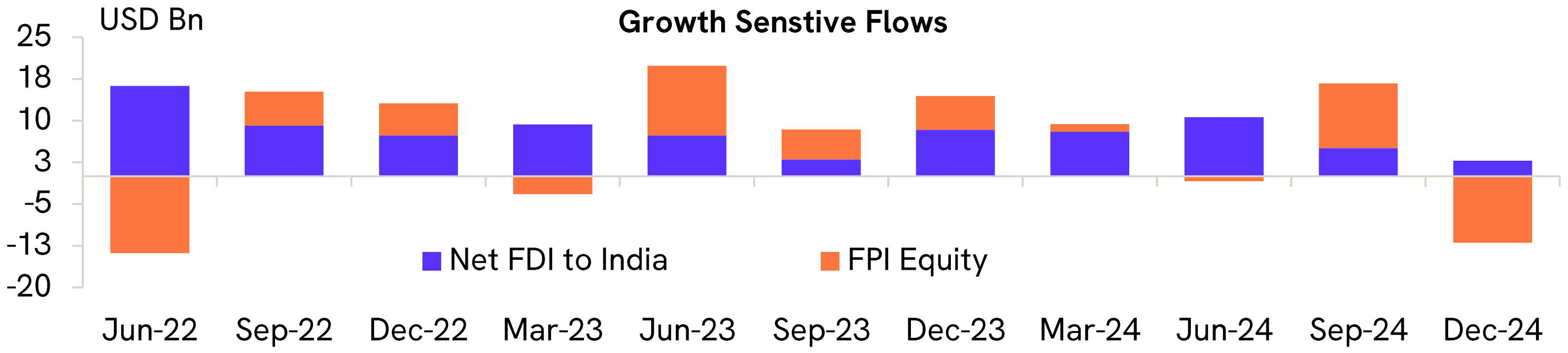
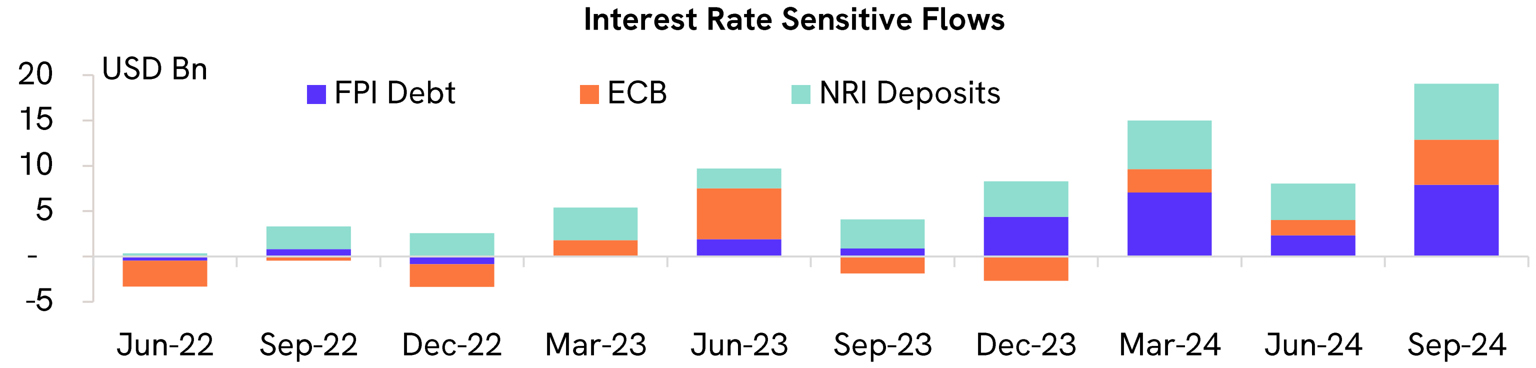
Growth-sensitive flows are larger in magnitude and more volatile, exerting a greater impact on the INR





Growth-sensitive flows include Foreign Direct Investment (FDI) and Foreign Portfolio Investment (FPI) equity flows

FPI equity flows are highly volatile and have been the main driver of the recent depreciation of the INR

Interest-sensitive flows include FPI debt, External Commercial Borrowings (ECB), and NRI deposits

Note that since Dec'23, FPI debt flows have been driven by global bond index inclusion rather than interest rate differentials

As of Feb 2025, FPI equity assets under custody stand at Rs 62.4 tn, far exceeding Rs 6 tn in debt assets

Capital flows to India are driven more by its distinctive growth story rather than interest rate differentials*.... Interest rate defence of exchange rate could turn out to be counter-productive especially during periods of global tide towards outflows driven by factors that do not differentiate across nations such as the risk-taking propensity of global investors or uncertainty driving reserve currency strength.*

\- Dr. Rajiv Ranjan, Minutes of the Monetary Policy Committee Meeting, February 2025

Source: CMIE, RBI, 360 ONE Asset Research

Growth-sensitive flows have a higher negative correlation with INR

INR's correlation with growth-sensitive flows at -0.39, compared to -0.17 with interest rate-sensitive flows

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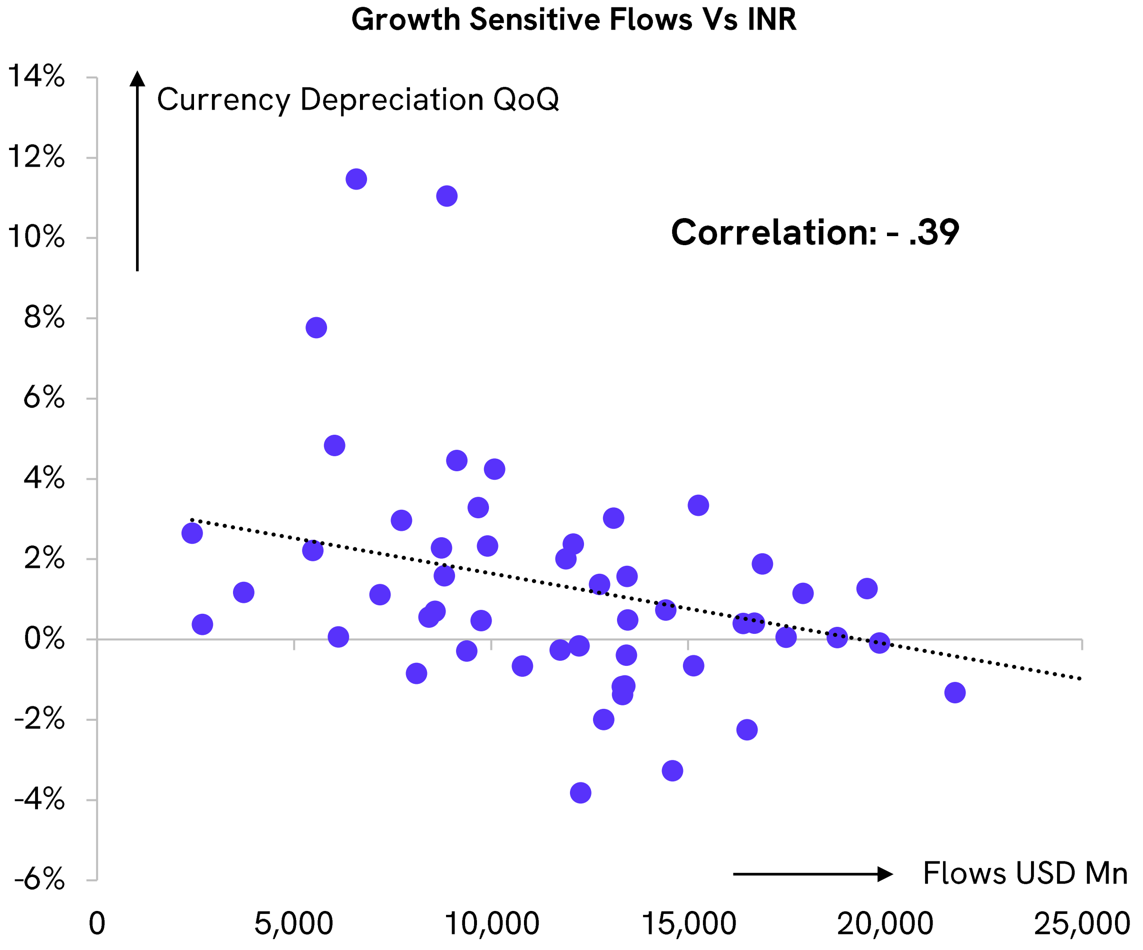
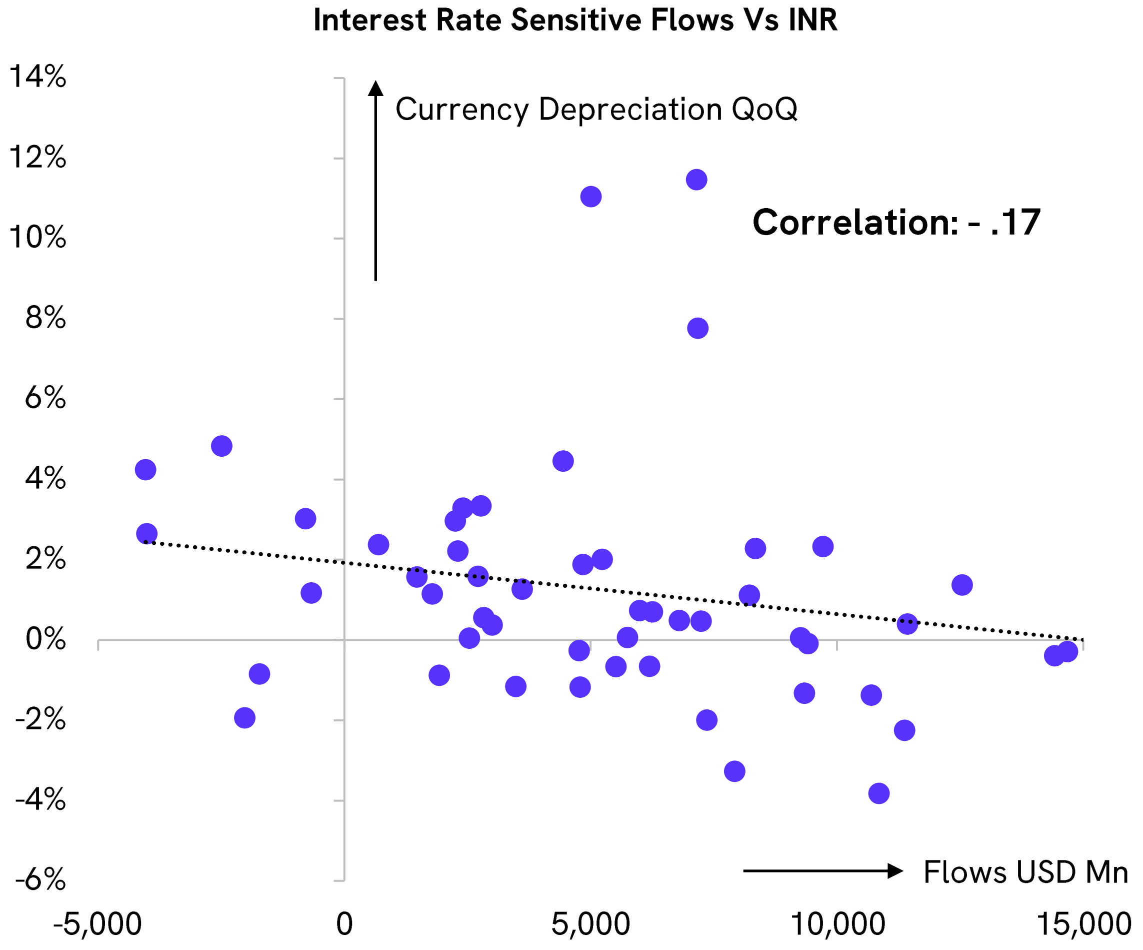


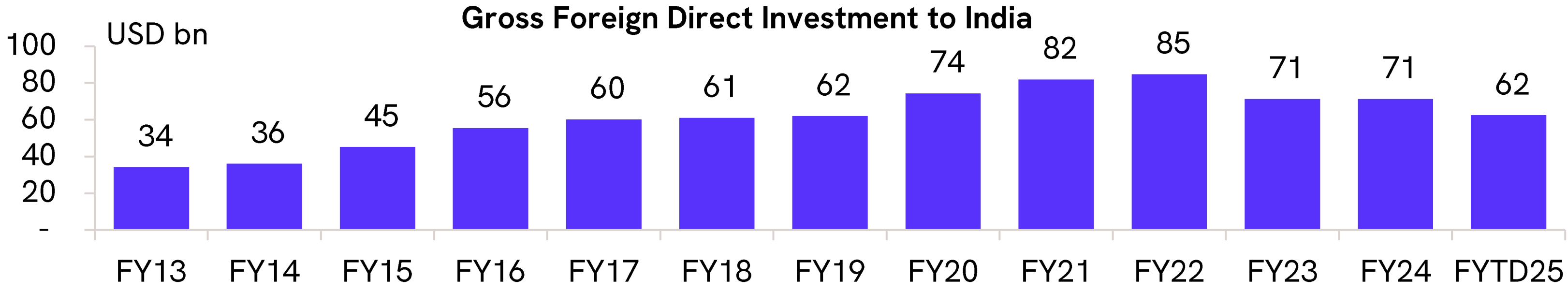


Source: CMIE, RBI, 360 ONE Asset Research

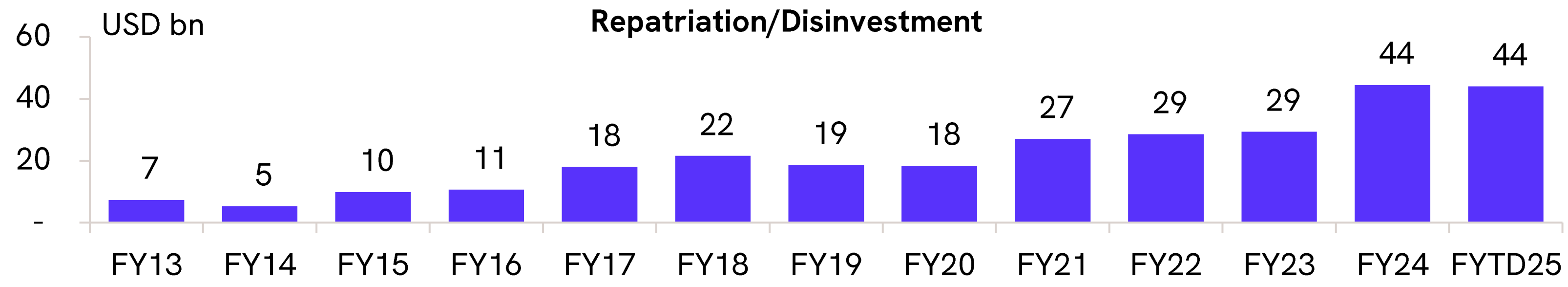
Note: Analysis done for the period June 2011 to September 2024

Net FDI flows to India have declined substantially over the past two years

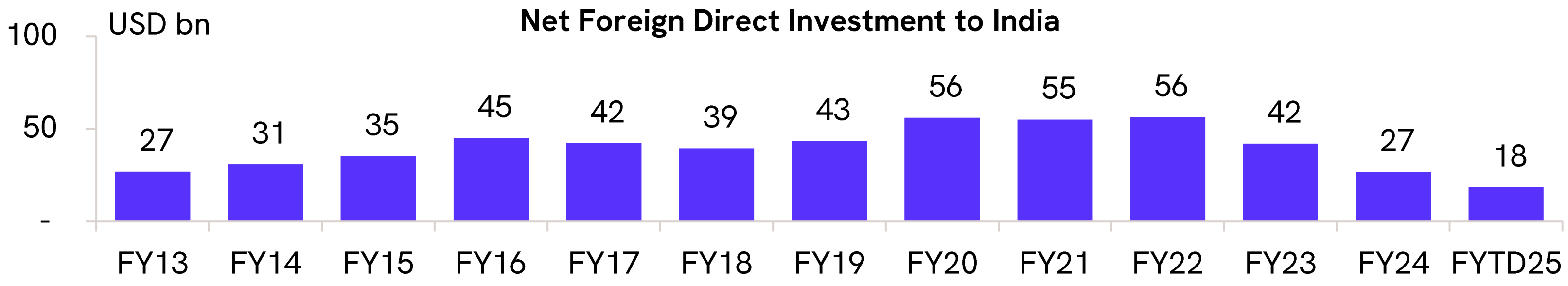
The decline has been primarily due to high repatriation/disinvestment caused by rich equity valuations



Gross Foreign Direct Investment (FDI) in India has moderated from the peak of USD 85 bn in FY22



Repatriation/disinvestment has risen significantly over the past two years due to the rich valuations offered by the Indian markets



Consequently, net FDI (gross – repatriation/disinvestment) in India has declined significantly

Muted net FDI has further contributed to the overall weakness of the INR

However, the recent market correction could temper repatriations and improve net FDI

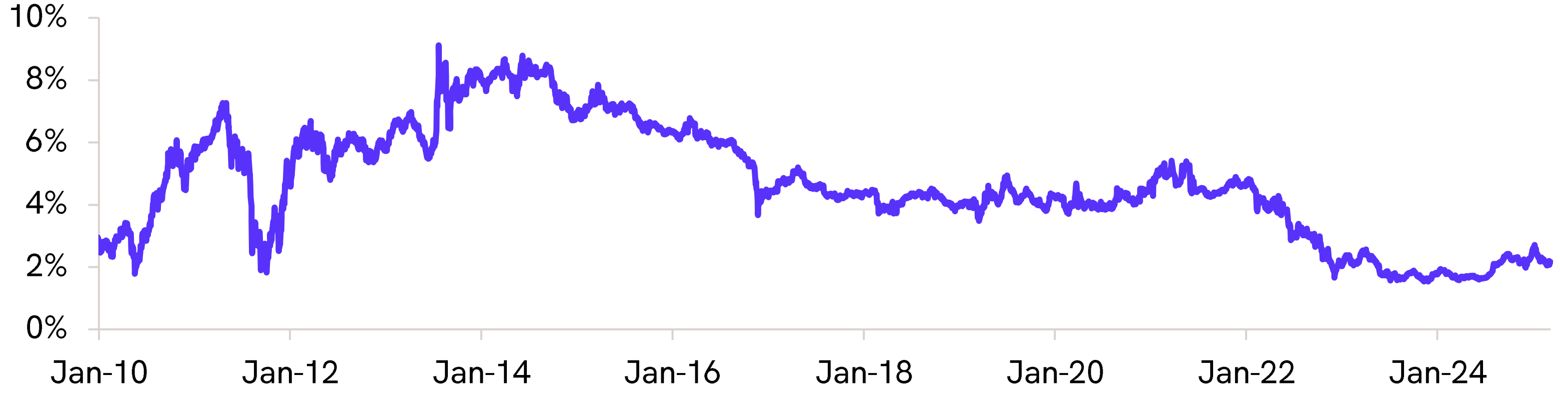
Source: CMIE, 360 ONE Asset Research

Note: FYTD25 FDI data till December 2024

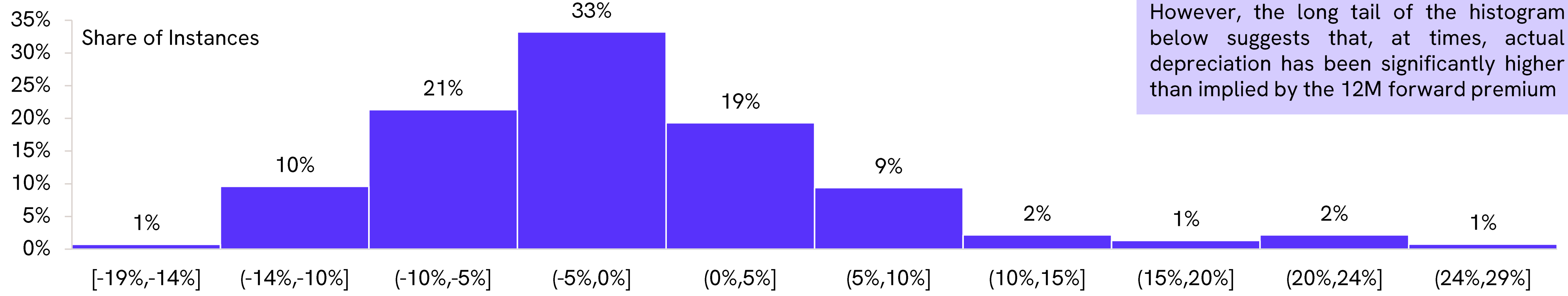
INR forward premium has declined substantially over the past two years

The decline has been driven by a reduction in the India-US interest rate differentials, and INR stability

USD/INR -12M Forward Premium (%)



Actual 12M Depreciation minus 12M Forward Premium - 1 yr ago



Source: Bloomberg, 360 ONE Asset Research

The INR 12-month forward premium has declined from an average of 4.2% during 2017–22 to 2.0% in 2023–2025 to date

The decline has been driven by a reduction in interest rate differentials between India and the US

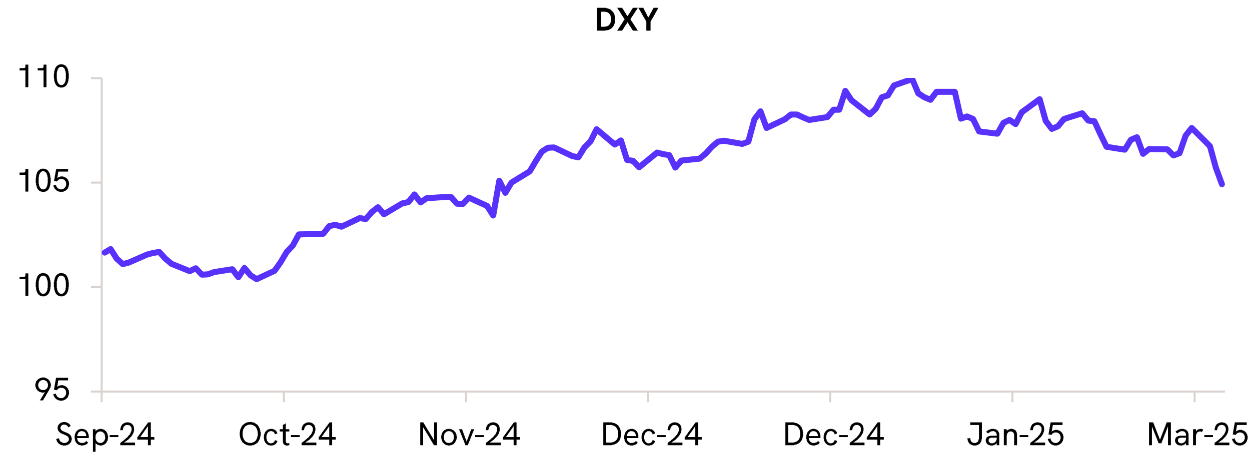
INR stability has also contributed to the decline in forward premia

Historically, 65% of the time, the INR has depreciated less than implied by the 12M forward premium a year earlier

However, the long tail of the histogram below suggests that, at times, actual depreciation has been significantly higher than implied by the 12M forward premium

Both external shocks and domestic vulnerabilities have eased

The DXY has peaked, India's current account deficit remains contained, and economic growth has bottomed out

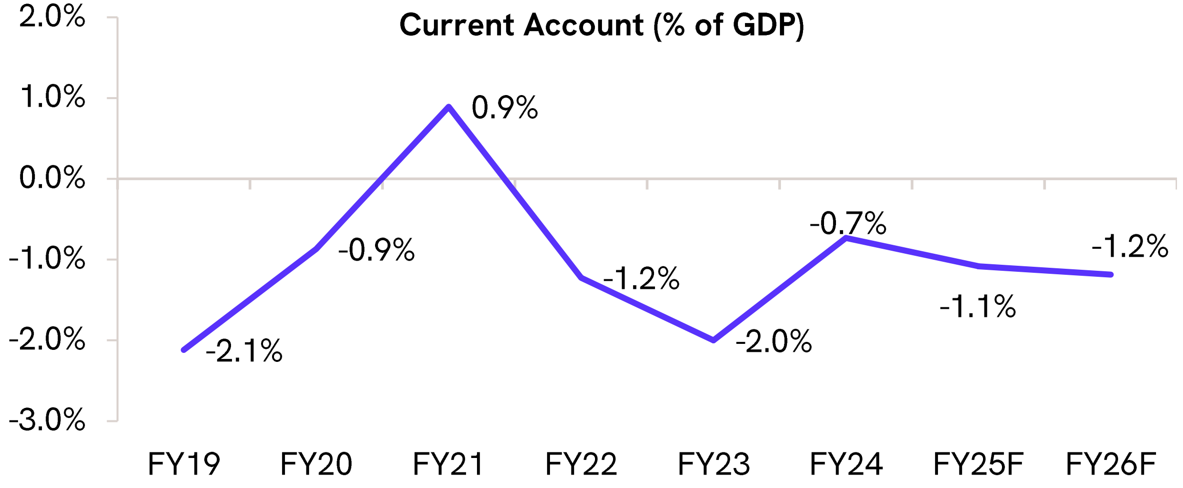


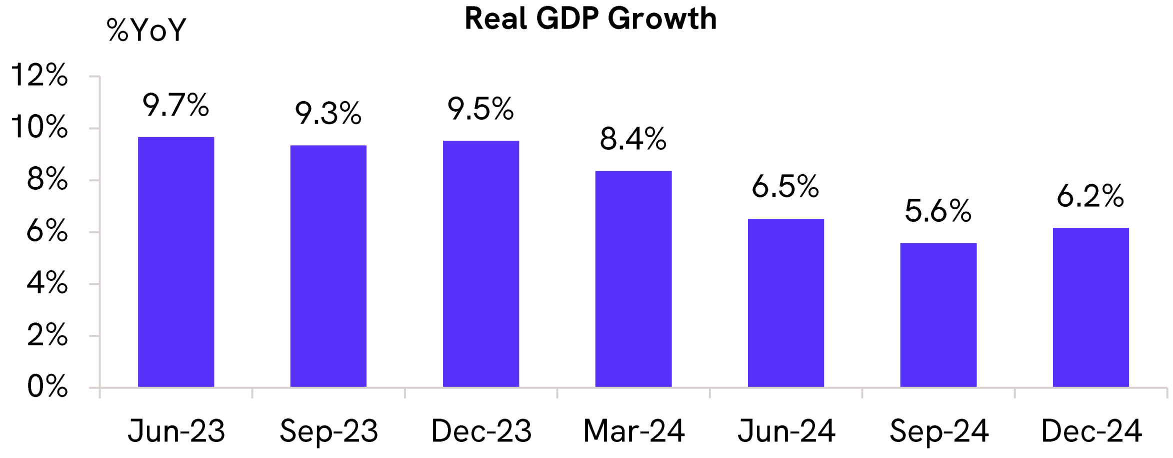
The Dollar Index (DXY) has declined from its peak levels on account of expectations of moderation in US economic growth

India's current account remains under control and does not contribute to INR weakness, unlike in past instances

India's GDP growth bottomed out in the September 2024 quarter, and future growth prints are expected to be better

Consequently, we expect the INR to remain stable in the near term and undergo a steady depreciation of ~2-2.5% over the medium term



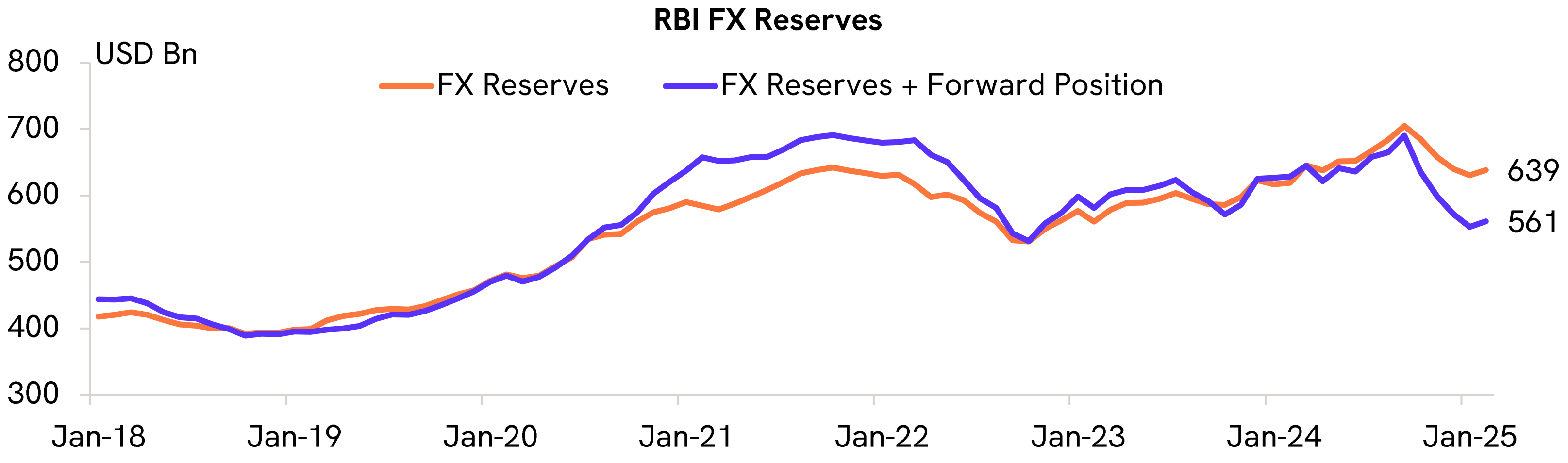


Source: CMIE, Bloomberg, 360 ONE Asset Research

Note: F- Forecasts

RBI's FX reserves have declined due to intervention to stabilise the INR

The decline is sharper when the change in RBI's net forward position is considered



RBI's foreign exchange reserves have declined from a peak of US$705 bn to US$639 bn as of 2nd March 2025

RBI's outstanding net forward sales (-)/purchases (+) position has declined from US$ -15 bn in September 2024 to US$ -78 bn as of January 2025

RBI's FX reserves appear sufficient as per the IMF's Assessing Reserve Adequacy (ARA) framework

However, the reserves fall below the minimum required under ARA when the forward book is also considered

Source: CMIE, IMF, 360 ONE Asset Research

Note: Feb'25 RBI forward position assumed same as Jan-25

Q3FY25 Results & Earnings Revisions

Corporate results show that muted sales growth persisted in Dec'24

Profit growth, however, improved due to an increase in operating profit margins

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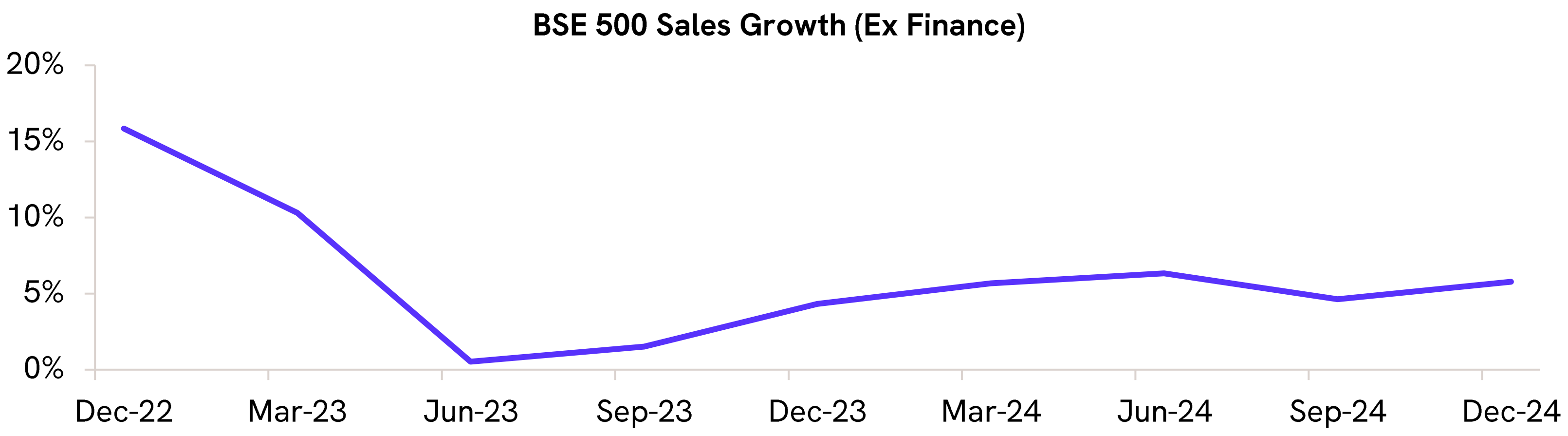
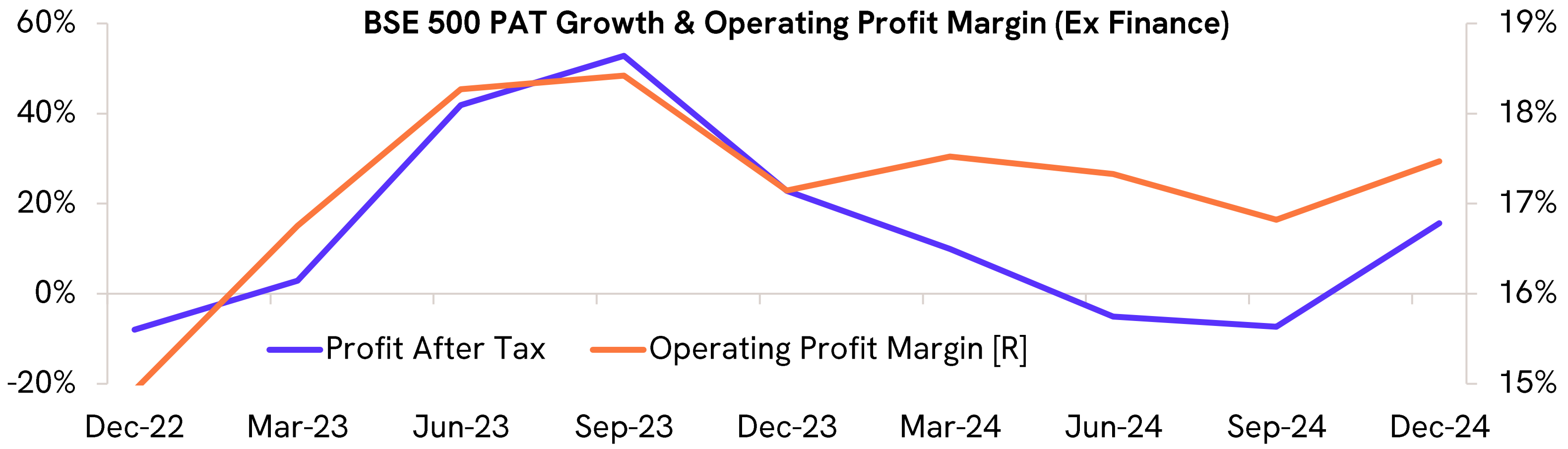


Sales growth remained muted for BSE500 companies (excluding financial firms) in the December 2024 quarter, though it showed a marginal improvement from the previous quarter



Profit After Tax (PAT) growth, however, improved significantly in the December 2024 quarter due to an improvement in operating profit margins (OPMs)

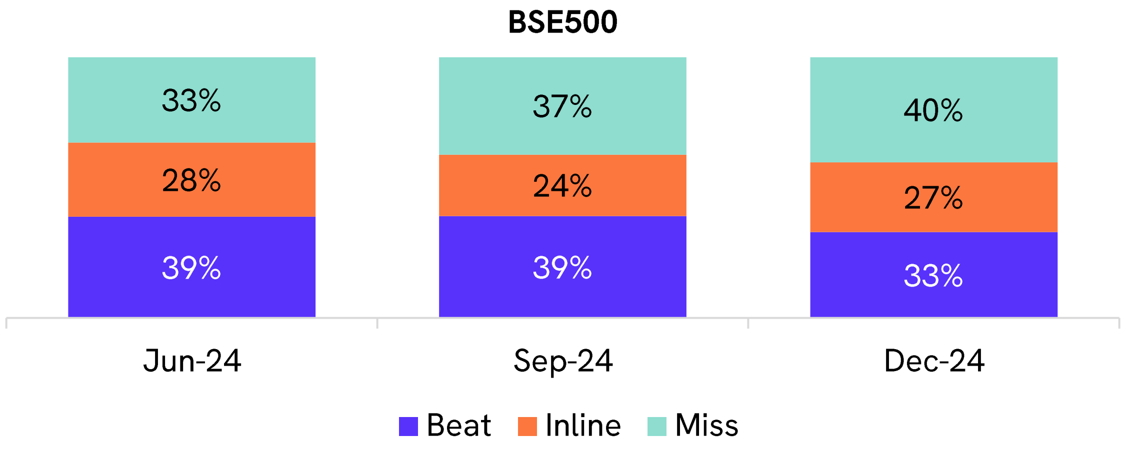
OPMs improved due to lower raw material and employee costs as a proportion of sales

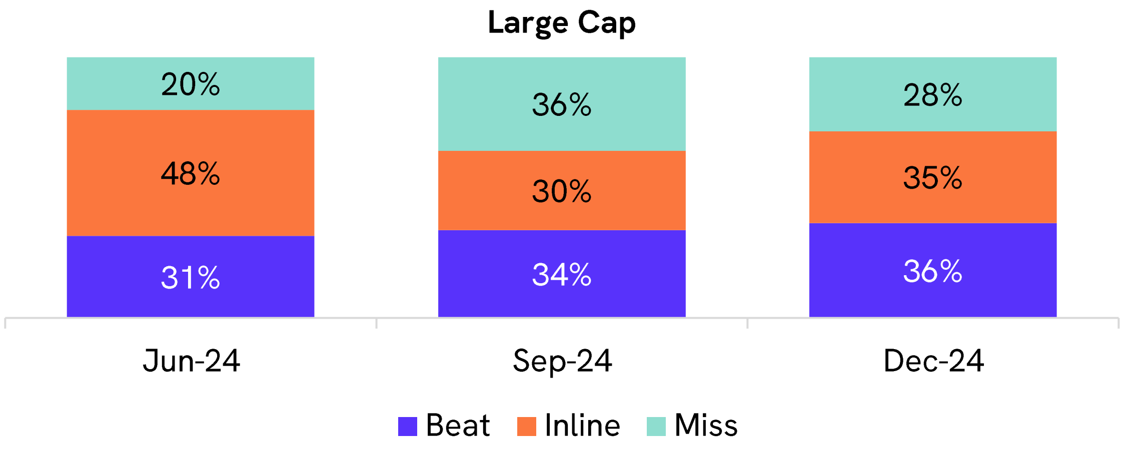
Source: ACE Equity, 360 ONE Asset Research

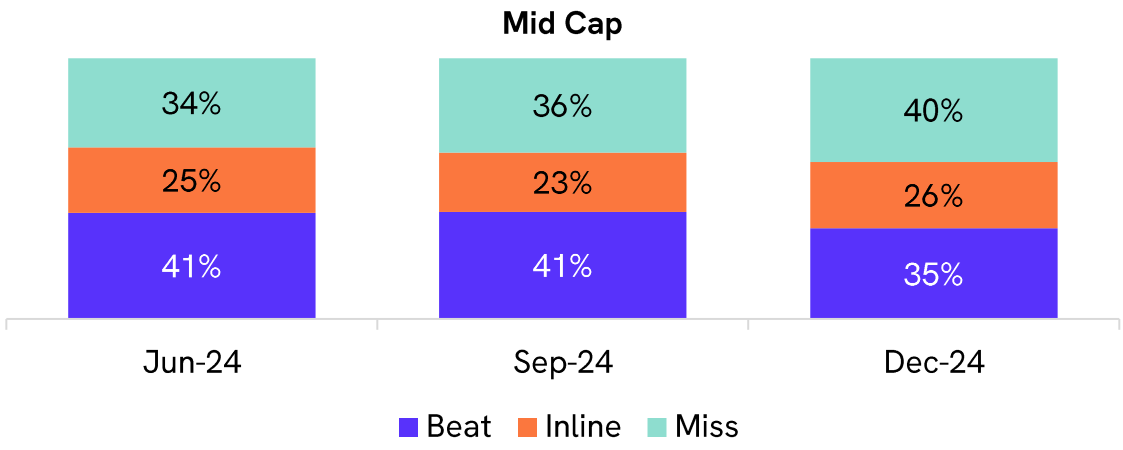
Beats-to-misses ratio continued to deteriorate for BSE500 companies

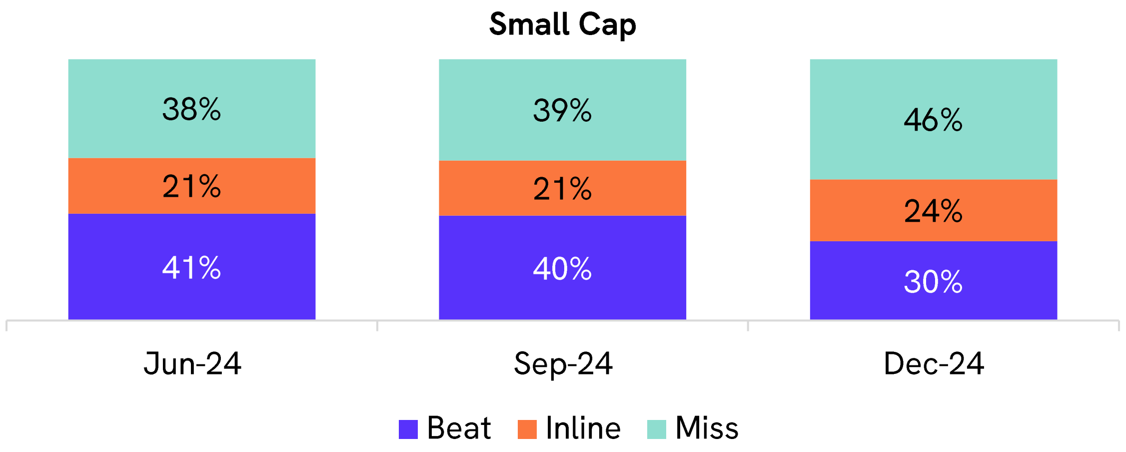
However, the ratio improved for large caps but declined for mid caps and even more for small caps

BBG Consensus Earnings Estimates Vs Actuals





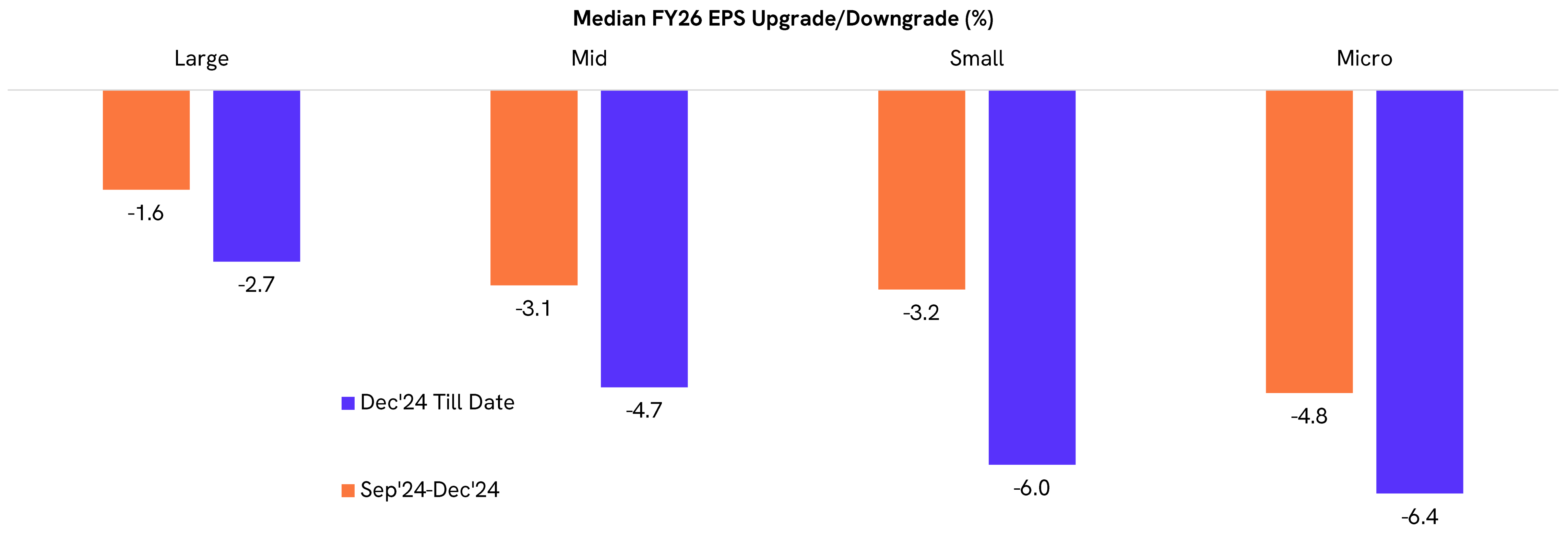




Source: Avendus Spark, 360 ONE Asset Research

EPS downgrades accelerated during the Dec’24 results season

Earnings downgrades became more pronounced as market capitalisation declined

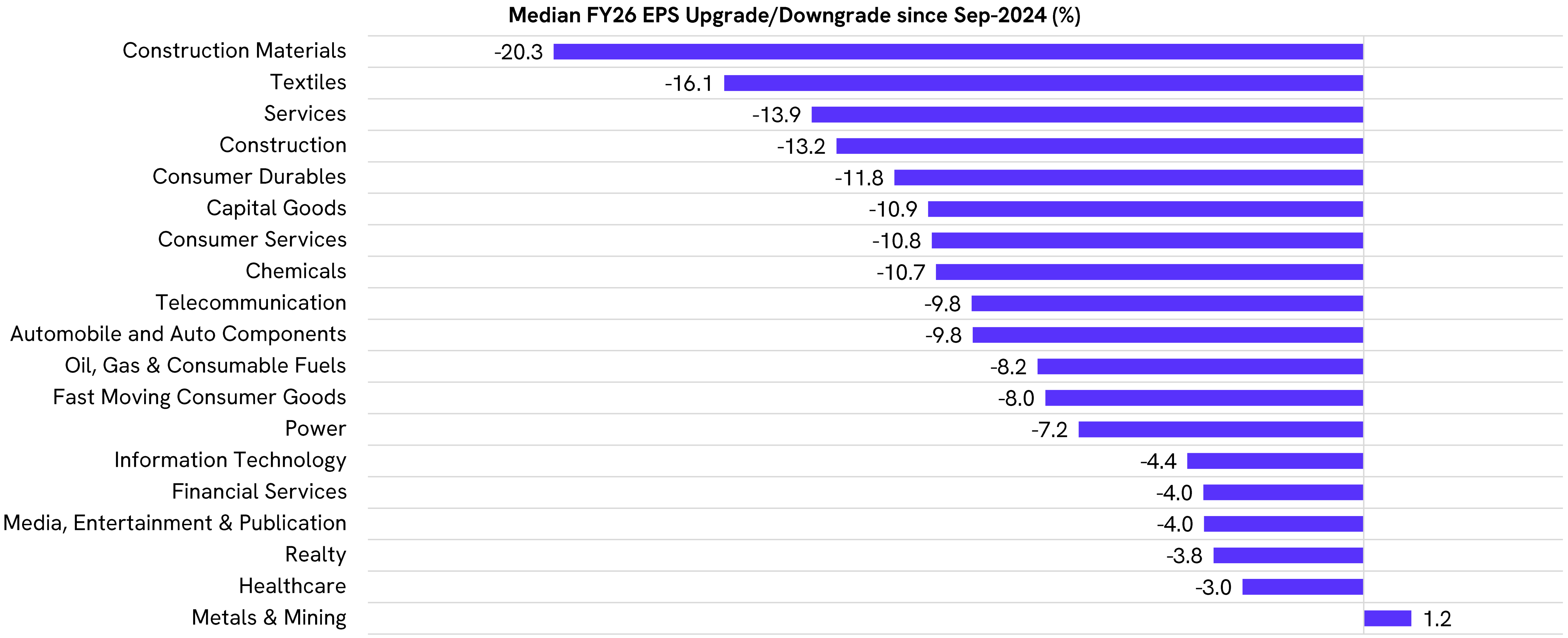


Source: Yes Securities, 360 ONE Asset Research

Note: EPS – Earnings Per Share

Broad-based decline in EPS witnessed across sectors since Sep'24

Earnings downgrades have been more pronounced in the construction materials and textiles sectors



Source: Yes Securities, 360 ONE Asset Research

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