

20 Sessions after Yuan Devaluation

The devaluation of the Yuan on 11th of August has caused considerable volatility in the currency markets across the globe. The sense was that this move was being pursued by the Chinese central bank to provide support for exports given that the economy was slowing down. This development was also accompanied by a major collapse in the stock market which had spillover effects across all stock markets with a substantial measure of panic setting in.

How have currencies moved since then?

The table below provides the currency movements for two periods on a point to point basis. The first period is 20 days before the Yuan devaluation and the second is 20 sessions after this act up to 8th September.

Table1: Point-to point changes in currency (%)
(11th August the base period)

	Prior	Post
Euro	1.41	-1.67
Argentina	1.02	1.28
Brazil	9.02	9.73
Chile	4.17	2.49
China	0.00	2.58
Hong Kong	0.02	-0.02
India	0.68	4.06
Indonesia	2.68	5.46
Malaysia	3.55	10.51
Mexico	2.69	3.89
Philippines	1.64	2.21
Russia	11.89	7.58
S Africa	1.68	8.44
Korea	3.05	2.90
Taiwan	1.98	3.17
Thailand	3.40	2.83
Turkey	4.50	8.02

Source: Pacific Exchange rate service

Key Observations

- In the period prior to the Yuan devaluation, the rupee was probably the most stable currency which can be justified by the fairly strong fundamentals. The current account deficit has been reined in and with foreign capital flows being positive in net terms, there was a net accretion to forex reserves which had reached nearly \$ 355 bn with an addition of between \$ 12-13 bn during the financial year.
- Hong Kong and China were the only countries which had a better performance in terms of stability in exchange rate.

- Following the Yuan shock the rupee has also lost ground and declined on a point by point basis by around 4%.
- Of the 17 currencies considered here, the euro and Hong Kong dollar have appreciated.
- Out of the 15 currencies that have depreciated, 5 have declined by more than the rupee (i.e. 4%) and include Brazil, Indonesia, South Africa, Russia and Turkey.
- From the point of view of relative advantage in export competitiveness on account of the depreciation of the currency, the rupee does perform better than the other 9 currencies. But it would be at a disadvantage when compared with the 5 countries mentioned above.

Market volatility

While the table above does compare currencies at two points of time before and after the devaluation, a distinct feature has been the high level of volatility in the market. The average annualized daily volatility in these currencies has been calculated and tabled below for the same 20 sessions before and after the Yuan issue.

Table2: Average Annualized daily volatility (%)

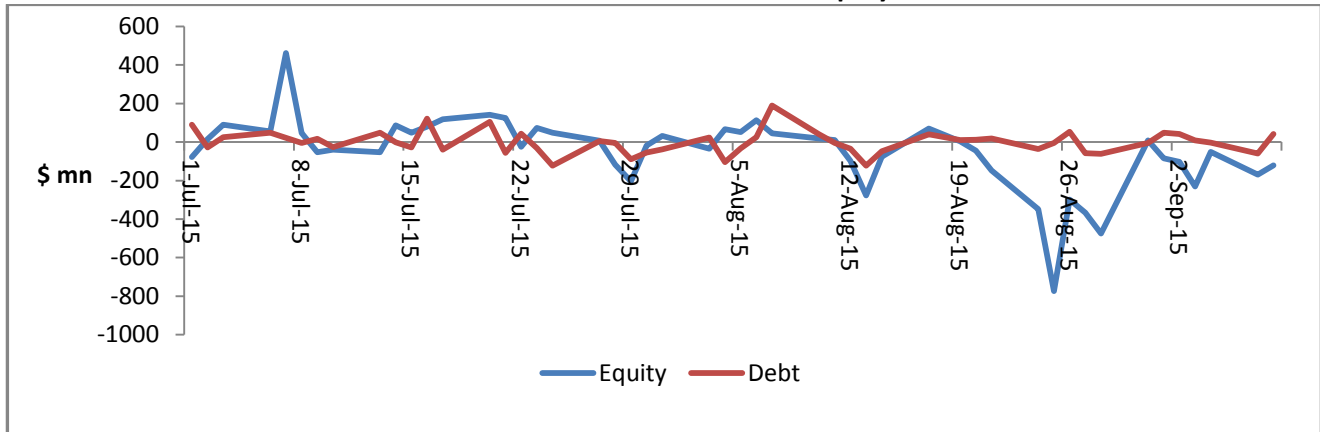
	Before	After
Euro	11.48	14.60
Argentina	0.76	0.84
Brazil	21.43	20.87
Chile	8.16	10.93
China	0.36	7.61
Hong Kong	0.20	0.60
India	4.28	9.13
Indonesia	8.42	11.01
Malaysia	5.05	15.70
Mexico	14.12	11.23
Philippines	3.48	3.77
Russia	20.21	27.24
S Africa	12.86	13.56
Korea	10.76	10.03
Taiwan	4.53	10.19
Thailand	5.25	5.56
Turkey	11.66	11.48

- Even before the devaluation of the Yuan several currencies had witnessed considerable volatility of above 10%.
- Brazil, Mexico and Turkey had lower volatility subsequent to the devaluation, though the levels were higher than the median.
- The increase in volatility was high for the rupee and was lower than that of Malaysia, China and Russia.
- Some of the most volatile currencies have been those of Russia, Brazil, Turkey, S Africa, Korea, Mexico and the Euro.

Future direction for the rupee

Based on the economic fundamentals, the rupee should be in the range of Rs 65-66/\$ though the current conditions could keep it elevated at the \$ 66-67 range. Volatility will continue as the FII flows have been in the outflow mode. The chart below shows that FII flows, both debt and equity have generally been negative after 12th of August. These investors may also be looking at the Fed decision to be taken next week on interest rates.

Exhibit 1: FII Flows- Debt & Equity



Our forex reserves have also shown a declining trend subsequently. On 15th August they were \$ 354.4 bn and peaked at \$ 355.4 bn on 21st August only to decline to \$ 351.9 bn on August 28. Both fundamentals and sentiment will drive the rupee in the next couple of weeks.

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