

The Fall of Currencies

The rupee has been under pressure over the last week and the decline in value has been attributed to several factors. While the overriding explanation has been the possible increase in interest rates in the USA, other explanations on the domestic side have also been put across. However, an interesting observation is that exchange rates have been moving downwards (depreciating) for almost all emerging markets which actually indicates that this is a global development and not restricted to India. Surprisingly, we may have just done better in relative terms.

The Table below provides the movement in currencies during the month of July. It has been calculated at two levels: July 2nd to July 24th and July 17th to July 24th. To gauge the intensity of the movements, a point-to-point comparison has been made and preferred to an average as the latter would be less stark. As can be seen, the second period was more important for the rupee as the 64 level was also crossed.

Table 1: Depreciation across Currencies (Relative to USD)

Currency	Jul 2-Jul 24	Jul 17-Jul24
Brazil Real	7.0841	4.3473
Russia Ruble	5.3726	2.6809
Korean Won	4.3979	1.8361
Mexico Peso	3.4289	1.9795
Thai Baht	3.2073	1.9524
S. Africa Rand	2.8278	2.2197
Turkey Lira	1.9698	3.363
Singapore dollar	1.6977	0.3658
Rs	1.0762	0.9202
Euro	1.0458	-1.1629
Philippines Peso	0.8891	0.6169
Malaysia Ringgit	0.839	0.0368
Argentina peso	0.722	0.1946
Indonesia Rupiah	0.7181	0.4776
China Renminbi	0.0774	0
Kuwait dinar	0.0758	-0.0659
HK Dollar	0.0052	0.0116

Source: Pacific Exchange Rate Services

The table shows that the rupee stands almost at the median value of the depreciation in currencies for the longer period of 2nd July to 24th July. Interestingly, the depreciation of the rupee was almost 90% of the total in the last week. (This should be interpreted with caution as the depreciation has been reckoned on a point to point basis and there could be swings in the interim period).

Further depreciation of 1% during this period is better than that of the real, ruble, won, Mexican peso, baht, rand, lira and the Singapore dollar. The main reason for the across the board fall in currencies could be the impending increase in interest rates in the USA. In fact the acceleration witnessed in the fall in currencies last week was on account of the news that the employment numbers in the last month were better which indicates that the Fed may start to increase rates in September '15 instead of December '15. The crucial Fed meeting this week will provide further clues to this action which in turn will cause volatility in the currencies.

The fundamentals that drove the exchange rate for the rupee were as follows:

- The total forex reserves declined by \$ 1.2 bn between July 3 and July 17th. But the rupee had declined by just 0.15% during this period.
- For the last week, reserves would have been affected by the revaluation of the gold reserves on account of the decline in the price in the market. (Information not yet available on exact impact on gold reserves).
- FII flows for July up to 24th have been positive at \$ 1.34 bn though for the last week, there was an inflow of around \$ 140 mn.
- The trade deficit may be assumed to be stable at the \$ 10-11 mark for this month too which has been the average in the last few months. With stable prices of crude, this number is not expected to have turned vastly different.
- The falling rupee always becomes self-fulfilling for importers who rush in to buy dollars, and exporters who try and delay bringing in the dollars. However, this would work more at the margin and cannot explain the sharp depreciation witnessed last week.

Presently all attention is on the Fed. The Federal Reserve Open Market Committee (FOMC) is to meet on Tuesday and Wednesday and a decision is expected by Wednesday afternoon. Markets are waiting for some signals on whether the Fed will become the first major Central Bank of the developed countries to raise interest rates since the financial crisis set in.

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