Economics

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Rupee at 64

The continuous decline in the rupee has caught the market by surprise considering that it was expected that the currency would be stable and move towards the Rs 60 mark if left to the fundamentals. In fact it was felt that the RBI was buying dollars to prevent the rupee from appreciating. This was so as the external account had strengthened: trade deficit narrowed leading to CAD coming down further and FPI flows came in steadily along with FDI. Put together in FY15 we added to our forex reserves which have crossed $ 340 bn. All these factors are preconditions for a currency appreciation.

However, since April the rupee has started to decline and has moved from Rs 62.19/$ to cross Rs 64/$ on the 7th of May. Why is this happening?

- Sentiment has turned negative after the proposal was moved for application of MAT on FPIs. They have turned net sellers and are withdrawing from the market. A sum of $ 1.25 bn has flowed out in May with $ 825 mn in equity and $ 400 mn in debt.
- The NDF market has carried this negative sentiment and the forwards are increasing in this market.
- This may be considered as a correction for the past as the rupee did not depreciate last year when other currencies did.
- The trade numbers may not be good enough as exports are still not showing signs of increasing. On the other hand oil prices have increased to put pressure on imports.
- The dollar has been falling of late against strengthening last year.
- An increase in Fed rate has caused flow of funds away from emerging markets, and the uncertainty on the timing has caused some amount of volatility.
- The REER justifies this decline as the rupee is overvalued in real terms.

All these arguments do contribute a bit to this decline in the rupee.

The table below shows how other currencies have fared between April 1 and May 7.

Currency movements: point-to-point (%)

Currency	Depreciation	Currency	Appreciation
Dollar	4.57	Brazilian real	3.58
Turkish Lira	3.48	Malaysian ringgit	2.83
Thai baht	3.30	Russian ruble	13.0
Rupee	3.11	Korean won	0.36
Indonesian rupiah	1.48		
Mexican peso	1.42		

The dollar has started falling vis-à-vis the euro in April and once section of the market believes that with the US economy strengthening the economy has to retain its competitive edge through such depreciation. On the other side, as the Fed did state that conditions were probably not yet congenial for a rate hike, the impression gotten was that the economy has not yet picked up thus weakening the dollar. Further, higher bond yields for countries in the euro zone have also given the euro a boost.

If the last one year were to be looked at, then it is clear that the rupee was the best performer as the dollar also appreciated sharply from 0.72 /€ to 0.92/€ between March 2014 and March 2015. The table below shows how other currencies fared.

Currency depreciation (month on month) 2014-15

Real	Lira (T)	Rand	Peso (M)	Ringgit	Rupiah	Rupee	Won
35.1	17.2	12.5	15.5	12.2	14.5	2.49	4.0

T: Turkey M: Mexico

Quite clearly based on global influences and not the fundamentals other currencies fared less satisfactorily than the rupee.

What does this mean for us?

- A depreciating rupee based on such factors could lead the currency further down as the market will wait for signals from the RBI.
- The withdrawal of FIIs from the debt market through selling has increased the supply of paper and lowered the prices thus leading to higher yields on GSecs.
- Combining this development with the recent increase in price of crude oil and sub-normal monsoon forecast, the RBI may wait longer before invoking the next rate cut.
- Corporates have to pay more attention to their forex exposures especially if they do not have a natural hedge as a weaker rupee can cause potential loss to them.

Where will the rupee go?

In the absence of any intervention and continuation of such sentiment the rupee can slide further towards Rs 65. This will hence be earlier than what CARE has projected in its Prognosis FY16.

It would otherwise strengthen and be in the 63-64 range, which is more likely in the immediate run which can be a new normal range as against Rs 62 in March 2015.

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