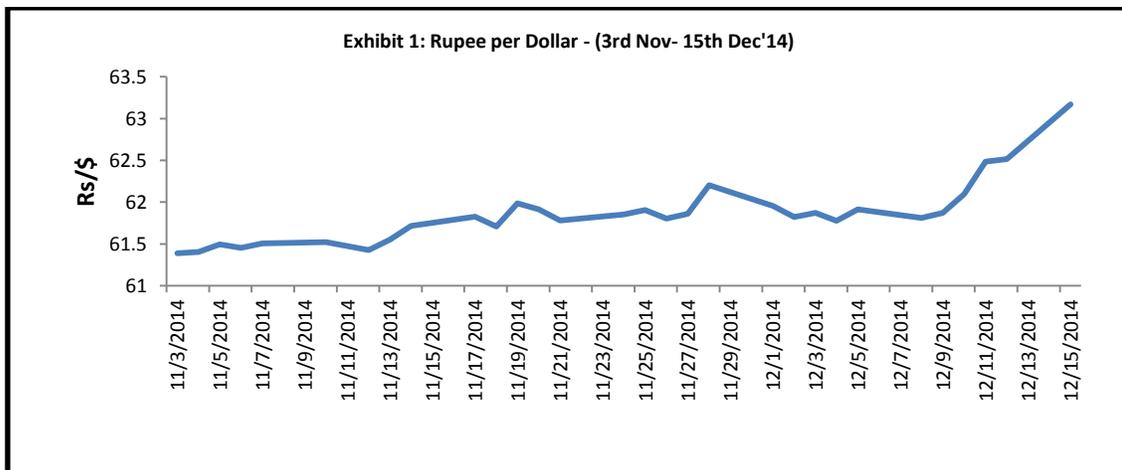


Why is the rupee and other currencies are tumbling against the American Greenback?

In the last month and a half, the rupee has tended to decline against the U.S dollar, with the pace accelerating in the latter part of November and December. It has been depreciating since the beginning of November'14. As on 3rd Nov'14 the rupee was at 61.38/\$ and remained range bound till 13th of November below Rs 61.5/\$ after which it fell to Rs.62.21/\$ on 28th Nov'14 depreciating by 0.6%. Following this a reversal in trend was witnessed during the first week of Dec'14. However, the rupee again lost the gaining ground and depreciated to Rs.62.09/\$ on 10th Dec'14. It further touched its lowest of Rs. 63.17/\$ on 15th Dec'14. Overall, the rupee has recorded 2.9% depreciation against the US currency as depicted in Exhibit 1.



Source: Pacific Exchange Rate Services

In line with the falling rupee, the other major currencies across the world have also witnessed similar trend when compared on a point to point basis i.e. 15th Dec'14 over 3rd Nov'14 against the dollar (refer Table1).

- The USD remains the strongest currency given that it is one of the few regions that are expected to grow in 2015. The removal of QE and the possibility of an increase in interest rates in 2015 do indicate that the dollar will continue to rein strong. The euro declined by 0.14%.
- The sharpest decline was recorded by Russian ruble which tumbled by nearly 47% followed by the Mexican peso (9.27%). Russia has been affected by a series of factors - both economic and political.
- The only currency which remained unaffected was the Philippines Peso which appreciated by 0.58%.
- In relative terms the decline in the rupee appears to be more moderate and within the range of that witnessed within emerging markets.
-

Table 1: Currency movements

Currency/\$	3 rd Nov'14	15 th Dec'14	Rate of change (%)
Euro	0.80085	0.80501	0.14
Japanese Yen	113.93	117.76	3.36
Brazil real	2.50	2.69	7.83
Chinese yuan	6.12	6.19	1.15
Indian rupee	61.39	63.17	2.91
Indonesia rupiah	12172	12641	3.85
Malaysian renminbi	3.32	3.50	5.40
Mexican Peso	13.54	14.80	9.27
Philippines peso	44.97	44.71	-0.58
Russian ruble	43.54	63.87	46.69
South Africa rand	11.08	11.75	6.06
Korean won	1078.10	1099.20	1.96
Thai baht	32.71	32.97	0.82
Turkey lira	2.24	2.38	6.29

Source: Pacific Exchange Rate Services
 (+) Depreciation, (-) Appreciation

Which are the factors driving down the rupee?

- **Deteriorating trade balance**

One of the important factors driving down the domestic currency has been the deteriorating trade deficit. India's cumulative Trade deficit for the period April-November'14 widened to US\$ 100.6 bn which was 3.85% higher when compared with US\$ 97.0 bn recorded during April-November'13.

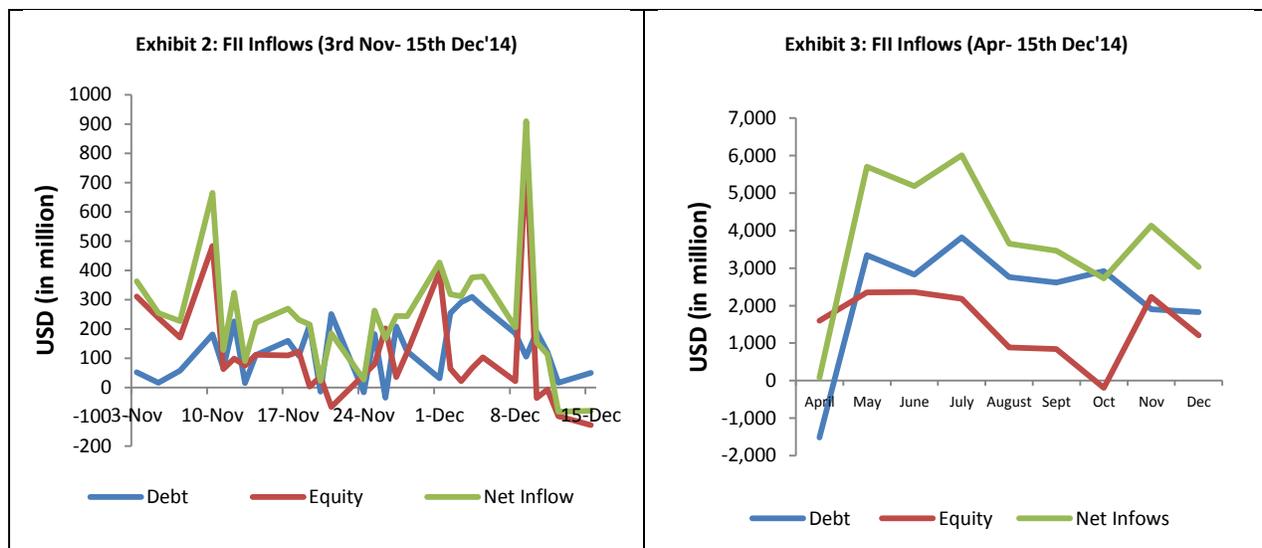
- The twin factors that have led to widening of trade deficit are the slower growth in exports at 5.0% and the increasing non-oil imports particularly gold.
- The resurgence in import of gold is significant. This has in turn led to increase in demand for dollars by the importers causing the domestic currency to weaken further.
- It may be conjectured that this trend has persisted in December too so far.

- **Moderation in Foreign investment inflows**

The cumulative net FII inflows during the period Apr- 15th Dec'14 were recorded at US 34.0 bn. However, the monthly trend as depicted in Exhibit 3 clearly indicates that the FII inflows into the country have been moderating.

- The slowing of inflows has been witnessed particularly in the equity segment.
- It may also be noted, that though the cumulative figures remain positive, the FIIs inflows lately have not only been moderating but have also turned negative when tracked on a daily basis as is reflected in Exhibit 2.

Why the Rupee and the other currencies are tumbling against the American Greenback?



Source: NSDL, SEBI

- **Strengthening dollar**

The recovery in the US economy has been the contributing factor for the appreciation of the US currency. The dollar has been strengthening with pick up in the US economy leading to the depreciation in the Euro. This has caused increased volatility in the global currency markets recently with India being one of the markets that have been impacted.

- **Declining global crude oil prices**

The currencies of the oil producing nations like Russia and Indonesia have also witnessed depreciation in their respective currencies- rouble and rupiah as indicated in Table 1. The run up in these nations have been mainly on account of declining crude oil prices due to demand-supply concerns (with Russia also being impacted by sanctions by the western nations). Moreover, it may be noted that Russia is the second largest producer of oil accounting for 12.8% of the world total output as well as the second largest net exporter of crude oil. Clearly, there has been a larger impact on the Russian rouble.

- **Constant Forex reserves**

The volume of forex reserves in a way reflects the net impact of all dollar transactions. A net outflow of dollars results in a fall in forex reserves.

- The total Forex reserves of the country have remained fairly constant during Nov- Dec'14. As on 31st Oct'14 the Forex reserves stood at \$ 315.91 billion which reduced only marginally to \$ 314.66 billion as on 5th Dec'14.
- Hence, the dollar flow fundamentals have had less of an impact on the current round of rupee depreciation.

Why the Rupee and the other currencies are tumbling against the American Greenback?

Market Sentiments/ Expectations

Market sentiments have also played a significant role in pushing down the rupee. The market has been expecting a decline in the rupee going ahead on account of –

- Expectation of a cut in interest rates- with declining inflation the market expects the central bank to reduce its interest rates in order to support growth. The corollary is that the FIIs are likely to pull out capital from the country.
- Expectation of an increase in US interest rates- While the US is expected to raise its interest rates this is likely to put pressure on the Indian rupee as funds may flow out.
- Crude oil prices are expected to decline further as OPEC tries to stress out the shale oil producers. Therefore, this free fall will continue to put pressure on the existing market forces.
- RBI intervention- on account of falling exports the RBI expects the rupee to touch a low of Rs.65/\$. Hence, it is unlikely to intervene in this scenario.

Our view

- Taking the above factors into consideration, CARE expects the domestic currency to hover between Rs 64- Rs 65 a dollar in the coming days until there is intervention from the RBI and the global situation returns to normalcy.
- There may also be measures imposed on gold imports in case the available trends suggest a continuation of the trend of increasing imports.

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Why the Rupee and the other currencies are tumbling against the American Greenback?