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Currency Movements and View

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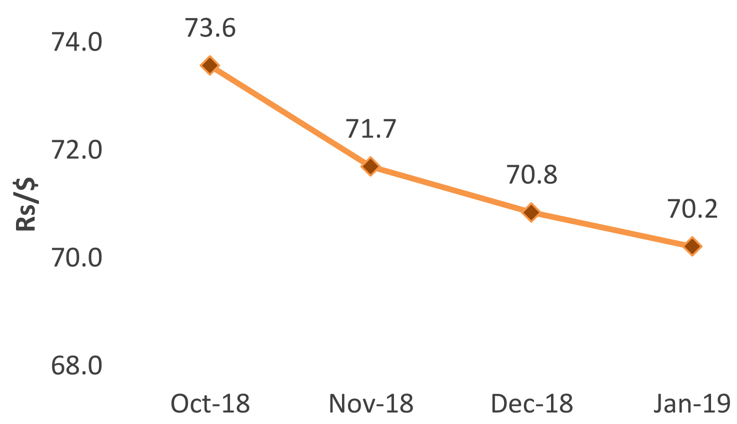
The rupee remained volatile in 2018, depreciating by 15% during Jan- Oct (from monthly average of Rs 63.6/$ in Jan'18 to Rs 73.5/$ in Oct'18). This was on account of various global and domestic factors including rising crude oil prices, erratic trade balance, overseas strengthening of dollar and sustained FPI outflows. In addition, geo-political tensions including trade wars between US and China and US sanctions on Iran, interest rate hikes by the US Federal Reserve and resultant FPI outflows further weighed on Indian currency.

However, rupee witnessed a reversal in trend post Oct'18 with the currency appreciating against dollar on month-on-month basis. This can be put in the context of global developments where several currencies have also appreciated against dollar, as well as the fundamentals on external account.

In this Report, we have analysed the performance of the Indian rupee against the dollar by examining the changes in the average monthly exchange rate from Oct'18 to 14th January'18. October was the time when the rupee was under pressure. After November 4th there was a reversal as the Iran sanctions by the USA was deferred for a period of 6 months.

The chart below plots the movement of the rupee-dollar during Oct'18- 14th Jan'19.

Exhibit 1: Movement in Rs/$ during Oct'18 -14th Jan'19



Source: Pacific Exchange rate services;
Note: Monthly average is considered

The rupee has witnessed appreciation by 5% vis-à-vis dollar from a monthly average of Rs 73.6/$ in Oct-18 to Rs 70.2/$ in January'19 so far. The appreciation can be attributed to easing of crude oil prices, improvement in trade flows, positive FPI inflows in the month of Nov and Dec'18 among other factors which has also led to an improvement in forex reserves. In addition, six months waiver granted by the US government on the Iran sanctions further led to appreciation in the domestic currency in the month of Nov'18.

Since, the external factors also drive rupee, we have juxtaposed rupee movements with other select emerging market economies to observe how these international developments have percolated in the currency of these countries.

How have the other currencies fared vis-à-vis dollar?

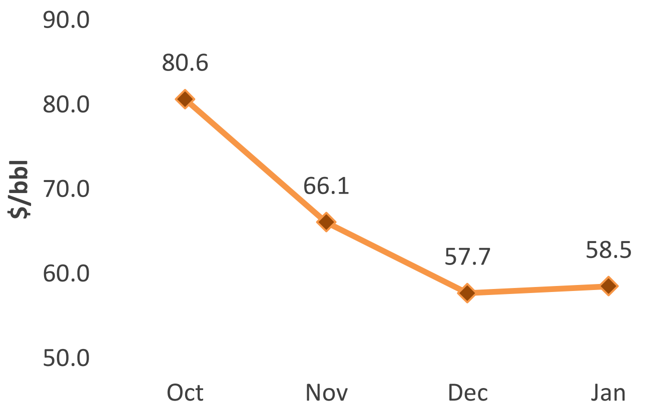
Table 1: Appreciation (-)/Depreciation (+) in currencies vis-à-vis dollar

% change	Nov'18 over Oct'18	Dec'18 over Nov'18	Jan'18 over Dec'18	Jan'19 over Oct'18
Brazilian Real	0.6	2.6	-4.0	-0.9
Chinese Renminbi	0.2	-0.8	-0.8	-1.4
Indian Rupee	**-2.5**	**-1.2**	**-0.9**	**-4.6**
Indonesia Rupiah	-3.6	-1.0	-2.0	-6.6
Malaysian Ringgit	0.6	-0.4	-1.3	-1.0
Mexican Peso	5.5	-0.7	-3.9	0.7
Philippines Peso	-2.3	0.2	-1.0	-3.0
Russian Rubles	1.0	1.4	0.1	2.6
South Africa Rand	-3.0	1.2	-1.7	-3.4
South Korea Won	-0.6	-0.3	-0.2	-1.0
Thai Baht	0.5	-0.7	-2.1	-2.3
Turkish lira	-7.8	-0.6	2.2	-6.3

Source: Pacific Exchange Rate Services; Note: % change in monthly average rate has been considered; Data uptil 14th Jan

- Of the 12 currencies considered above (including India), 6 currencies have appreciated against dollar during Oct-Nov'18, 8 currencies have appreciated against dollar during Nov'18- Dec'18, 10 currencies during Dec'18-Jan'18 and 11 currencies during Oct'18-Jan'19.
- Among currencies that witnessed appreciation during Oct'18 -Jan'19, Indonesian Rupiah recorded the highest level (6.6%), followed by Turkish Lira (6.3%), Indian Rupee (4.6%) and South African Rand (3.4%).
- Russian Ruble and Mexican peso have witnessed depreciation against the US dollar during the period. Decline in oil prices can be attributed to depreciation in Ruble (As Russia is one of the major oil producers, declining oil prices is considered to be a negative for the country).

Movement in Oil prices (Monthly average)



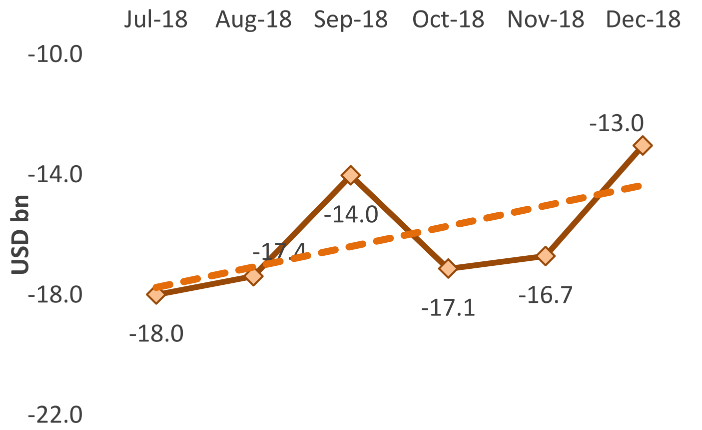
Source: Bloomberg

Brent crude oil prices have declined from a monthly average of $80.6/bbl in Oct'18 to $58.5/bbl in January so far. This has been one of the major driving forces for rupee's appreciation. Waivers granted by the US government on the Iran sanction, oversupply of crude oil by OPEC countries and increasing US shale production resulted in lower oil prices. In addition, recent increased concerns over fall in oil demand following reports of subdued Chinese trade data further led to the decline.

How about India's fundamentals?

Reduction in Trade Deficit

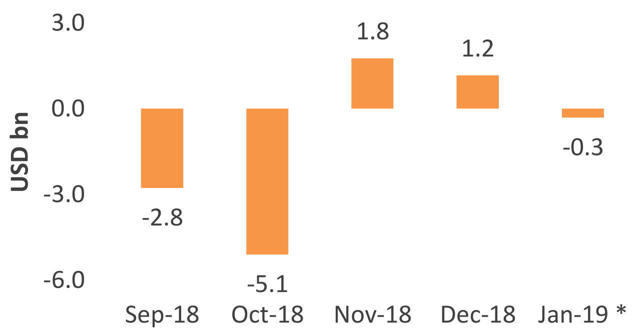
Trade deficit after reaching a high of $18 bn in July'18, declined and stood at $13 bn in December'18 owing to decline in oil imports in line with falling global oil prices. This is a positive sign.



Source : PIB

Higher FPI inflows in Nov and Dec'18

FPIs turned net buyers in the month of Nov'18 and Dec'18 after witnessing two consecutive months of outflows. The economy witnessed FPIs inflows to the tune of $1.8bn in Nov'18 and $1.2bn in Dec'18. However, it is to be noted than FPIs have turned net sellers in the month of January'19 that could pressurize the Indian currency if the trend sustains**.**



Source : NSDL, Data uptil 10th Jan'19

Increasing Foreign Exchange Reserves

Foreign currency reserves have witnessed an increase from $392 bn as on 28th Oct'18 to $396 bn as on 4th Jan'19. It needs to be seen whether this can be maintained.

Sale of US dollar by the RBI

The RBI has also sold $26.5 bn during April-Nov'18 (period for which information is available) to steady the rupee at various points of time.

Concluding Remarks

Rupee has appreciated vis-à-vis dollar during Oct'18- 14th Jan'19. A part of this appreciation can be explained by:

- Decline in crude oil prices.
- Domestic factors including higher FPI inflows in Nov and Dec'18, benign domestic inflation, and reduction in trade deficit.
- Fundamentals have hence strengthened marginally as reflected in an increase in forex reserves.

Going forward, factors including FPI inflows, direction of oil prices, monetary policy decision by the US Federal Reserve will determine the final direction of the rupee. In addition, upcoming general elections, global developments related to US-China trade war and Brexit negotiations will further influence the movement in the currency.

CARE Ratings expect:

1. Oil prices could move gradually upwards (on account of possible supply cuts by OPEC members and removal of waivers granted by the US government on the Iran sanctions).
2. FPIs would be muted in the next few months.

Both these factors are likely to work towards keeping the rupee range bound between Rs 70-71/$ for the remainder of the fiscal year.