A stronger rupee now…

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The strengthening of the rupee in the market has been quite unexpected. It ended at Rs 64.31 (RBI Reference rate) on the 13th of April. Based on the fundamentals which have prevailed until January it did appear that the rupee would move towards the Rs 69/$ mark. However, conditions have changed and the rupee has been strengthening almost relentlessly.

How have the fundamentals moved?

The trade balance was negative in all the three months in this calendar year and the other components of the current account like software receipts ($ 53 bn in 9M-FY17 as against $ 54 bn last year) and remittances ($ 41.8 bn as against $ 47.4 bn last year) were stable or lower. This was an immediate outcome of the sluggish growth tendencies in the developed world as well as the policies announced by Donald Trump which affected business levels of the IT industry.

Trade deficit ($ bn)	2016	2017
January	-7.7	-9.8
Feb	-6.6	-8.6
March	-4.4	-10.4

Source: Ministry of Commerce

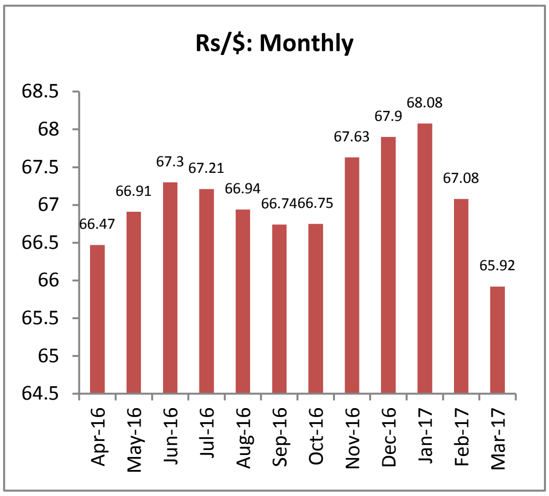
FPI flows were negative till January as the Fed's decision to increase rates did send a message to the market that there would be further rate hikes which would cause funds to remain invested in the USA and move back from the emerging economies. The system was just about recovering from the major task of providing for the redemption of the FCNR (B) bonds till November. FDI was the only positive in the balance of payments. This was in an environment when the dollar had strengthened and remained fairly stable in the region of $ 1.05-07/euro.

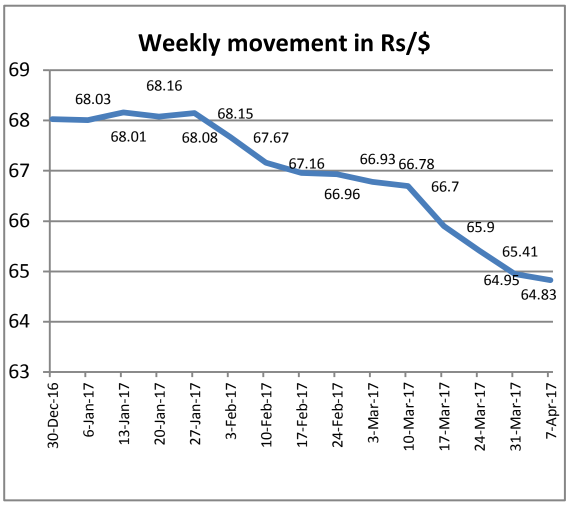
However, since February the rupee has been strengthening aided mainly by the inflow of dollars through the FPI route. The forex reserves have increased by almost $ 10 bn between end January and March end.

How has the rupee moved?

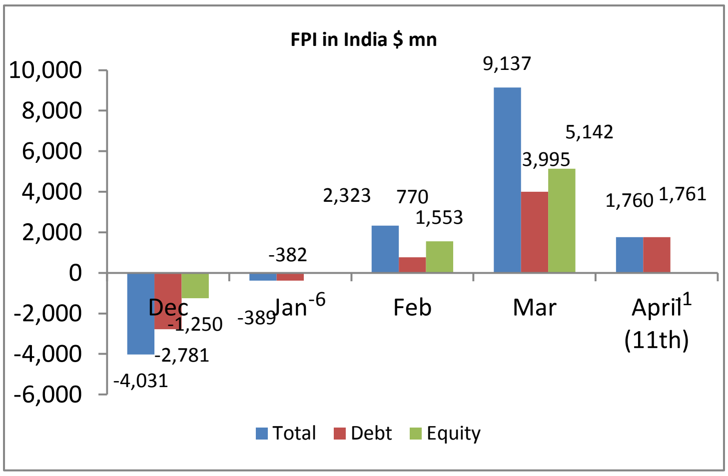
The charts below track the movements in the dollar on a monthly basis for the year and on a weekly basis in 2017 so far. As can be seen the rupee has reached a high in March 2017 in FY17 which had been further strengthened in April. A concern in the market has always been whether or not the RBI will intervene to stabilize the rupee and prevent the sharp rise. However, there has been no direct action. Higher inflows have also added to the liquidity in the system which the RBI is addressing through conventional monetary tools such as reverse repo auctions which will be supplemented by MSS bonds and open market operations.

Movement in the rupee





FPI flows



As can be seen in the Chart, FPI flows have turned positive quite sharply in March and have remained so in April too. Positive flows were viewed in both the debt and the equity segments. In March, a record $ 9.1 bn flowed into the system with $ 5.1 bn entering the equity segment. This also helped to buoy the stock market where the indices scaled new heights. The debt segment in particular has witnessed a steady rise in March and April after turning positive in February. This was notwithstanding the narrowing of the rate differential in India against those in the developed world.

The higher inflow of FPI into the debt segment may be attributed to the enhanced limits offered to FPIs in the GSec segment as well as better utilization in the corporate debt market.

Rs crore	Dec 31	April 12
GSecs		
Limit	227,500	258,000
Investment by FPI	151,858	181,722
Utilization ratio	66.75%	70.4%
Limit available	75,642	76,278
Corporate bonds		
Limit	244,323	244,323
Investments by FPI	167,909	192,152
Utilization ratio	68.7	79%
Limit available now	76,414	52,171

As may be seen in the table alongside, the utilization ratio has improved for both the segments by almost 4% in the GSec market and 10% in the corporate bond market in a span of just a little over three months. As the investments in the GSec market are now linked with the o/s debt of the government, the limit has gotten enhanced. The higher utilization in the corporate debt market is a good sign as heightened interest is evident which can be attributed to the interest rate differential between Indian markets and others notwithstanding the increase in rates by the Federal Reserve. These are positive signs for the market as these flows may be expected to continue during the year.

Where will the rupee go?

The rupee will most definitely be driven by the FPI funding in the equity and debt markets as the other fundamentals are unlikely to change significantly. Assuming that these FPI funds continue to flow in the next 2-3 months the rupee will be fairly volatile but range bound between Rs 64-65/$ before moving back towards the 65-66 mark, which could be an equilibrium range. However, the view is contingent on the FPI flows, which may be affected by geo-political as well as monetary policy measure. Hence, this aspect of inflows needs to be monitored carefully.

How will industry be impacted?

A rising rupee is good for importers but comes in the way of exporters. This can be seen from the table below which gives data on the net forex earnings in various industries for FY16.

- The industries that would be impacted negatively with a stronger rupee are IT, automobiles & ancillaries and textiles followed by Finance companies and diamonds and jewelry.
- The gainers would be crude oil, iron and steel, telecom, chemicals including industrial gases and capital goods.

Appendix: Net forex flows in FY16: Sectoral picture (Rs crore)

Sectors	Number	Inflows	Outflows	Net flows
IT	356	321,463	129,563	191,901
Automobile & Ancillaries	409	202,721	97,601	105,119
Healthcare	297	108,310	37,676	70,634
Textile	382	45,106	17,484	27,622
Finance	286	23,187	6,091	17,096
Miscellaneous	189	12,972	5,021	7,951
Diamond & Jewellery	41	66,801	59,212	7,589
Hospitality	113	4,619	2,703	1,915
Ferro Manganese	12	2,542	900	1,641
Logistics	113	12,320	10,925	1,395
Infrastructure	140	31,381	31,130	251
Retailing	56	7,399	7,419	-21
Abrasives	4	538	722	-184
Mining	34	1,677	1,928	-251
Alcohol	22	692	1,144	-452
Realty	155	1,256	3,058	-1,801
Consumer Durables	69	28,707	31,273	-2,566
Diversified	39	5,980	8,607	-2,627
Plastic Products	134	9,229	11,889	-2,660
Paper	63	2,152	5,039	-2,886
Ship Building	11	539	3,844	-3,304
Electricals	71	4,011	7,522	-3,511
FMCG	235	30,802	34,434	-3,632
Construction Materials	133	5,250	11,572	-6,322
Non - Ferrous Metals	52	32,225	39,557	-7,332
Aviation	15	11,838	19,255	-7,416
Media & Entertainment	127	3,797	13,297	-9,501
Agri	183	20,044	35,589	-15,545
Power	124	3,612	29,820	-26,208
Capital Goods	513	51,217	81,118	-29,901
Inds. Gases & Fuels	28	1,423	32,822	-31,399
Chemicals	338	38,164	69,876	-31,712
Trading	235	35,159	77,170	-42,011
Iron & Steel	169	24,199	69,049	-44,850
Telecom	58	21,945	71,862	-49,917
Crude Oil	50	218,884	564,419	-345,535
Total	**5256**	**1,392,161**	**1,630,592**	**-238,431**

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