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Home > Business & Investment > Volatile Re To Calm Post Elections

Volatile Re To Calm Post Elections

Monday, March 10, 2014
 By Mayura Shanbaug

The Indian rupee which is below the sub 61 level, has been quite volatile in the last few months, primarily due to domestic and International macroeconomic factors. Generally elections are usually associated with higher volatility, and particularly the election this year is being viewed with much interest. According to a Reuter's poll, Indian shares may scale new highs in 2014 after general elections, attracting offshore funds, despite an expected rough period for emerging markets, when the US Federal Reserve shifts monetary policy and one may expect that the Indian currency will benefit from the funds inflow and may go back to trade at sub 60 levels or an unstable government or hung parliament may send it to trade beyond 65 levels feel experts.



Historically, the relationship between the election period and the rupee has never been undemanding or uncomplicated. The Rupee volatility was an expected certainty. India will start voting from April 7th and after going through different stages will ultimately culminate on May 12th. May 16th will reveal the name of the party which will rule the most populace democracy at this very important economic juncture.

According to Naveen Mathur, Associate Director, Commodities & Currencies, Angel Commodities Broking, it is quite difficult to assess which major political party will form the new government or will it be a coalition government, "but still, we expect the Indian rupee to be volatile during the election times," he says. Mathur feels that more business-friendly approach and much needed reforms are awaited to be undertaken by the new government. "There are host of other issues too with which our country is grappling with like high inflation, slowdown in manufacturing growth, lower GDP, deficits etc. These have to be addressed immediately and with conviction," says Mathur.

"While, the reforms, if undertaken by the new government might help to strengthen sentiment towards the Indian economy over a long term, the immediate challenges with respect to the slowdown in growth and high inflation will remain to be concerns for some more time," he explains.

Pramit Brahmabhatt, CEO, Alpari Financial Services (India) says, "Currently it is primarily reacting to the movements of Dollar coming in and moving out from Indian markets by the FII community and Dollar demand from Oil Marketing Companies."

He says that the data releases have had a very short term impact on the rupee as markets are keenly awaiting the outcome of the General Elections to be held in the month of April - May 2014. "A clear mandate to any of the parties will definitely bring in a lot of cheer to rupee and we will see it trading at sub 60 levels. However, if there is a hung parliament, it will definitely be a death kennel for rupee and it will trade beyond 65 levels," he says.

Echoing similar sentiments, Anindya Banerjee, Currency Analyst, Kotak Securities feels that the government has continued to act on long pending bills, but much needs to be done on that front. "With national elections a month away, there is a binary risk over the horizon for the rupee," he says. According to him, in case, the mandate is decisive then the Indian rupee can enter a phase of sustainable appreciation. As inflows in the real economy in the form of FDI and in the financial assets, in form of FII and QFI investments, can become a major catalyst for a strong rupee. "However, a fractured government can once again raise the risk premium, leading to depreciation in the Rupee. Volatility was low over the last 5 months but going ahead we expect volatility to pick up from April-June period," adds Banerjee.

D.R. Dogra, MD & CEO, CARE Ratings has a contrarian view on the whole issue. He feels the rupee will remain volatile only in a limited frame on account of the Elections. "It would be driven more by the fundamentals on both domestic parameters like CAD and FII flows and foreign concerns like Fed tapering," he says.

"Post Elections this sentiment will play less of a role as foreign investors will have a clearer sense on the state of things to come. But to my mind, Elections per se will have a limited effect on rupee volatility and would come in indirectly through FII and FDI flows which will consider the outcome as one of the factors for investing in India," says Dogra.

What may trip the equation for the rupee is, according to Dogra; on the domestic front, the trade deficit will play an

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important role as also the FII inflows. "The market will look for a strong coalition government in place and as long as the sentiment is in this direction, the rupee should remain stable and strengthen marginally," says Dogra.

"Global factors hinge around tapering as the Ukrainian problem seems less likely to threaten the global dynamics though admittedly further distortions in oil prices could upset calculations," he feels.

Dogra expects the rupee to trade between 61-63 levels against dollar with 62 being the anchor in the short run.

According to Pramit Brahmabhatt, the rupee is expected to trade in the range of 60.80 levels to 63.00 levels in the short term, with some violent fluctuations during the important data release dates and towards the end of every month as the Dollar demand by Oil marketing companies usually increase towards the end of the month. "It might see some more stress towards the end of this financial year ending March 31st, as India has a substantial amount of corporate foreign loans to be settled by that date, thus leading to an increased demand for US Dollars by other corporates apart from OMCs and importers, and this will put some serious pressure on Rupee," he says.

"Over the next one-two months, we expect a ranged trading in USD/INR, between 60.00/60.50 and 62.50 on the Rupee," predicts Anindya Banerjee.

The "RBI reserve replenishment and hedging from corporates with FCY liabilities will keep the pair well supported around the level of 60.00/60.50 on spot, but at the same time, the hope rally in the equity markets may keep the US Dollar capped between 62.00/62.50 on spot," he adds.

Naveen Mathur believes that the Indian rupee in the coming fortnight is expected to trade on range bound note against US Dollar with major support at Rs. 61.40 and resistance seen at Rs. 62.70 (CMP: Rs. 61.86). "For the next three months, major support is seen at Rs.60.80 and Resistance at Rs. 63.00," he says.

However, as Anindya Banerjee puts it, "Indian macros remain in a sorry state with stressed assets piling up in the financial sector. Therefore, urgent attention is needed to remove economic constrains and promote a robust manufacturing lead economic revival." "Therefore, the next policy guideline or Union Budget will be a key event to watch post national elections," he concludes.

The domestic & global factors which would influence rupee fluctuations

- Rupee movement going forward will take cues from macroeconomic fundamentals like expectations of further decline in retail and wholesale inflation data of the country. Forecast of favorable industrial production and manufacturing output data from the country will provide clues to the domestic currency in the medium term.
- Apart from the domestic factors, International landscape will also play a pivotal role for the Indian rupee. Economic growth in the western world will drive the future course of action by the leading central banks and with US / Euro economic recovery on cards, we are of the view that the US Fed shall continue with its tapering program.
- However, the major global event which needs to be looked at is QE tapering decision by the US Federal Reserve in its forthcoming meeting scheduled on 18th-19th March 2014. There is an uncertainty over the QE tapering by the Fed, as slower economic growth of 2.4 percent was seen in Q4 of 2013, although unemployment rate has reached near the Fed's target of 6.5 percent. Various other economic data points from China, US and Euro Zone will also have an impact on the currency and these factors need to be taken into consideration while predicting Indian rupee movement.
- Chinese financial system remains a sore point for the world economy and we have to keep a close eye on the upcoming maturities of trust products in China, where the number of issues heading for maturity is going to rise over the remainder of the year.
- The geopolitical tension in the East European region between Ukraine and Russia has the proportion to push up commodity prices across the globe thus putting a lot of pressure on Dollar thus affecting Indian rupee too in an adverse way
- Expected announcements of interest rates and asset purchases decision by European Central Bank (ECB) and Bank of England (BOE) respectively in meetings scheduled this week will also have an impact on the Indian rupee. Strength in US Dollar may result into a slight weakness in Indian rupee, relatively.
- With expected reforms and RBIs clear cut intention of taming inflation, the macroeconomics for our country looks positive. This shall help the rupee to appreciate and consolidate at around Rs. 59-60 levels against the US Dollar.

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