Currency update

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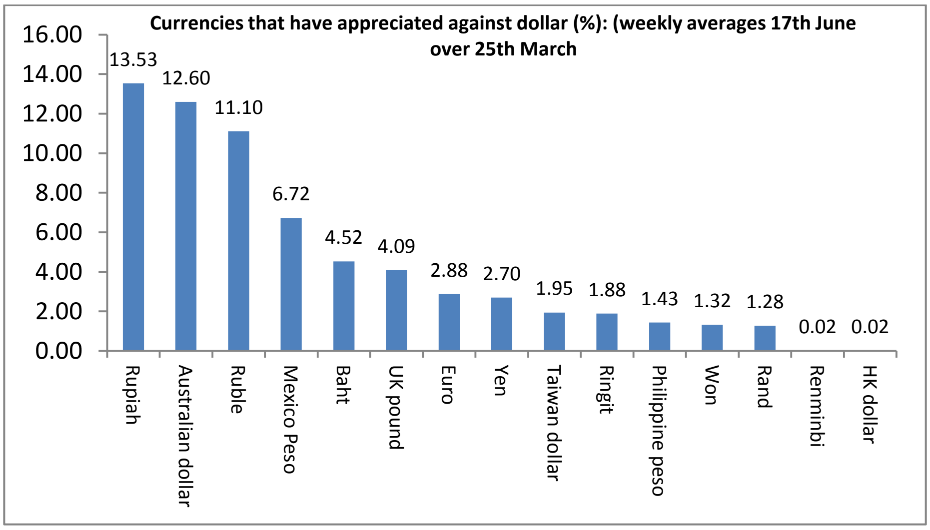
The dollar has been under pressure since the world, or almost all countries, went in for a lockdown starting in March. The confidence in the US economy is lower due to a combination of factors. First, growth is expected to decline by 6.5% in 2020 and unemployment increase to 9.3%. In the December 2019 projection growth was estimated to be + 2.2% and unemployment 3.6%. Hence the impact of the pandemic has been severe for the economy and hence gets reflected in the dollar.

Second, the Fed has also reinforced this sentiment by promising to increase its holding of commercial MBS besides increasing overnight and term repo operations. This has been interpreted as acknowledgement of sustained weakness in the economy. Third, uncertainty on the US-China front continues to pervade sentiment and make the market volatile. Last, with the elections going to be held in November there is again apprehension on how things will turn out. At the theoretical level too, the market believes that the REER as calculated by the BIS points to correction through the year.

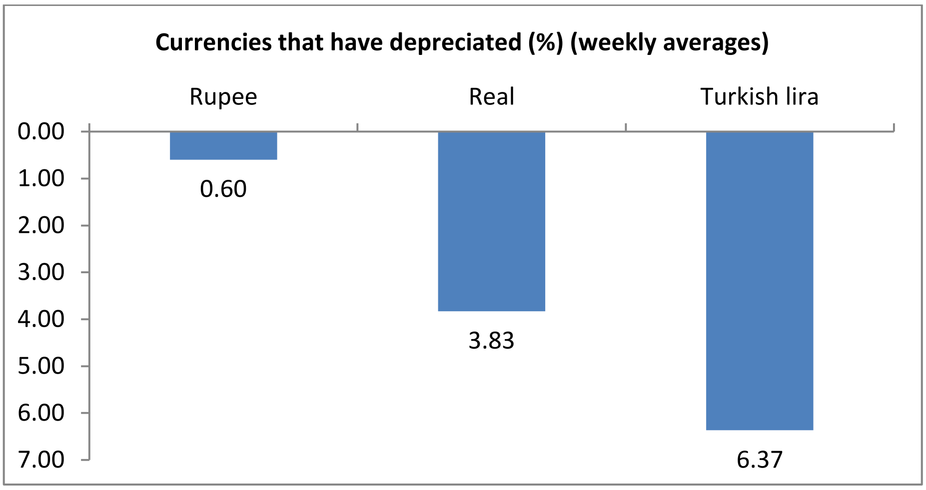
The result has been that most of the currencies have strengthened against the dollar as can be seen in the chart below. It gives the extent of appreciation of currencies based on weekly averages for week ending 17th June over week ending March 25th. The euro is up by almost 3% while the pound gained by around 4%. The biggest gain was for the rupiah at almost 14% followed by the Australian dollar with 13% and ruble 11%.



Source: Pacific exchange rate services

The Indian rupee was however one of the exceptions with a fall of 0.6%. The other two currencies which depreciated were the real (3.8%) and the Turkish lira (6.4%).

The Indian case is quite unique because the depreciation comes at a time when the forex reserves have been increasing to an all-time high of $ 500 bn. In fact, with such inflows the rupee should have been getting stronger. The main reason given in the market for this phenomenon is the dollar purchase by the central bank which in turn is ensuring that the excess supplies do not lead to rapid appreciation. Otherwise with lower CAD and higher capital inflows from FDI and ECBs, the rupee should perform better. FPIs have been quite positive in the month of June so far. The RBI's ostensible reason for shoring up reserves is to ensure that the external account is strong in the face of the pandemic which has eroded growth prospects sharply. Also with the global rating agencies doing a review of the sovereign a very strong external account as depicted by the forex reserves did send a right signal which has been acknowledged by all the three rating agencies.



Source: Pacific exchange rate services

Also with the global economy in a downswing, keeping the rupee from strengthening can afford an export edge as and when conditions improve. Another reason for the rupee tending to remain weak is the uncertainty in the extension of the lockdown which has buffeted the economy negatively. It can be recalled that when the shutdown as announced the UN and IMF had spoken of India registering positive growth this year. However, with the lockdown now running through its 5th tranche all estimates point towards a negative growth rate, which has also been acknowledged by the RBI though a number has not been provided.

We may expect the rupee to be in the range of Rs 75.5-76.5 for the next 3 months till September as the fundamentals will continue to remain firm. The risk factor is once again crude oil price going up and exerting pressure on the CAD which can weaken fundamentals.

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