

Exchange Rate Movement in FY16

The rupee has been under pressure for the last few months now due to various factors, with domination of external conditions. Economic fundamentals driving the exchange rate have been positive with lower CAD and higher inflows from FDI. FIIs however have been marginally positive. The rupee breached the psychological mark of Rs 68/\$ in the month of February 2016 but has recovered partially since then.

However, an interesting observation is that exchange rates have been moving downwards (depreciating) for almost all emerging markets which actually indicates that this is a global development and not restricted to only India. Surprisingly, we may have just done better in relative terms.

The Table below provides the movement in currencies. To gauge the intensity of the movements, a point-to-point comparison has been made (March 2016 over March 2015) where the monthly rates are the average for this period. The table also provides information on the annualized monthly volatility of the currency which indicates the noise factor that should alarm central banks more than the actual change in currency.

Table 1: Depreciation across Currencies (Relative to USD)

Currency	Depreciation	Volatility
Argentina Peso	70.4	23.2
South African Rand	27.5	12.5
Brazilian Real	17.9	19.1
Russian Ruble	16.7	26.7
Mexico peso	15.9	8.4
Turkish Lira	11.3	11.0
Malaysian Ringgit	10.8	10.6
Thai Baht	7.9	5.0
Rupee	7.1	4.4
South Korean Won	6.4	7.1
UK Pound	5.0	6.0
Philippines Peso	4.6	3.8
Chinese Yuan	4.3	3.1
Indonesian Rupiah	0.9	8.4
Hong Kong Dollar	0.03	0.5
Singapore Dollar	-0.2	5.6
Euro	-2.7	8.2
Yen	-6.2	6.0

Source: Pacific Exchange Rate Services

Negative sign denotes appreciation.

The table shows that:

- 15 of the 18 currencies covered here witnessed depreciation during this period. Of these 10 have declined by more than 5%, with the Argentina Peso witnessing the highest decline, followed by South African Rand and Brazilian Real. Russian Ruble (16.7%) and Mexico Peso (15.9%) also witnessed high level of depreciation. The rupee performance was better at 7.1%.
- Hong Kong Dollar and Indonesian Rupiah depreciated by less than 1%
- Further, 6 out of the 18 currencies witnessed annualized volatility of more than 10%. Rupee registered lower volatility of 4.4%.
- Higher annualized monthly volatility was witnessed also in the currencies which depreciate at sharper rates.
- Singapore Dollar, Euro and Yen witnessed appreciation during the period. It also needs to be noted than the currencies with appreciation also had lower volatility (less than 10%). Hong Kong dollar remained unchanged and also was very stable during this period in terms of volatility.

What will drive the rupee now?

- The rupee has been fairly stable based on the fundamentals, but one cannot escape the impact of the global influences such as strength of the dollar.
- The rupee will be driven by a combination of the dollar impact and the fundamentals. Any strengthening of the dollar will necessarily mean a weaker rupee in the absence of RBI intervention.
- Daily FPI flows will provide direction to the rupee. Debt flow in particular would be influenced by two factors:
 - The space provided by the limits that are available for FPI to operate in the GSec/SDL market. Recently the RBI has increased the limits for investment by FPIs in Central Government Securities for the next half year in two tranches, i.e., by Rs. 105 billion from April 4, 2016 and by Rs.100 billion from July 5, 2016 respectively. As in the previous half-year, the limits for State Development Loans (SDL) are proposed to be increased in two tranches, each of Rs.35 billion, from April 4, 2016 and July 5, 2016 respectively.
 - The Fed rate hike - Presently, it does appear that the Fed is going to be cautious with the rate hike, thus causing lesser outflow of funds from the emerging markets.
- Other fundamentals such as trade deficit and invisible flows would tend to remain stable.

Our View

Any volatility in the rupee in recent times has mainly been on account of external factors and sentiments while the fundamentals have been quite stable. A fair range for the rupee would be between **Rs 66-67/\$**, and while there could be downward (depreciation) movements across this band, it should mean revert to this mark. As trade and current account deficit may be expected to remain well under control and FDI continues to be strong, a return to this mark can be expected.

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