Currency Movements

Contact:

Madan Sabnavis
Chief Economist
madan.sabnavis@careratings.com
91-022-6754 3489

Dr Rucha Ranadive
Associate Economist
Rucha.ranadive@careratings.com
91-022-6754 3531

Mradul Mishra (Media Contact)
mradul.mishra@careratings.com
91-022-6754 3515

The Indian Rupee (INR) has been performing very well of late and contrary to expectations that the currency should weaken over time, has been gaining in strength. FPI funds provide an answer to this phenomenon with cumulative flows being \$ 3.6 bn and \$ 3.9 bn in April and May respectively followed with \$ 1.8 bn so far in June. Benign commodity prices do support a stable rupee and with FDI being brisk, there are expectations that the rupee should hold on to this level ranging Rs 64-65/\$ for the next couple of months. India's forex reserves have increased by \$ 11.2 bn since March 2017.

The concerns are more in the space of software receipts and other invisible flows like remittances which will be driven by global developments, with the latest skirmish in Qatar proving to be an impediment. Also the narrowing of the interest rate differential between US rates and domestic rates will make borrowing from overseas markets less attractive.

However, while the INR has been strengthening, a similar trend has been viewed across several currencies, which is more a reflection of the weak dollar, which has materialized contrary to expectations. With Donald Trump taking over as President, it was largely expected that the dollar would strengthen as growth will receive a fillip. However, the developments have been different and the dollar has been pressurized continuously on account of the following factors:

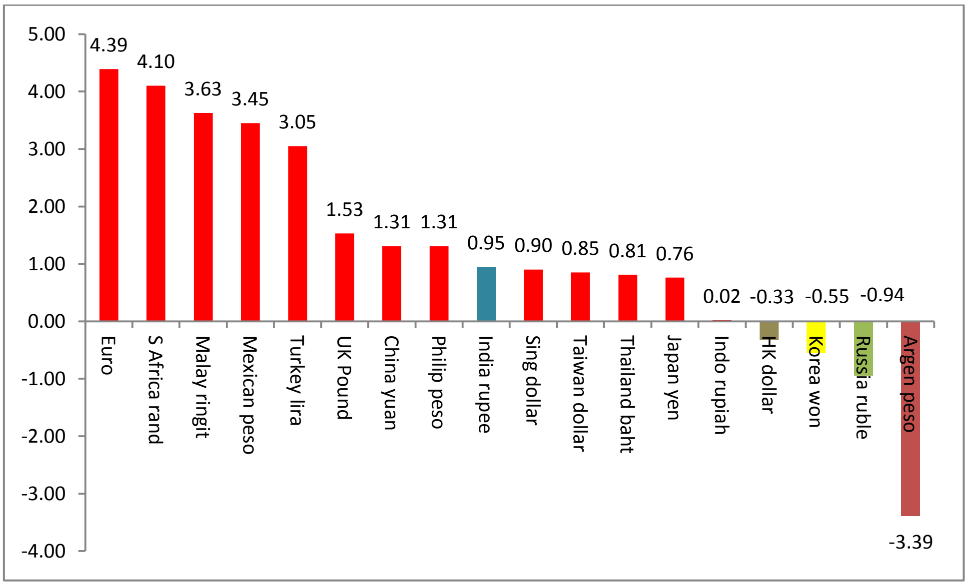
1. The trade deficit has been widening at an alarming pace and in April was \$ 47.6 bn – the highest after January, with China accounting for \$ 27.6 bn. For the first four months of the year, the trade deficit was higher by 13.4% at \$ 187 bn.
2. There is growing scepticism on the ability of the present government to implement aggressive fiscal policy which was

to be a combination of large expenditure on infrastructure and tax cuts for corporates as well as the rich. There has not been much progress on these fronts so far to reassure the markets.

3. Employment numbers for May were lower than expected and while 138,000 jobs were created, the number was much lower than the expected 185,000 which has made the dollar weaker this month. This is notwithstanding the fact that the unemployment rate at 4.3% is one of the lowest since 2001.
4. The Fed's action on rates is still being anticipated by the market as it will signal the state of growth in the economy as well as the prospects for the same. The June meeting will hold some clues on this aspect.

Against this background, the INR movement has not been off-line and as can be seen in the graph below, almost all currencies have tended to strengthen against the dollar between April1-June 10.

Movements in exchange rate: April 1-June 9 (%: +is appreciation)



Source: Pacific Exchange Rate service

The chart above shows that besides the euro, 13 of the 17 currencies strengthened vis-à-vis the USD. The rand, ringgit, Mexican peso and Turkish lira appreciated by above 3%. The UK pound, Yuan, and Philippine peso improved by above 1%. The rupee appreciation of around 1% is hence below the median level of appreciation witnessed within this basket of currencies during this period.

The four currencies which fell against the dollar were the Hong Kong dollar, Won, Rouble and Argentina peso.

Therefore, the stronger rupee must be viewed more in terms of how it is moving in relation to other currencies. The weaker dollar would be playing a dominant role here as the fundamentals of the external account would be weaning towards weakening especially if higher industrial growth necessitates higher imports of non-oil commodities. We would expect the INR to move towards the Rs 66 mark by March 2018.

CORPORATE OFFICE:
CREDIT ANALYSIS & RESEARCH LIMITED
Corporate Office: 4th Floor, Godrej Coliseum, Somaiya Hospital Road,
Off Eastern Express Highway, Sion (East), Mumbai - 400 022.
Tel: +91-22-6754 3456 I Fax: +91-22-6754 3457
E-mail: care@careratings.com I Website: www.careratings.com
CIN : L67190MH1993PLC071691

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