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Movement of USD-INR Exchange Rates

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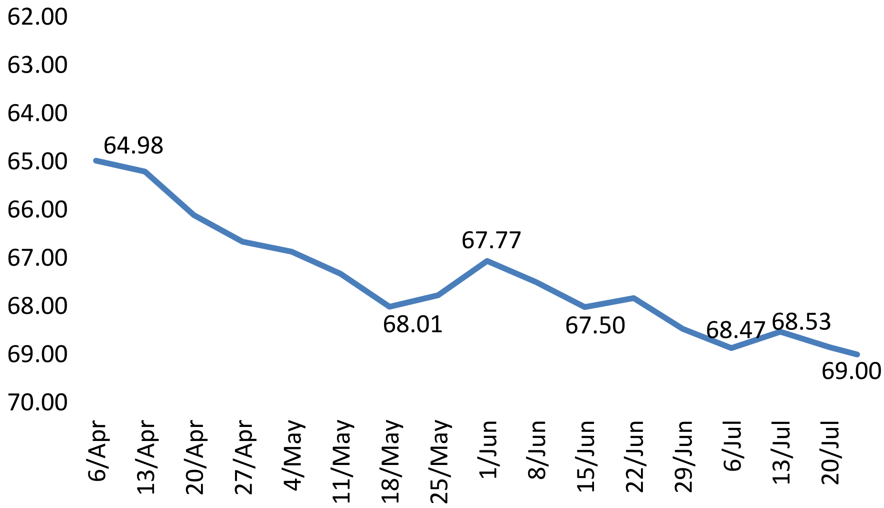
The exchange rate situation remains quite fluid with the rupee tending to weaken driven by both fundamentals and extraneous forces. A higher trade deficit combined with negative FPI flows has contributed to the weakening of the rupee. With the RBI selling dollars intermittently to stabilize the rupee, the forex reserves too are lower than in March 2018.

Added to this is the heavy air in and around global trade which may prove to be a major impediment for the emerging markets. In this report we give a perspective about where the rupee-dollar rate is headed as of March 2019.

Exchange Rate (April to July '18)

Chart 1 depicts the end of week USD-INR exchange rates for the months of April, May, June and July '18. The exchange rate as on 6th April closed at around Rs 65/$ and since then has continued to depreciate going up to Rs 68/$ by mid-May. The rate has been hovering around Rs 67-68 since then. In the very first week of July the rupee-dollar rate began to move above Rs 68/$ and on 24th July '18 it closed at Rs. 69/$.

Chart 1: USD-INR Exchange Rate as on end of week for April-Jul '18



Source: RBI

The Monetary Policy Committee raised the repo rates by 25 basis points to 6.25% in June '18. Simultaneously, the US treasury yields have been rising. The expectation of interest rates increasing further in the USA has caused the volume of net portfolio to decline. The depreciation of rupee vis-s-vis dollar has been affected by: fundamentals and external factors.

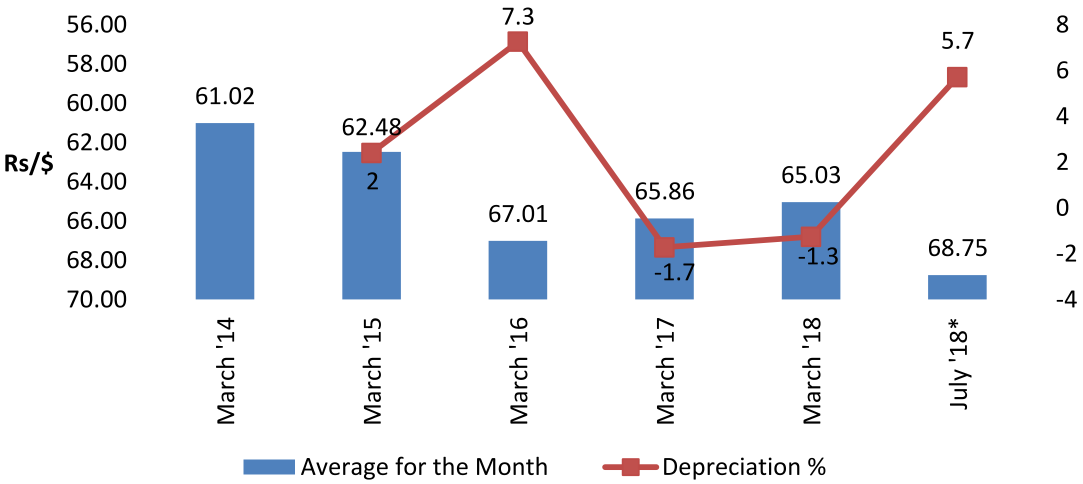
The fundamentals include changes in the foreign currency assets position which is a result of the net position taking into account the current account deficit, FPI, FDI, ECB, NRI deposits etc. The international factors include interest rate actions of the Federal

Reserve, trade battles being spoken of by the USA, geo political factors affecting the oil price etc.

Exchange Rate Path (March 2014 – March 2018)

The rupee has treaded along an uneven path, as is shown in Chart 2 which gives the average exchange rate for the month of March over the last five years, beginning from 2014 to July ’18 (up to 24th July ’18). The depreciation in the currency was the highest at 7.3% FY16. This was followed by a 2% appreciation in FY17. The position of dollar continued to be strong as the rupee depreciated by 1% in FY18. However in the first 4 months of the FY19, the rupee had fallen by around 6%.

Chart 2: USD-INR Exchange Rates average over March (FY 14 –FY 19)



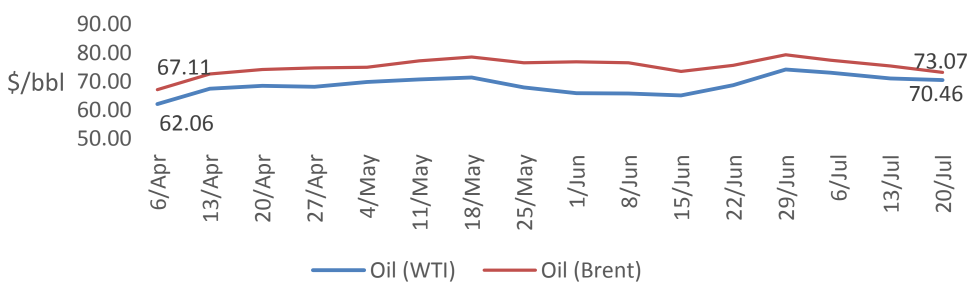
*Average Rate from 2nd July to 24th July ‘18
Source: RBI

Oil Prices

The movement of WTI Oil Prices is given in Chart 6. In the face of supply shocks given the US sanctions on Iran, a volatile oil market is anticipated. Supply factors will determine the movement of oil prices as it is highly susceptible to the geo-political dynamics. The ensuing hyperinflationary situation in Venezuela, which is also the OPEC’s largest producer in Latin America, is likely to put pressure on the supply side.

Brent Crude Oil Prices rose from 67 $/bbl to 73$/bbl between 6th April ’18 and 20th Jul ’18. This was closely followed by WTI Oil Prices which went from 62$/bbl to 70$/bbl, for the same period. We expect Brent oil prices to remain around 70-75$/bbl in FY19.

Chart 5: Oil Prices end of week (April – Jul 2018)



Source: Bloomberg

Trade Deficit – Increasing

The trade deficit for the first quarter of the year had increased by 12.2% from $ 40.05 bn to 44.94 bn. This was notwithstanding the fact that exports grew by 14.2% as imports also surged by 13.5%. Higher import of commodities including oil was responsible for the higher trade deficit.

Table 1: Trade Balance (Billion $)

Month	2017	2018	% Change
Apr-June	-40.05	-44.94	12.2

Source: CMIE

Foreign Portfolio Investment (FPI)

Net portfolio investments fell sharply mid-April. The reasons for this fall can be attributed to:

- A raise in federal funds rate by the U.S. Federal Reserve
- U.S. bond yields have risen in response to the rate hike by the Feral Reserve, making investment in the US more attractive
- Consequent to the above two factors, carry trade has become less attractive.
- Global growth prospects have widened
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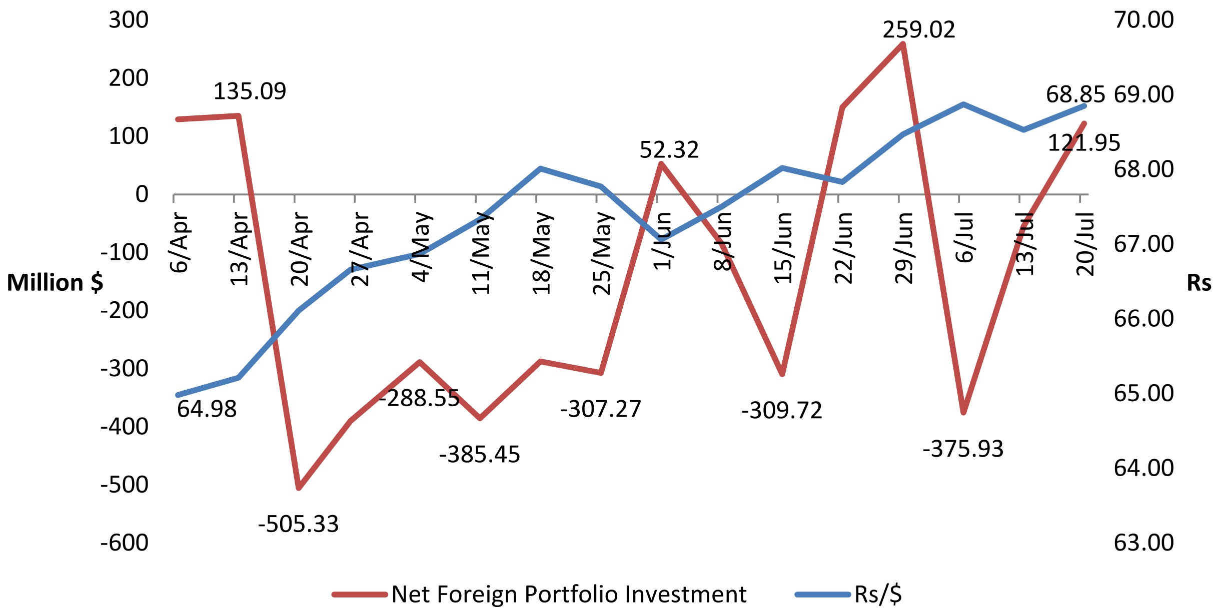
With the sudden continuous decline in foreign portfolio investments in the country, the rupee has weakened against the dollar.

RBI's move of lowering the limits on FPI in April 2018 was expected to have a positive effect on investment flows. However going against expectations, the economy saw huge outflows especially on the debt side, by end of April '18. By June end, a positive net investment was recorded owing to portfolio investments in equity. As of 20th July '18, the net investments have picked up and are at $121 million.

Chart 3: Net Foreign Portfolio Investment and USD-INR Exchange Rates (April-Jul '18, End of week)

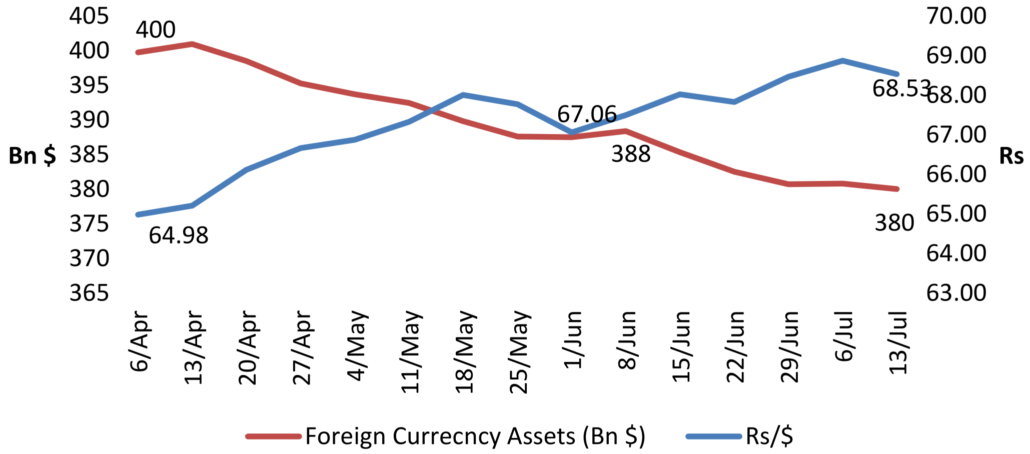


Source: NSDL

Foreign Exchange Reserves

The foreign exchange reserve has been declining since April ’18. The RBI, in the face of a weakening currency has intervened by selling dollars. As of mid- July ‘18, foreign currency assets of the RBI stand at 380 billion dollars. The cumulative sale of dollars for the months of April and May ’18 is around $8.25 Billion

Chart 4: Foreign Currency Assets and USD-INR Exchange Rates



Source: RBI

Table 2: Net Purchase/Sale of U.S. Dollar by RBI (Billion $)

Month	Net Purchase/Sale of Foreign Currency
April '18	-5.76
May '18	-2.48

Source: RBI

Concluding Remarks:

- Futures trade in currency also project a depreciation, as the underlying currency contract dated September 2018 closed trading at Rs. 69.35/$. There is an anticipation of a slight appreciation in the rupee, given the intervention by the RBI through sale of dollars. The close price for December ‘18 dated contracts is Rs. 70.08. The effect of intervention has not brought in much positive expectation as, the close price for the March 2019 dated contract is at Rs.70.75/$.
- ***We however believe that with an equilibrium returning to the oil sector and FPIs turning positive during the course of the year, there will be more stability in the forex rate. By December we expect the exchange rate to be around Rs 68-68.5/$. As the rupee has already fallen quite significantly so far, we may expect further attention from the RBI through the sale of forex to ensure that the rupee does not fall sharply in future. Continued weakness in CAD coupled with negative capital flows and fall in forex reserves can drive the rupee lower and remain the chief risk factors. The global sentiment relating to trade wars and Iran is also expected to become stable in the coming months.***
- A rebound in the foreign portfolio investments is much needed for the external account to stabilize.
- It remains to see how the RBI will time its intervention in order to protect the rupee from depreciating further.
- The global currency movements are another set of factors that affect the exchange rates, which has not been covered in this study.

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