Currency round up and what to look for in 2021

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2020 was the year which witnessed one common theme in the currency market which was the weakening dollar. The question has always been why the dollar has been weakening against the euro. There were phases of the dollar regaining strength during the year, but in general it has been a downward journey. On a point-to-point basis the dollar started off at 1.1176/€ and ended the year at 1.2259/€. Such lows were witnessed a couple of years back and hence does cast a shadow on the future too. The annualized average daily volatility was as high as 6.9%.

The fall of the dollar by 9.7% on a year-on-year basis was an unmixed blessing for the rest of the world. Other currencies tended to strengthen which did not help the cause as global trade slowed down and the US gained in terms of competitive edge. Japan, UK, China as well as the European zone had better currency rates but had the disadvantage in the trade arena.

Emerging markets witnessed some depreciation due to a combination of central bank action and movement in fundamentals. The LATAM currencies declined as fundamentals were adverse. The same held for Russia and Turkey outside this zone. In Asia, India and Indonesia were the exceptions where there was depreciation. In India's case, fundamentals were strong leading to current account surplus which was topped by healthy capital inflows. The rupee declined by 2.8% but most of this was prior to the pandemic. The RBI was also active in the market buying up dollars to ensure that the appreciation was checked. Almost $ 58 bn was purchased up to October.

Two factors weighed heavily on the dollar weakness. The first was the spread of the virus with US topping in terms of the number of infections. Even today the situation appears to be out of control. While the developed world came out of the infection bubble and re-entered under the second wave, the first round seems to be prevalent in the US leading to speculation on future growth prospects.

The second was the US Elections and the outcome which dominated the market even after the results were announced. However, there seems to be less confidence even post the election of a new President. It appears to be the virus all the way.

The dollar did have a relatively better time in March but once the Fed had gone in for a very aggressive stimulus programme relative to those of other central banks, it was assumed that the economy was weak and hence the downslide started. The dollar has not quite recovered since then.

Investors are preferring stocks today with the equity markets doing very well guided by the news on the vaccine trials and its effectiveness. With a number of developed countries all set to vaccinate their population,

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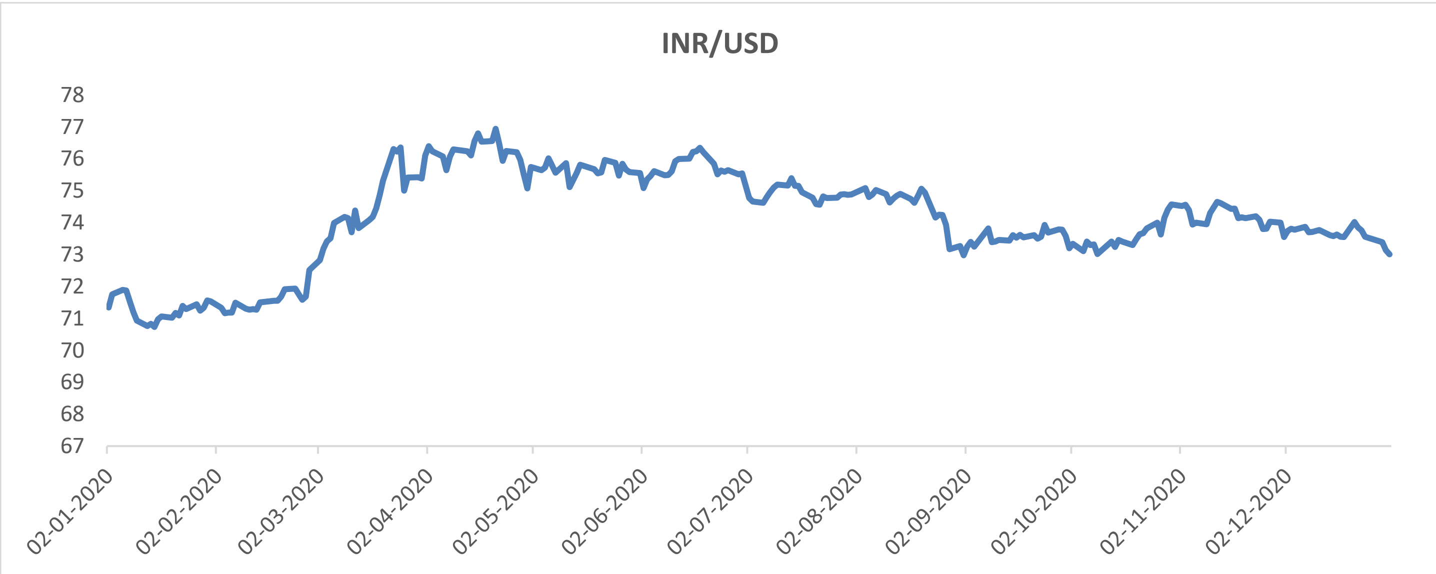
investors may not be looking too much at the dollar and would continue investing in stocks.

On the economic front there are expectations that a new President and further action of the Federal Reserve can lead to inflation spiking in the USA which is not good news for the dollar. Hence there are expectations that the slide witnessed this year will continue into 2021 and another 5% depreciation cannot be ruled out.

The rupee had depreciated to a low of close to Rs 77/$ in April but since has recovered and strengthened all the way to close the year at around Rs 73/$.



The future of the rupee will hinge on the following matrix:

- CAD, which can turn to deficit as economy recovers and demand for imports goes up. Also, a reviving world economy can lead to an increase in price of crude oil which can put pressure on trade account.
- Capital flows are presently buoyant as ECBs are attractive and FDI continues to flow. This will persist. FPI is however going to be an unknown and while the flows into equities have been high in 2020 in almost all markets, their sustenance will depend on opportunities in the western nations.

- RBI intervention in the market will always be a factor controlling the upside to the rupee appreciation.
- A weak dollar in 2021 which seems a certainty today will mean that the external factor will be at work putting pressure on all currencies that will fight hard to retai9n export edge in a narrow trade world.

Therefore, while the rupee would on the whole tend to not appreciate a range of Rs 73-74 is what can be expected for the greater part of the year in the absence of any major surprise – positive or negative on the virus front.

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