

## Will Rupee Continue Its Rally?



In 2016, a lot of significant events took place, which affected global markets - One being UK's exit from the European union, called Brexit, which led pound to decline 20% against dollar (1.50 in June 2016 to 1.20 in October 2016). Another event that evidenced a shift in global economy was the outcome of US Presidential elections. However, rupee remained unaffected by these events. During 2016, it was not expected that rupee would break out of the range of 66-68.

### ***Then what was it that led to a sudden growth in rupee?***

The rupee has been showing signs of strength, with the dollar-rupee rate breaking past the 66-level. In the last week of April 2017, it even touched 63.93, marking a 20-month high.

### ***Strong foreign inflows***

One amongst the many factors that supported the rupee rally has been strong foreign inflows. It all began in the month of March 2017, with the BJP's victory in State Assembly elections in Uttar Pradesh. This victory regained foreign investor's confidence in the Indian markets expecting faster reforms and implementation of various government policies. They began investing in Indian debt and equity segment. March and April witnessed strong inflows in the Indian debt segment. After selling USD 6.36 billion in 2016, FPIs have already poured in USD 7.52 billion in the first four months of this year. This inflow is higher than the USD 7.4 billion for the entire calendar year 2015. FPIs have also pumped in USD 6.38 billion into the Indian equity segment, which is twice the USD 3.19 billion and USD 3.18 billion flows seen in 2015 and

2016 each, respectively. At the same time, SEBI raised the investment limit for FPIs in government securities by around 20%.

### ***Fed's stance on interest rates***

Another significant factor contributing to strengthening of the rupee is the US Federal Reserve's perspective on the rate hike. It has not been as aggressive as it was expected to be and hence it pushed the dollar index below 100 over the last couple of months. Unless the Fed gets more aggressive on the rates, failing which a recovery in dollar is unlikely and has a room to fall further, which may help rupee strengthen further.

### ***European events***

The recent developments in Europe like the ongoing French elections and upcoming UK elections has been adding the pressure on the dollar. These have ignited significant gains in the euro and the pound over the last one month. However, pound recovered only some of its lost ground after the Brexit referendum in June 2016, when it had tumbled against dollar.

### ***Widening of the Current Account Deficit (CAD)***

It can also be said that strengthening of the rupee would affect the performance of exports. However, it is important here to note that there are other determinants of exports like market environment, government policies, global economy, etc. which would contribute in determining the performance of exports. India's merchandise exports grew at the fastest pace in almost six years in March led by petroleum, textiles, engineering goods, and gems and jewellery, up 27.5% from a year ago to USD 29.2 billion. But at the same time imports have risen too. Hence, it failed to narrow the trade deficit. The trade deficit, after widening to USD 13 billion in November 2016, narrowed to USD 8.9 billion in February this year. But a 45% increase (year-on-year) in imports in March has widened the trade deficit to USD 10.4 billion. So, if the imports continue to rise at a pace, faster than the exports, there is a possibility of the deficit widening further. Given that there is low possibility of the trade deficit to improve in the coming months, there is a probability of the CAD widening further. India's import bills majorly comprise of gold and crude oil. The outlook for both the commodities is bullish in the near future. Also, gold is gaining its shine due to geo-political uncertainty between US and North Korea. The rising prices of these two commodities would weaken the rupee further.

### ***RBI's intervention***

Additionally, any unexpected volatility in the market currently can be tackled by the RBI with its strong forex reserves. Since, the rupee has appreciated in a short span of time, RBI has interrupted and resorted to selling rupee and buying dollars. This would obstruct further strengthening of the rupee, which in turn would boost its reserves.

### ***Impending phenomenon and conclusion***

The upcoming events like the next Fed meeting would decide the exchange rate. Very clearly, if the Fed hints at additional hike in the rates, dollar may strengthen. The uncertainty in US – North Korea relations

may trigger a global risk-off trade. French and UK elections could be significant too. The combined impact of these major events has been adding further unpredictability to an already uncertain outlook on the foreign exchange markets. Considering all the above factors, foreign exchange market is expected to have a short-term volatility. Thus, the rupee is expected to strengthen further, however this strength might not endure.