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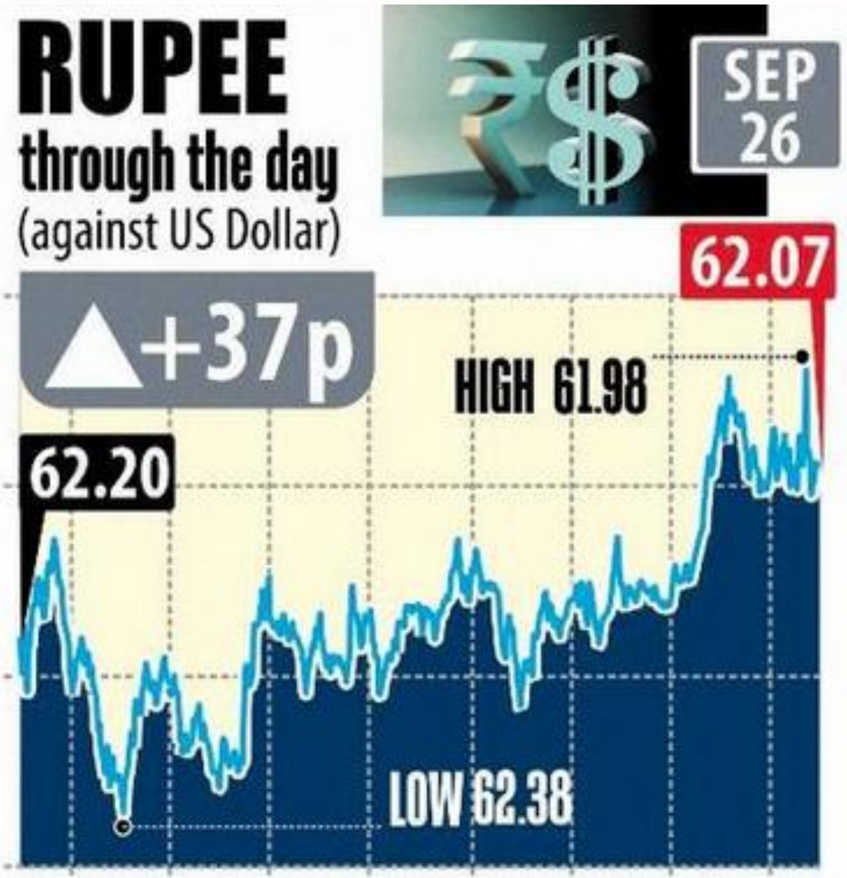
Rupee in 2014

The rupee seems to flourish in 2014 and is predicted to stabilise against US Dollar

Rupee strengthening against US$ & expected to stabilize in 2014



New Delhi: Indian rupee rose recently against US dollar. Rupee went up by 70 paise or 1.12% against US dollar to settle at 62.40 compared to previous close rate of 63.11.

Rupee touched a high of 62.39 and low of 62.92 after opening at 62.85.

The Reserve Bank of India (RBI) fixed reference rate of rupee for US dollar at 62.6250 compared with 63.0645 a week back.

Good Factors

Median expectations from 20 strategists in the poll conducted this week were for rupee to trade at 62 against the dollar at the end of January next year, roughly around its rate on Thursday.
It is then seen weakening slightly to Rs 62.50 a dollar by April and Rs 63.0 by October 2014.

+TIVE NEWS

The three most important points under the good are -- a) agriculture could provide the biggest upside to GDP growth this year. Agriculture growth rate could be as high as 4.5%, more than double of what we saw last year at 1.9%, b) boost in exports that we see arising from an improved competitiveness and the fact that the western economies are showing signs of growth firming up, and c) in our analysis of 2481 investment grade companies that CRISIL rates, which represent more than 30% of total bank credit, face a fairly low level of vulnerability to forex volatility and forex volatility is affecting only 6% of these companies.

Interest Rates

Liquidity was an important source of stress for 16% of CRISIL's investment grade companies. But we believe that the impact on the larger companies where the turnover is greater than Rs 1000 crore will be higher. In fact, 24% of these companies are likely to be stressed on account of liquidity factors because of the upcoming repayment obligations or stretched working capital cycles.

Bad or Ugly Factors

The Indian rupee has rebounded a little more than 10 per cent since falling to a record low of 68.8 against the dollar at the end of August, boosted by inflows after the Fed refrained from reducing its $85 billion a month bond purchase programme and as the Reserve Bank of India tightened liquidity.

-TIVE NEWS

What we are seeing in ugly is the continued stress on the current account deficit. We are expecting a significant improvement. It was 4.8% last year. We are forecasting an improvement to 3.9%, which is definitely better, but it is still at very high levels. We believe that the rupee will appreciate to a level of 60 vs the US dollar by March 2014. On an overall basis, it will still be 12% to 14% lower than what it was last year. The second challenge which we have classified under the ugly is that the industrial growth continues to be anaemic. We have forecasted an overall industrial growth rate of just 1% this year and particularly the stress sectors are going to be areas related to infrastructure, construction, transportation, real estate and automobiles. The third factor that we have classified under the ugly is the fact that inflation is going to continue to remain high. We have forecasted inflation for the full year to be at 6.2% and the contributing factors to this are high oil prices and a weak currency.

NEWS

The Fed is now expected to begin cutting its stimulus in March 2014, according to a Reuters poll, but analysts in this survey said the effects of such a move would not be as disastrous for the rupee this time around

The Indian rupee will struggle to gain any ground in the next 12 months against US dollar due to uncertainty around elections, the external deficit and the impact of a possible tapering in the Federal Reserve's stimulus programme, a poll showed.

The poll also showed analysts expect the Chinese yuan will slowly appreciate over the same time period as the economy improves and on expectations that its central bank will widen the currency's trading band.

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But that rally came after a 20 per cent plunge since mid-May when rising interest rates in the United States and fears of Fed tapering led investors to dump emerging market assets.

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Those expectations are much better than what analysts predicted last month.

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Factors Determining Exchange Rates

1. Differentials in Inflation

As a general rule, a country with a consistently lower inflation rate exhibits a rising currency value, as its purchasing power increases relative to other currencies. During the last half of the twentieth century, the countries with low inflation included Japan, Germany and Switzerland, while the U.S. and Canada achieved low inflation only later. Those countries with higher inflation typically see depreciation in their currency in relation to the currencies of their trading partners. This is also usually accompanied by higher interest rates.

2. Differentials in Interest Rates

Interest rates, inflation and exchange rates are all highly correlated. By manipulating interest rates, central banks exert influence over both inflation and exchange rates, and changing interest rates impact inflation and currency values. Higher interest rates offer lenders in an economy a higher return relative to other countries. Therefore, higher interest rates attract foreign capital and cause the exchange rate to rise. The impact of higher interest rates is mitigated, however, if inflation in the country is much higher than in others, or if additional factors serve to drive the currency down. The opposite relationship exists for decreasing interest rates – that is, lower interest rates tend to decrease exchange rates.

3. Current-Account Deficits

The current account is the balance of trade between a country and its trading partners, reflecting all payments between countries for goods, services, interest and dividends. A deficit in the current account shows the country is spending more on foreign trade than it is earning, and that it is borrowing capital from foreign sources to make up the deficit. In other words, the country requires more foreign currency than it receives through sales of exports, and it supplies more of its own currency than foreigners demand for its products. The excess demand for foreign currency lowers the country's exchange rate until domestic goods and services are cheap enough for foreigners, and foreign assets are too expensive to generate sales for domestic interests.

4. Public Debt

Countries will engage in large-scale deficit financing to pay for public sector projects and governmental funding. While such activity stimulates the domestic economy, nations with large public deficits and debts are less attractive to foreign investors. The reason? A large debt encourages inflation, and if inflation is high, the debt will be serviced and ultimately paid off with cheaper real dollars in the future.

In the worst case scenario, a government may print money to pay part of a large debt, but increasing the money supply inevitably causes inflation. Moreover, if a government is not able to service its deficit through domestic means (selling domestic bonds, increasing the money supply), then it must increase the supply of securities for sale to foreigners, thereby lowering their prices. Finally, a large debt may prove worrisome to foreigners if they believe the country risks defaulting on its obligations. Foreigners will be less willing to own securities denominated in that currency if the risk of default is great. For this reason, the country's debt rating (as determined by Moody's or Standard & Poor's, for example) is a crucial determinant of its exchange rate.

5. Terms of Trade

A ratio comparing export prices to import prices, the terms of trade is related to current accounts and the balance of payments. If the price of a country's exports rises by a greater rate than that of its imports, its terms of trade have favorably improved. Increasing terms of trade shows greater demand for the country's exports. This, in turn, results in rising revenues from exports, which provides increased demand for the country's currency (and an increase in the currency's value). If the price of exports rises by a smaller rate than that of its imports, the currency's value will decrease in relation to its trading partners.

6. Political Stability and Economic Performance

Foreign investors inevitably seek out stable countries with strong economic performance in which to invest their capital. A country with such positive attributes will draw investment funds away from other countries perceived to have more political and economic risk. Political turmoil, for example, can cause a loss of confidence in a currency and a movement of capital to the currencies of more stable countries.

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Our Location

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