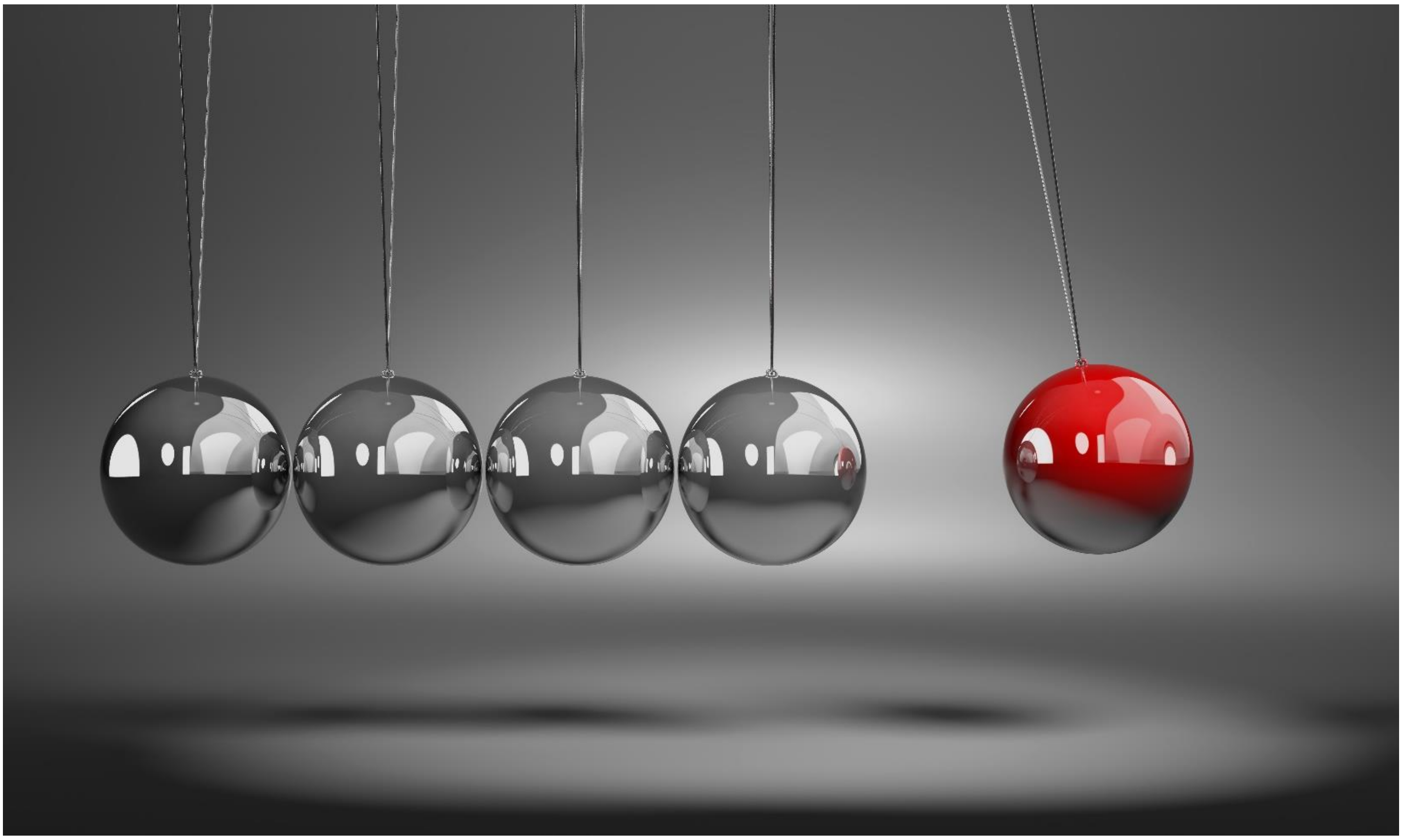
Research

CRISIL
An S&P Global Company

Reckoning rupee's reversion range

There's a 50% chance of 71/$ by March 2019

November 5, 2018



Analytical contacts

Dharmakirti Joshi
Chief Economist, CRISIL Ltd
dharmakirti.joshi@crisil.com

Dipti Deshpande
Senior Economist, CRISIL Ltd
dipti.deshpande@crisil.com

Pankhuri Tandon
Junior Economist, CRISIL Ltd
pankhuri.tandon@crisil.com

Media contacts

Saman Khan
Media Relations
CRISIL Limited
D: +91 22 3342 3895
M: +91 95940 60612
B: +91 22 3342 3000
saman.khan@crisil.com

Hiral Jani Vasani
Media Relations
CRISIL Limited
D: +91 22 3342 5916
M: +91 982003 9681
B: +91 22 3342 3000
hiral.vasani@crisil.com

Parmeshwari Bhumkar
Media Relations
CRISIL Limited
D: +91 22 3342 1812
M: +91 841184 3388
B: +91 22 3342 3000
parmeshwari.bhumkar@ext-crisil.com

50% chance of 71 by March 2019

The rupee has fallen sharply against the US dollar this fiscal, losing nearly 13.8% beginning April to October 31, as global headwinds multiplied and the current account deficit (CAD) widened.

On average basis, the decline is less steep at 7.4% on-year, but still much higher than the trend rate of depreciation, of ~2.5% average per year, in the last fifteen years.

So, is a course reversal possible? Indications say yes, with some correction from where we stand today on the horizon, unless global conditions turn more adverse.

- **We believe the rupee can strengthen to 71 per US dollar by March 2019. This is our base case, with 50% probability of occurrence. The falling oil prices and currency swap deal with Japan should provide some support to the rupee.**
- **However, there is a 35% probability of the rupee settling at 74 per US dollar, and a 15% probability of it appreciating to our previous forecast of 68.5 per US dollar.**
- **Risks are tilted on the downside because rising interest rates in the US could continue capital outflows from India, putting pressure on the rupee.**

No, this is not 2013

The rupee's sharp decline this year easily evokes memories of 2013, the year the Fed's taper tantrum had severely pummeled the local currency.

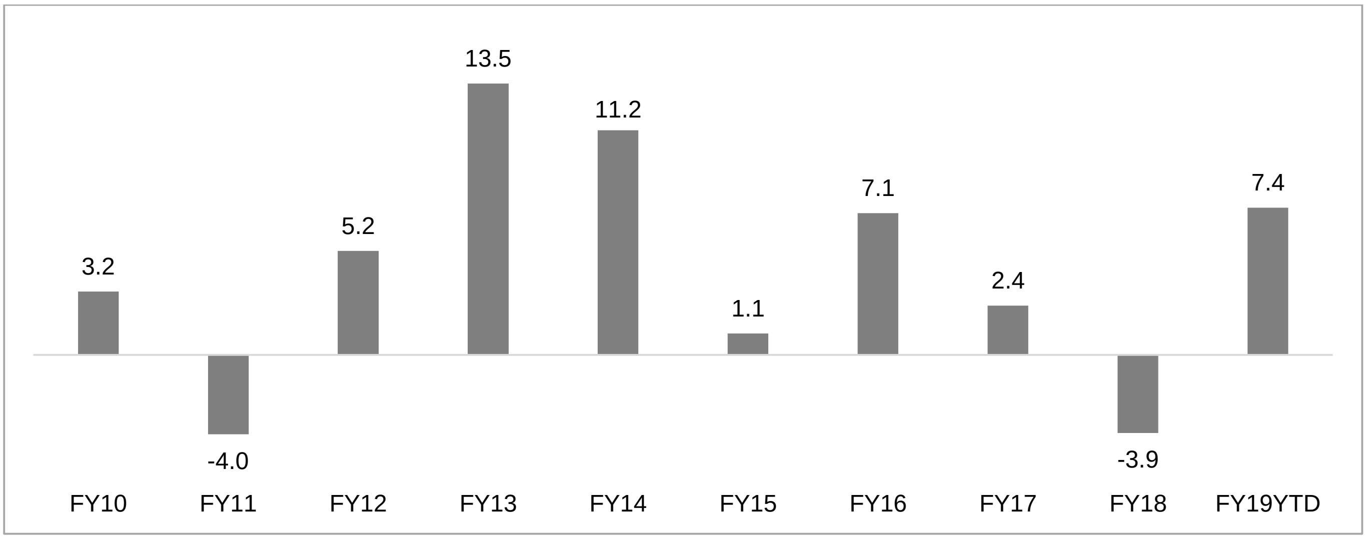
Only, the beating hasn't been as severe this year – on average basis, the rupee's fall over April-October has been 7.4% compared with 13.5% and 11.2% in fiscals 2013 and 2014.

Also the decline has been more gradual. Back in the 2013 cycle, the local currency had depreciated 27% against the dollar (from 53.7 to 68.4 at its lowest) in 83 days. But this time, the depreciation has been 15% (from 64.9 in April to 74.4 at its lowest on October 11) in 125 days.

The 2013 fall was in an environment of high CAD (accompanied by weak macro fundamentals - high fiscal deficit and inflation and low growth) and a drying up of foreign capital flows as a result of the taper tantrum.

The drivers are not too different this time – CAD is rising (higher oil prices, rising coal imports and other core imports as well) and there are outflows of foreign portfolio investments or FPIs (as they chase high-yielding US securities). But there is the additional blow from the US dollar- the dollar index1 has strengthened over 7% fiscal thus far.

Against dollar, the rupee has fallen less this year than in 2013 (%)



Source: Reserve Bank of India (RBI), CEIC, CRISIL

[1] *The dollar index (trade-weighted) measures the value of US dollar against a basket of currencies of its major trading partners*

The fall is not as much

The rupee's depreciation in 2018 has been less severe than 2013 despite greater intensity of global shocks.

First, the value of the US dollar is much higher today compared with 2013. It has also appreciated at a much sharper pace. This year, the dollar index has appreciated over 7% since April, while for the same period in 2013[2] it was fairly stable, having gained only 0.4%. A stronger dollar value directly erodes the value of the rupee.

Second, FPI outflows have been larger in 2018 vs 2013. FPIs net withdrew $16.2 billion between April and October this year, compared with $3.5 billion in the corresponding period of 2013. If we compare the outflows during the depreciation cycles of 2018 and 2013 mentioned previously, FPI outflows were $14.6 billion net in the 2018 cycle, double of $7.3 billion net outflows in the 2013 cycle.

A lower depreciation despite bigger global shocks indicates the stronger underlying resilience of the economy relative to 2013. The shocks have increased, but vulnerability remains lower on most macro parameters.

Indeed, GDP growth is expected to be stronger, inflation lower and foreign exchange cover higher in 2018 compared with 2013. While CAD is expected to cross the 2.5% mark in fiscal 2019, it will still be less than the 4%-plus levels seen in the two years preceding 2013.

Macros are healthier today

Indicator	FY12	FY13	FY14	FY15	FY16	FY17	FY18	FY19P
GDP growth (% y-o-y)	6.6	5.5	6.4	7.4	8.2	7.1	6.7	7.5
CPI inflation (% y-o-y)	8.4	9.9	9.4	6	4.9	4.5	3.6	4.8
CAD (% of GDP)	4.3	4.8	1.7	1.3	1.1	0.7	1.9	2.6

Note: P: CRISIL's projections

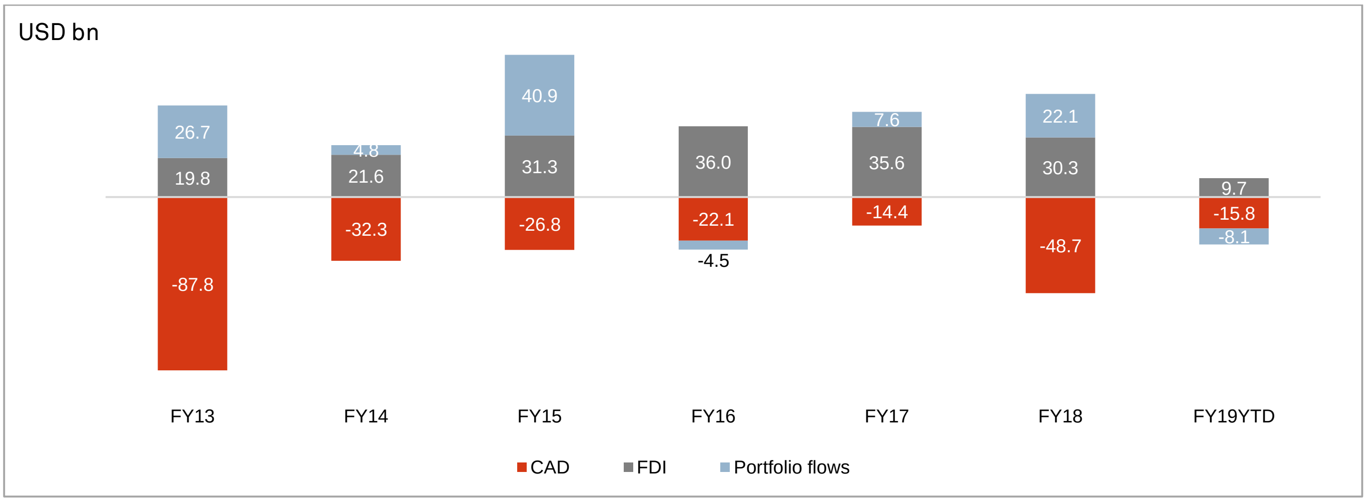
Source: Central Statistical Office, RBI, CEIC, CRISIL

Looking ahead, the US economy is expected to continue raising its interest rates which would drive capital flows towards the high yielding US assets for some more time. S&P Global expects the US Federal Reserve to raise policy rate one more time in 2018 and three times in 2019. The good news is from oil because the global economy is slowing which means demand will ease and help soften prices. Oil prices have already fallen from a peak of $86.1 per barrel on October 4, to $75.3 by October 31. This bodes well for India's ballooning CAD. The enhanced swap agreement with Japan will also help support the rupee.

Also, while there have been foreign portfolio outflows from the economy, Foreign Direct Investment (FDI) – considered more durable than FPI – is still growing.

[2] *April-October 2013*

Financing of CAD is being supported by FDI



Note: FY19YTD refers to the first quarter of fiscal 2019

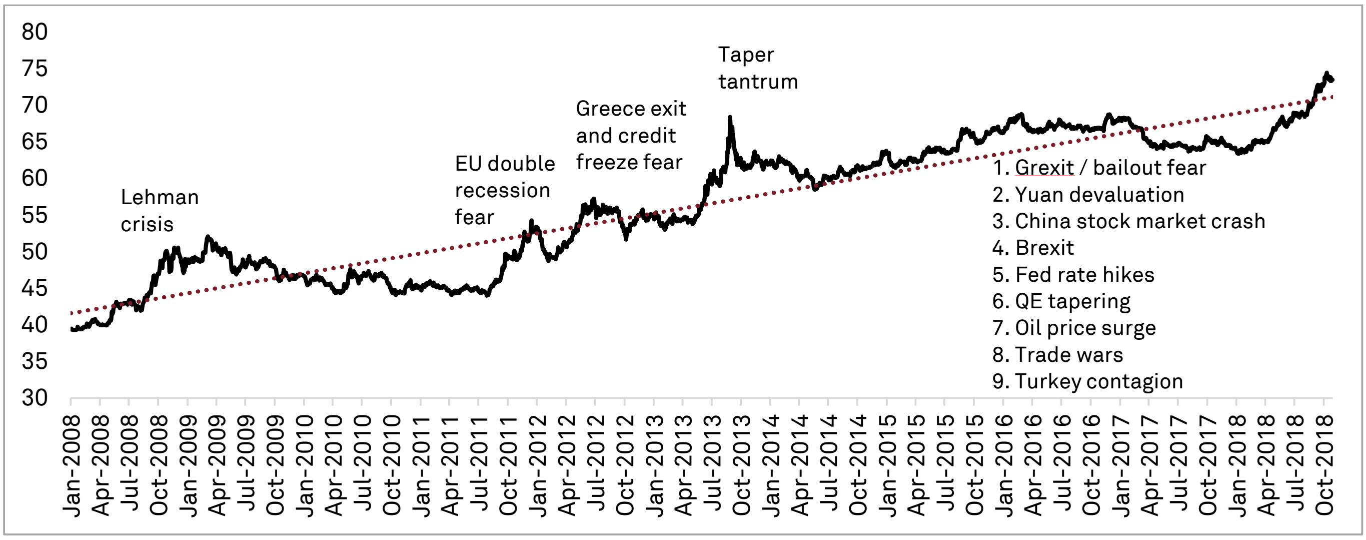
Source: RBI, CEIC, CRISIL

Rupee has overshot its trend depreciation rate

The rupee has overshot its trend value in recent past. The trend line drawn through the value of the rupee for the past decade shows how the local currency tends to revert to the trend after the impact of shocks eases. It is seen that the speed of reversal to trend was lower in years when the underlying macros for the economy were weak. Since 2014, despite more number of complex shocks and of higher intensity, rupee has been quicker to revert to the trend with improvement in macros.

It also appears that the rupee is making up for the appreciation in the last two years. A back-of-the-envelope calculation shows the rupee would have settled around 71 by fiscal 2019-end had it continued to depreciate in fiscals 2017 and 2018 (instead of appreciating 1 to 2% average). This calculation assumes an average annual rupee depreciation rate of ~2.5% per year observed in the last over these years, which is as per the average depreciation rate in the past fifteen years.

Rupee seems to have overshot trend



Source: RBI, CEIC CRISIL

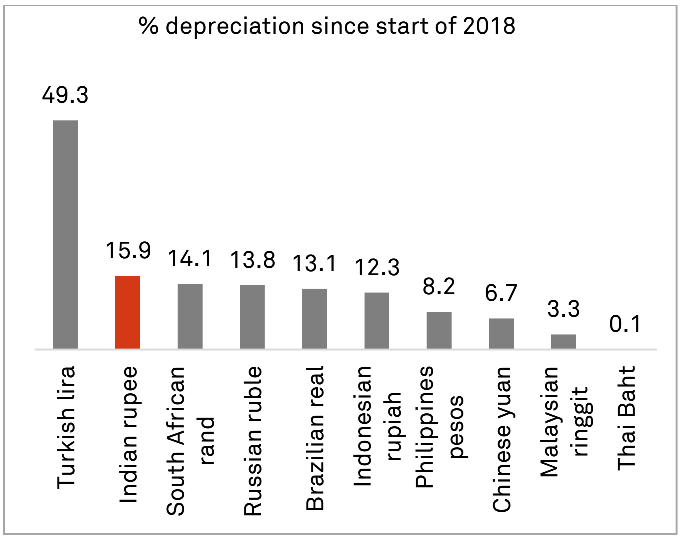
If investor appetite changes, we stand a chance

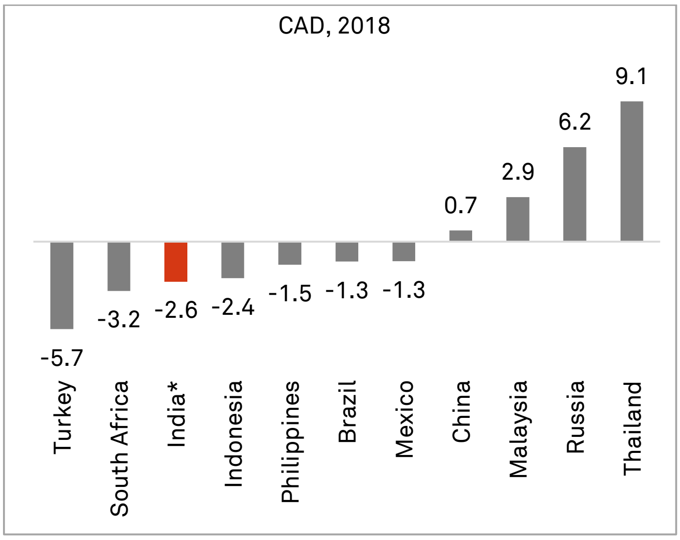
Another factor that can turn the rupee's fortunes is if investor appetite changes. Currently, the global risk aversion is causing investors to flee emerging markets and those with high CAD are seeing a bigger negative impact on the currency.

This year, the rupee, along with South Africa's rand, Russia's ruble, Brazil's real, and Indonesia's rupiah, has seen the steepest decline. Incidentally, these countries have some of the largest CADs.

However, if investors' risk appetite does improve and they look towards emerging markets, then India stands better-positioned – with higher GDP growth rate, lower inflation rate, high forex cover and better policy stability.

Rupee among the worst-performing emerging markets due to large CAD…

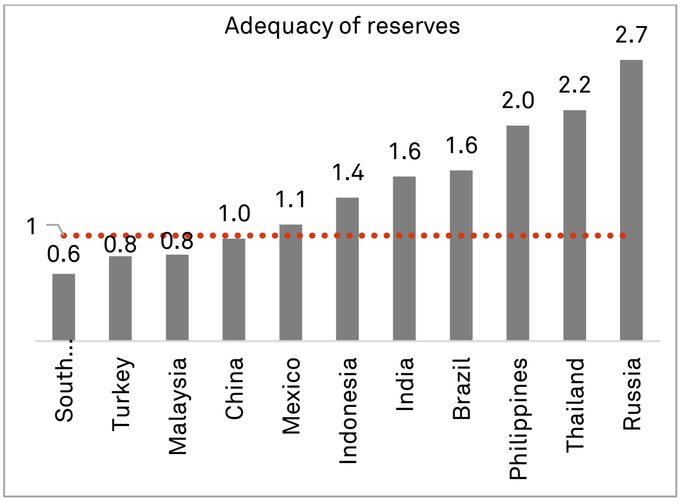


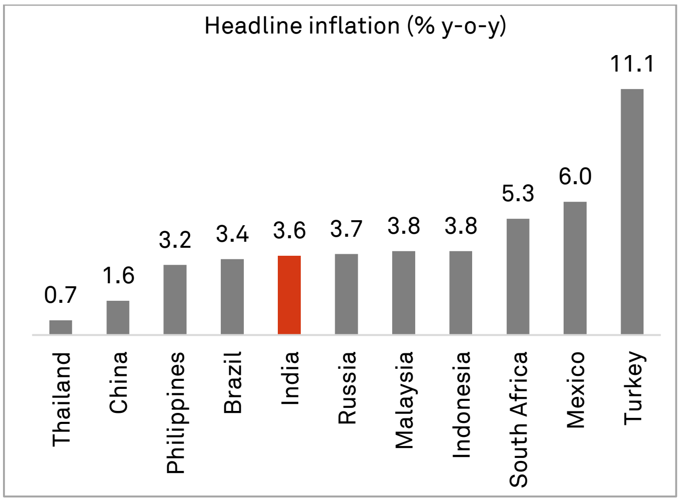


**CRISIL Forecast*

Source: IMF, CRISIL

…but underlying macros show it can attract investors if risk appetite improves



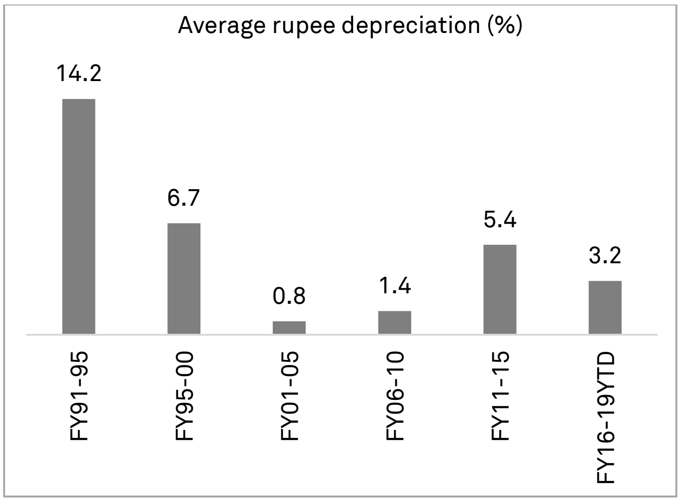


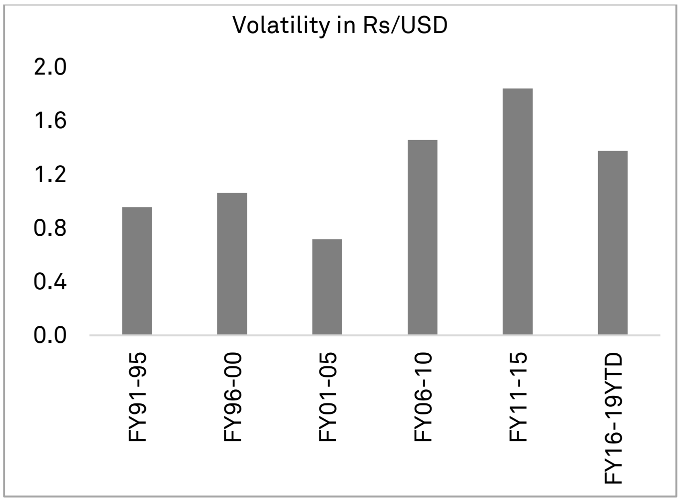
*Note: *Relative to IMF's ARA benchmark. Reserves are adequate if the number is greater than one; Data is for 2017*

Source: IMF, CRISIL

Appendix

Over the years, as India has become more integrated with the global economy, the rupee's average depreciation has decreased while the volatility of exchange rate movement has increased.





Note: Volatility for a given year is given by standard deviation of the average exchange rate for each month of the year

Source: RBI, CEIC, CRISIL

About CRISIL Limited

CRISIL is a leading, agile and innovative global analytics company driven by its mission of making markets function better.

It is India's foremost provider of ratings, data, research, analytics and solutions, with a strong track record of growth, culture of innovation and global footprint.

It has delivered independent opinions, actionable insights, and efficient solutions to over 100,000 customers.

It is majority owned by S&P Global Inc, a leading provider of transparent and independent ratings, benchmarks, analytics and data to the capital and commodity markets worldwide.

About CRISIL Research

CRISIL Research is India's largest independent integrated research house. We provide insights, opinion and analysis on the Indian economy, industry, capital markets and companies. We also conduct training programs to financial sector professionals on a wide array of technical issues. We are India's most credible provider of economy and industry research. Our industry research covers 86 sectors and is known for its rich insights and perspectives. Our analysis is supported by inputs from our large network sources, including industry experts, industry associations and trade channels. We play a key role in India's fixed income markets. We are the largest provider of valuation of fixed income securities to the mutual fund, insurance and banking industries in the country. We are also the sole provider of debt and hybrid indices to India's mutual fund and life insurance industries. We pioneered independent equity research in India, and are today the country's largest independent equity research house. Our defining trait is the ability to convert information and data into expert judgments and forecasts with complete objectivity. We leverage our deep understanding of the macro-economy and our extensive sector coverage to provide unique insights on micro-macro and cross-sectoral linkages. Our talent pool comprises economists, sector experts, company analysts and information management specialists.

CRISIL Privacy

CRISIL respects your privacy. We may use your contact information, such as your name, address, and email id to fulfil your request and service your account and to provide you with additional information from CRISIL. For further information on CRISIL's privacy policy please visit www.crisil.com/privacy.

Argentina | China | Hong Kong | **India** | Poland | Singapore | UK | USA | UAE

CRISIL Limited: CRISIL House, Central Avenue, Hiranandani Business Park, Powai, Mumbai – 400076. India

Phone: + 91 22 3342 3000 | Fax: + 91 22 3342 3001 | www.crisil.com

/company/crisil @CRISILLimited /CRISILLimited /user/CRISILLimited Follow us on @lifeatcrisil

CRISIL

An S&P Global Company