ARIHANT capital markets ltd.
www.arihantcapital.com

USDINR - SEP 2013

Tuesday, 3rd Sep 2013

USDINR could approach at New High

As we have predicted from the start of the FY 14 second quarter, USD-INR stayed bullish and in the month of August pair printed a new historical high 69.80 (Spot 68.93). The pair gained more than 16% (June – Sep Quarter) while 9% in the preceding month. However, at end of the month pair gave up some gains and settled at 66.72 from record high as the RBI announced a special window to sell dollar to the 3 largest Oil companies to cutting down on the liquidity of currency on the secondary markets.

From a technical perspective - On the monthly chart, USDINR following an impulsive wave structure started from Point B (July 2011) around 43.83 which is still incomplete as this need five sub waves to the upside level 138.2% or 161.8% to make perfect ABC structure. Despite of the Central bank efforts from the Mid July, USD/INR did manage to break the 127% Fib Extension convincingly. Now, 68.98 will be the next door for the bullish rally, this break on the closing basis is further affirmed by the subsequent pullback towards Target 70.46-73.70. Sustaining above 68.98 levels in weeks to come will open for breach of 73.70 levels for 79.13 levels (261.80 FIB EXT) with mild resistance at 74.85 levels (200 % FIB EXT). Only RBI do manage to implement some sort of a stimulus plan to save the Rupee then movement and sustainability above 70 lives will be difficult, but possibility of this is quite low in viewing the current circumstances. On the below 65, downside level could be expected towards 63.87-61.50.

Trading Strategy: **Buy on dip around 66 Target 69.70-71.20-73.70 stop loss 65.08.**

Fundamental Factors for September : Economic data and events for September likely to start with the Bank of Japan meeting beginning on 4th while the European Central Bank will set monetary policy on 5th while 18th will be foremost important for the Forex Market as the USDINR will be come on Roller coaster Ride over the coming FOMC meeting. Conventional expectation is surrounding that the Fed will announce plans to trim its monthly purchases of bonds from $85 billion to around $75 billion, which may caused withdrawing money from local share market as FII to park it back in US, which may push dollar higher. On the domestic front, India Index of Industrial Production for July on 12th (Previous month stand negative at 2.2%) and WPI Inflation on 16th will determine the trend for the dollar. Thereafter second high impact data that will be the Balance of Payment (CAD) of for Apr-June on 30th will drive the USDINR.

Other factors to be watch –

Government Borrowing Programme 2013-14 - The Indian government plans to raise 6.29 trillion rupees through market borrowings in the fiscal year 2013/14 which starts April 1, the central bank said. The budgeted gross government borrowing for 2013/14 stands at 6.29 trillion rupees which includes government bonds and inflation indexed bonds. So far in the financial year the gross market borrowing stands at 3599.2108 billion rupees which includes 3010.00 billion rupees borrowed through 80 Government Bond issues, 559.211 billion rupees through 11 Treasury bill issues and 30.00 billion rupees through 3 Inflation Indexed Bond issues. This is 48.33 percent of the gross amount. (Does not include T-Bill)

Offshore Market Effecting USDINR - Market are looking more closely at forwards and futures markets which suggest the rupee could fall further yet. There are both onshore forwards and futures markets and offshore NDF markets for the rupee, with trade in the latter taking place in Singapore, Hong Kong, New York and London, unfettered by Indian central bank regulations that control the onshore market. The difference between the onshore and offshore quotes reflects the different players that are active in each market. While traditionally the NDF market has been the home of offshore speculators, and still is given the pressure the rupee is under, it is also home to genuine hedging now that so many restrictions have been imposed onshore. Regulators have taken steps to reduce arbitrage opportunities between the onshore and offshore markets because they believe that speculation in these markets puts pressure on the spot rate. The NDF market has influenced India's foreign exchange market but more so has influenced volatility, outgoing RBI chief said after his monetary policy review on July 30. "It will be a better world for us if there is no NDF market, but we cannot wish it away". The RBI has tried to make speculating on the rupee expensive. Among a wide range of measures the most acute has been to raise short-term interest rates, which have spiked by almost 300 basis points, roiling bond markets and raising the cost of funds for banks and companies looking to short the rupee as well as inducing a rupee credit squeeze. These measures have certainly reduced currency futures volumes, which traders estimate have plummeted to an average $2-$3 billion a day from as much as $7 billion before the measures were put in place. What they have not done, however, is stop the rupee falling. While the forwards and futures markets offer some bearish views, their quotes are positively sober compared to some of the bets being laid in offshore foreign exchange options markets.

Offshore Dollar Options - Many dollar options against the rupee had been bought around the 80 level with implied volatility on rupee options above 20 percent for the first time in almost a decade in Hong kong currency market. Wide volatility bands are closely associated with depreciation.

Fiscal and Current Account Deficits - India's twin fiscal and current account deficits are putting the rupee under pressure, problems that have been exacerbated by expectations that the U.S. Federal Reserve will begin reducing its monetary stimulus measures soon, prompting many investors to withdraw from emerging markets.

Credit Default Swaps - The currency market is not the only market where investors are laying negative bets against the country's fortunes. They are also doing so in the credit markets. Net notional volumes in State Bank of India credit default swaps, which investors use as a proxy for the Indian sovereign, have jumped by a fifth since the start of the year to $850 million, according to DTCC data on Thomson Reuters Credit Views. The spread on the five-year CDS contract, meanwhile, has blown out to 355 basis points since mid-May.

Emerging-Economy Joint Intervention in Offshore Currency Markets - India is liaising with other emerging-economy countries on a plan to co-ordinate intervention in offshore currency markets blamed for worsening a currency rout over the past three months. The idea of major emerging economies taking action together to offset the impact of a stronger U.S. dollar as the Federal Reserve reins in its stimulus had also been floated in June by Brazilian President Dilma Rousseff in a phone call to her Chinese counterpart. The leading emerging market nations that form the BRICS groups - including Brazil, Russia, India, China and South Africa - fretted about the global turbulence at a July G20 summit in Moscow, but no action materialized. G20 leaders are due to meet in St Petersburg next week. When the idea for coordinated action surfaced earlier, unlike their wealthier counterparts at the G7 group, the BRICS were still far from either coordinating monetary policy or jointly intervening in forex markets. Separately, the BRICS countries have been working during the past year on a $100 billion reserve fund and a joint development bank to reshape the global financial architecture long dominated by rich nations. These new institutions are expected to take some time to materialize. Offshore markets developed to allow foreign investors to hedge or speculate on emerging-market currencies when exchange controls in those countries made it difficult to trade directly in the domestic spot market. Such markets had exerted pressure on 12 of the main emerging market currencies, including Brazil, China, India, Russia, South Africa, Turkey and Malaysia. Acting together, even four or five members would have estimated international reserves of $1.2 trillion. With China, the total reserves exceed $6 trillion. Non-deliverable forward (NDF) markets operating mainly from Singapore, Hong Kong, New York and London allow trade in several Asian currencies, including the rupee. They allow investors to bet without ever having to physically exchange the currency involved. One Indian government estimate puts global trading of the rupee at $60-$70 billion per day. By that yardstick, authorities believe they would need fire-power of $6 billion to $7 billion per day to intervene and make a dent in the offshore currency markets. Officials say that is beyond India's reach along.

RBI can sell US$25bn; barely enough for 1 more FX crisis - How much more can the RBI sell to calm the market? $25bn, but every US Dollar will only breed further questions about the adequacy of FX reserves. Each FX crisis costs US$15-20bn. There, thus, is just about enough to last one more bout of FX volatility. It will be recalled that we had estimated that the RBI can sell US$30bn at the beginning of the present round; since then, the RBI has sold about US$5bn. And why US$25bn? Because the import cover will dip then to 6 months, last seen in 1993!. FX reserves will also come off to just 1.5x of 1-year's short-term external debt.

NRI/sovereign bonds to arrest falling import cover - What else can the RBI do? Issue NRI bonds (US$20bn) or sovereign bonds (US$5bn a year) to hold Rs58-62/USD; expectations will otherwise climb to Rs65/USD. We have welcomed last week's measures to compress the current account deficit or expand capital inflows as steps in the right direction. At the same time, we estimate that they will add only US$5bn to FX reserves (Tables 2-3). While the ongoing hikes in FDI limits or proposed FII equity limits for PSU banks will help medium term, immediate shock-and-awe options to raise FX include: NRI bonds (US$15-20bn Re-issuing 7-9% 5-year FX-denominated NRI deposits, with INR risk borne by the RBI or the government, a la 1998 Resurgent India Bonds or 2001 India Millennium Deposits that raised about US$5bn each. Sovereign USD debt (US$5bn a year): This could also mobilize US$5bn a year if listed on the JP Morgan EMBI Global Diversified Index.

Current account deficit - India may be able to contain its current account deficit (CAD) at $70 billion, about 3.7% of the GDP, in the current fiscal because of various steps taken by the government, Prime Minister's Economic Advisory Council chairman C. Rangarajan said on 26th August 2013. The government has increased duty on the import of gold and silver to 10 per cent in a bid to contain the Forex outflow, and also announced a slew of measures including easier overseas borrowing norms to fetch an additional $11 billion this fiscal to check the burgeoning CAD which could fall by $10-12 billion may reduce CAD from $88 billion (2012-13 fiscal) to $70 billion. India's CAD -- the gap between inflow and outgo of foreign exchange -- widened to a record high of $88 billion or 4.8 per cent of the GDP for the fiscal ended March 31, from $78.2 billion in 2011-2012, about 4.2 per cent of the gross domestic product.

Contact	Website	Email Id
SMS: 'Arihant' to 56677	www.arihantcapital.com	research@arihantcapital.com

Arihant is Forbes Asia's '200 Best under a $Billion' Company
'Best Emerging Commodities Broker' awarded by UTV Bloomberg

ARIHANT Capital Markets Ltd.

3rd Floor Krishna Bhavan, 67 Nehru Road, Vile Parle (E), Mumbai – 400057
Tel. 022-42254800 Fax. 022-42254880
www.arihantcapital.com