Kotak Securities

FOREIGN EXCHANGE INSIGHT

FX, RATES & MACRO DESK

DEC 05,2018

INSTRUMENT	LAST PRICE	1 DAY	1 MONTH	1 YEAR
USD/INR	70.69	0.26%	-3.5%	9%
EUR/INR	80.11	-0.32%	-3.8%	5%
GBP/INR	89.82	-0.58%	-5.9%	4%
JPY/INR	62.54	0.05%	-3.2%	8%
EUR/USD	1.1333	-0.09%	-0.6%	-4%
GBP/USD	1.2706	-0.10%	-2.6%	-5%
USD/JPY	112.94	0.15%	-0.2%	0%
USD/CNH	6.8645	0.20%	-0.7%	4%
10 YR YIELD- IN	7.56	(0.01)	(0.24)	0.50
10 YR YIELD- USA	2.91	0.00	(0.29)	0.56
GOLD ($/Oz)	1,235	-0.3%	0%	-2%
SILVER ($/Oz)	14.46	-0.5%	-1%	-10%
BRENT CRUDE ($/Brl)	60.97	-1.8%	-17%	-3%
COPPER 3M ($/Ton)	6209	-1.4%	-1%	-9%
NIFTY	10820	-0.45%	2.82%	7%
HANGSENG	26854	-1.49%	3.55%	-7%
S&P 500	2700	-3.24%	-1.40%	3%
INR 1M FWD	0.25	(0.01)	(0.01)	0.02
INR 2M FWD	0.48	0.00	(0.03)	0.05
INR 3M FWD	0.70	(0.01)	(0.05)	0.04
INR 6M FWD	1.45	(0.01)	(0.07)	(0.01)
INR 12M FWD	2.83	(0.02)	(0.21)	(0.00)

	1 DAY	MTD	QTD	CTD
FII INVESMENT- EQ ($ Mn)	23	23	(2,861)	(4,867)
FII INVESMENT- DEBT ($ Mn)	(220)	(220)	(683)	(7,792)
TOTAL- ($ Mn)	(197)	(197)	(3,544)	(12,659)

CURRENCY	ECONOMIC DATA
EUR	ECB President Draghi Speaks
GBP	Services PMI

FX VIEW

Rupee is caught in the great American circus. Yield curve is trapezing and US-Sino trade talks are doing somersaults. Both are making a clown out of the risk assets. Dollar is amused but Rupee is in pain. Oil is providing the balm.

US stock indices tanked 3-4% overnight as yield curve continued to flatten with spreads as flat as they were during 2007, just before the 08 recession. Historically inverted yield curve, where short term yields are higher than long term yields have preceded economic recessions. The logic is simple, as long term yields also bake in some amount of expected short term rates over the medium term, an inverted yield curve means, market is voting for a rates to fall in the future as current short term high rates can cripple growth over the medium term. However, one needs to careful here, there can be significant lag between an inverted yield curve and onset of recession. At the same time, there can be momentary inversions too, followed by steepening of the curve.

Fed continues to signal hawkish monetary policy with some Fed members still pointing towards 4 more hikes next year. However, if the yield curve inverts and it persists, then we expect Fed dial back the rate expectation and signal a pause in the cycle. Such a move can be negative for Dollar. However, for now Dollar against emerging market currencies like Rupee will be driven by risk appetite. Risk off would be supportive for USD against INR.

Indian bond traders are keeping their gaze focussed on RBI today. With oil prices down by 27 dollars from the top and Rupee having strengthened by 5%, inflationary pressures have eased. Domestic and global agricultural prices are still low. Growth has slowed due to loss of momentum in private consumption. However, one of the three headwinds have become tailwind. Oil is now down over 30% but low agricultural prices continues to strain finances of rural households. Credit stress in the shadow banking sector continues to crimp credit availability and hence growth. However, a deft handling of the NBFC crises has removed the default risk for now. All in all, RBI may be forced to downgrade growth outlook as well as inflation outlook. RBI may also announce further OMOs to augment liquidity in the interbank market.

The impact of a dovish stance from RBI can be clearly understood in the bond market but the impact is not so clear on the Rupee. On one hand, rally in bond market and rally in equity market post RBI are positive for INR as speculators would be tempted to go long INR and short USD but on the other hand, it reduces the incentive to play carry based on rate differentials. However, it can be said that, if the globally USD is not rising against EM currencies due to risk off mood, then a dovish stance from RBI can help Rupee strengthen against USD.

TECHNICAL VIEW & RUPEE CROSSES:

USDINR can open higher around 70.75 on spot and face resistance around 70.80/71.00 zone. As long as the pair holds below 71.00 handle, we remain bearish on USDINR. However, incase of a sustained move above 71.00 on spot, we would alter our bias to USD bullish with a target of 72.50/73.00 levels on spot. Support is around 70.50 and 70.00 levels. On majors, Euro or GBP both are trading closer to the bottom end of their last couple of week's range. GBPUSD is repeatedly probing the supports below 1.27. Political situation in UK getting precarious ahead of the key Parliament vote on December 11th. Last night, Theresa May suffered a setback when her government lost a vote and was found in contempt of parliament at the start of five days of debate over her plans to leave the European Union. If the Parliament rejects the deal, then GBPUSD can fall towards 1.24 levels against USD.

*****CHART IS ON NEXT PAGE*****

ANINDYA BANERJEE- CMT, anindya.banerjee@kotak.com

FLATTENING YIELD CURVE AND WEAK JUNK BOND PRICES ARE BEARISH SIGNALS FOR EMERGING MARKET CURRENCIES

Source: Bloomberg

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Kotak Securities Limited. Registered Office: 27 BKC, C 27, G Block, Bandra Kurla Complex, Bandra (E), Mumbai 400051. CIN: U99999MH1994PLC134051, Telephone No.: +22 43360000, Fax No.: +22 67132430. Website: www.kotak.com / www.kotaksecurities.com. Correspondence Address: Infinity IT Park, Bldg. No 21, Opp. Film City Road, A K Vaidya Marg, Malad (East), Mumbai 400097. Telephone No: 42856825. SEBI Registration No: INZ000200137(Member of NSE, BSE, MSE, MCX & NCDEX), AMFI ARN 0164, PMS INP000000258 and Research Analyst INH000000586. NSDL/CDSL: IN-DP-NSDL-23-97.

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