FOREIGN EXCHANGE INSIGHT

JAN 15'2019

INSTRUMENT	LAST PRICE	1 DAY	1 MONTH	1 YEAR
USD/INR	70.99	0.09%	-0.8%	11%
EUR/INR	81.53	0.28%	0.4%	4%
GBP/INR	91.56	0.45%	1.3%	4%
JPY/INR	65.41	-0.09%	3.0%	12%
EUR/USD	1.1482	0.11%	1.2%	-6%
GBP/USD	1.2895	0.24%	2.1%	-7%
USD/JPY	108.53	0.34%	-4.0%	-2%
USD/CNH	6.7578	-0.08%	-2.1%	5%
10 YR YIELD- IN	7.26	0.04	-0.18	-0.01
10 YR YIELD- USA	2.71	0.01	-0.17	0.17
GOLD ($/Oz)	1,292	0.0%	4%	-4%
SILVER ($/Oz)	15.68	0.2%	7%	-10%
BRENT CRUDE ($/Brl)	59.70	1.2%	-1%	-15%
COPPER 3M ($/Ton)	5897	-0.8%	-4%	-17%
NIFTY	10826	0.83%	0.19%	1%
HANGSENG	26747	1.70%	2.50%	-15%
S&P 500	2583	-0.53%	-0.67%	-7%
INR 1M FWD	0.27	-0.01	0.01	0.02
INR 2M FWD	0.46	-0.01	-0.01	0.00
INR 3M FWD	0.73	0.01	0.04	0.02
INR 6M FWD	1.43	0.02	0.03	0.02
INR 12M FWD	2.83	0.02	0.12	0.06

	1 DAY	MTD	QTD	CTD
FII INVESMENT- EQ ($ Mn)	-89	-327	-327	-327
FII INVESMENT- DEBT ($ Mn)	29	-48	-48	-48
TOTAL- ($ Mn)	-59	-375	-375	-375

CURRENCY	ECONOMIC DATA
EUR	ECB President Draghi Speaks
GBP	Parliament Brexit Vote

FX VIEW

The retail inflation rate declined to an 18-month low of 2.19 per cent. The wholesale inflation rate also came down to 3.8 per cent, the lowest in eight months. Falling fuel and food prices caused inflation to fall. The core retail inflation rate touched a nine-month low of 5.6 per cent. Inflation is expected to remain below 4% atleast for the first half of 2019, which paves the way for RBI to not only change its stance to neutral in the next meeting but open consider a 25 bps reduction in repo rate. We expect RBI to reduce repo by 50 bps over the next 6 months. This would help bond market attract some flows, which is a saving grace for the Rupee. However, over the next few months, risk is higher that Rupee can depreciate, than appreciate, unless globally, USD collapses.

Capital inflows drive the value of the Rupee. Capital flows can occur either through the derivatives market by way of speculative bets or also in the cash market, by way of FPI, FDI, NRI and corporate borrowing.

In order to gauge the direction of Rupee, we observe the factors that either encourage those flows or deter the capital flows. When factors are aligned to induce more capital inflows than outflows, Rupee would strengthen and vice versa.

Currently:

• Indian Equity market is trading quite expensive to rest of the world. Our valuation premium to major EM equity markets is highest level it has been in last 20 years.

• Political risk is rising as we head to LS elections. Traders are worried about a hung Parliament. In such a scenario, inflows may be patchy in the debt markets, as FPI would look elsewhere in EM for investment

• Economy has slowed as household consumption has slowed down. NBFC fiasco has affected disbursal of credit to consumers and MSMEs. Private capex can slow down due to weakness on private consumption and weak global growth. Weak growth is bad news for Indian equity markets.

• Oil remains a joker in the pack. Oil has exhibited high positive correlation with US equity markets. US equity markets have rebounded from oversold conditions aided by dovish US Fed and so has crude oil. If Fed remains dovish, then US equity rally may sustain, which in a way can keep pushing oil prices higher. Higher oil prices affect capital flows two ways:

- It raises the risk of inflation and hence reverses inflows in the debt segment. If price rise is large, then it can trigger massive outflows from debt and some outflows from equity as well. Higher oil prices is a tax on consumers. Indian economy being consumption driven, weaker consumption reduces the attractiveness of equity, and leads to outflows. Higher oil prices also encourage speculators to take short bets on Rupee expecting outflows. This is known as reflexive trade. Such trades are not just taken in the onshore market, but also in the offshore centers too. They can be large enough to fuel speculative trends in USDINR prices.

If US equity markets fall, crude oil can reverse, as traders may play the slowing world economy as the theme to hammer oil prices. However, OPEC has been quite hawkish about balancing the oil market through output cuts. Therefore, oil may show less correlation on the downside with US stock, due to the OPEC's support. In such a situation, positive impact of lower oil prices may be overshadowed by the negative impact of fall in US and hence global equity markets.

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

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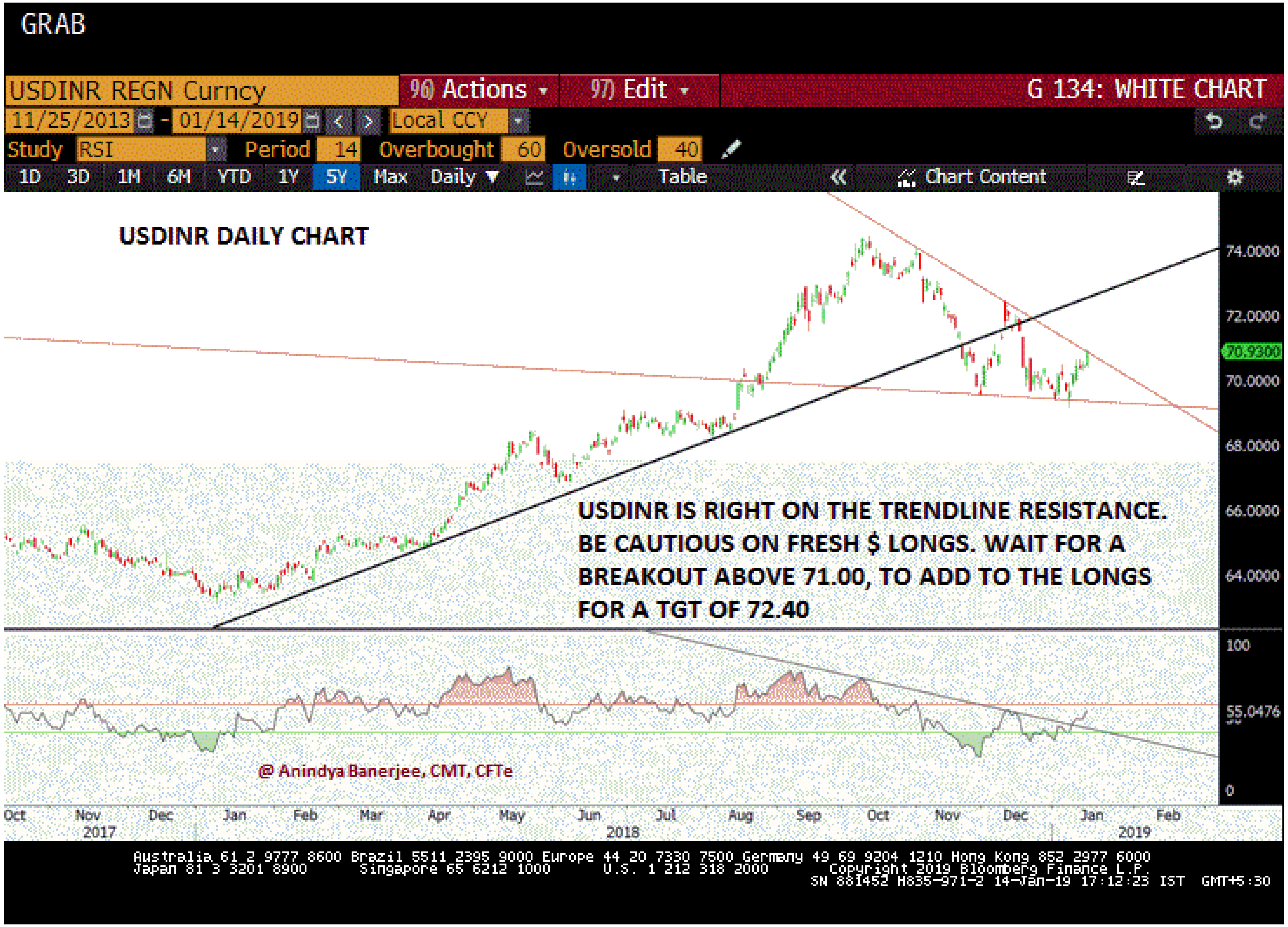

Source: Bloomberg

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