kotak Securities

FOREIGN EXCHANGE INSIGHT

FX, RATES & MACRO DESK

JUNE 17' 2019

INSTRUMENT	LAST PRICE	1 DAY	1 MONTH	1 YEAR
USD/INR	69.87	0.09%	-0.6%	3%
EUR/INR	78.36	-0.31%	-0.1%	-1%
GBP/INR	87.99	-0.28%	-1.8%	-2%
JPY/INR	64.34	0.09%	0.9%	4%
EUR/USD	1.1215	0.06%	0.5%	-4%
GBP/USD	1.2593	0.03%	-1.0%	-5%
USD/JPY	108.59	0.03%	-1.4%	-2%
USD/CNH	6.9301	-0.01%	-0.3%	7%
10 YR YIELD- IN	6.94	0.02	-0.43	-0.95
10 YR YIELD- USA	2.10	0.02	-0.29	-0.82
GOLD ($/Oz)	1,342	0.0%	5%	5%
SILVER ($/Oz)	14.88	0.0%	3%	-10%
BRENT CRUDE ($/Brl)	62.13	0.2%	-14%	-15%
COPPER 3M ($/Ton)	5822	-0.6%	-3%	-19%
NIFTY	11757	-0.56%	3.07%	9%
HANGSENG	27298	0.66%	-2.32%	-10%
S&P 500	2887	-0.16%	0.96%	4%
INR 1M FWD	0.26	0.00	-0.00	0.03
INR 2M FWD	0.52	0.00	-0.00	0.05
INR 3M FWD	0.77	0.01	-0.01	0.05
INR 6M FWD	1.52	0.00	-0.02	0.07
INR 12M FWD	3.07	0.01	0.02	0.21

	1 DAY	MTD	QTD	CTD
FII INVESMENT- EQ ($ Mn)	1	75	3,039	11,265
FII INVESMENT- DEBT ($ Mn)	5	1,110	77	1,345
TOTAL- ($ Mn)	6	1,184	3,115	12,610

CURRENCY	ECONOMIC EVENT
EUR	ECB President Draghi Speaks

FX VIEW

Will the Fed oblige? Fed pricing has changed rapidly during the past month, and Fed Chair Jerome Powell recently opened the door for policy adjustments if needed, suggesting to us that rate cut discussions will take centre stage at the June FOMC meeting. Market is pricing in four cuts in Fed Fund rate from 2.25-2.50% corridor, over the next 1 year. The rationale behind this aggressive pricing is based on the expectation that trade war and slowing global economy could cause a recession in US, if the Fed does not act pre-emptively now. The expectation is that the slowdown in the US economy to gather speed in the second half of this year and to reach the weakest growth numbers in the first half of next year.

Please note that it will not be easy for FOMC to signal a cut as soon as July. In terms of actual numbers the US economy is still growing above its potential, with unemployment at a decades-low level and core inflation close to target. The manufacturing sector is slowing, but without clear signs of spill over to the service sector yet. However, this will not be the first time, Fed will be delivering on the lines of what the bond market is indicating through Fed Fund futures, short term rates and the yield curve. At the every inflexion point in the Fed rate cycle, it was the market which front run the Fed.

If the Fed opens the door towards a cut in July, it will be seen as a pre-emptive cut like the 1995. Then, the Greenspan Fed cut rates by 75bp over an eight-month period, arguing that these cuts were justified by success in bringing inflation under control, at a time when downside risks to economic activity appeared to be on the increase. An economic soft landing followed.

What if the Fed does not oblige? The probability of that is less than the probability of Fed obliging. Fed fully remembers the market reaction after Powell became overly hawkish in autumn of last year, when he said that US rates are far away from neutral, shocking markets and causing a plunge in equity markets, spike in Dollar and widening of credit spreads, all together, causing significant tightening of financial conditions. However, if the FOMC, in their dot plot fail to signal rate cuts, if not in line but at least closer to what interest rate market is demanding, then USD can spiral higher against majors and EM currencies, including Rupee. US bond yields will rise but the yield curve can invert even further. Global equity markets can get knocked hard. Commodities can plunge and credit spreads can widen. All in all, markets can throw such a tantrum that Fed may be force to reverse in short time, like they did end of last year and early part of 2019.

Apart from FOMC, there is going to be some top tier data being released from Eurozone and UK. Eurozone will see the release of PMI for the month of May. Consensus is calling for an improvement in the sequential trend of the data. ECB chief will also be speaking and traders will be all ears. From UK, jobs data, BOE meeting and CPI will be in focus. Brexit politics is still likely to have the greatest impact on Sterling. The race to become the next Conservative leader and Prime Minister will continue this week. It is widely expected that Boris Johnson will be the next Prime Minister. Therefore, it is not a Johnson win that will move GBP, instead we believe it is what he says about his intentions on Brexit that will most likely matter going forward. He favours a renegotiated deal with the EU, and a 'no deal' Brexit is not his preferred outcome on October 31. However, if the EU are unwilling to renegotiate he has indicated that he will pursue a 'no deal' Brexit. All in all, GBP remains a sell on rise but mind the wild swings.

Primary trend remains downward in USDINR as long as the pair holds below 70.20 on spot. Therefore, the tactical trade remains to sell on rise.

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Source: TradingView

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