

NEWS

1. The US\$ strengthened across the board this week against its major international partners. It gained the most (by 2.5%) against the Canadian \$, followed by 2% against the British Pound, 1.3% against the Swiss Franc and 1.2% against the Euro and the Danish Krona each. The greenback also strengthened by 0.6% against the Australian \$ and the Japanese Yen.
2. The US economy grew at an annualized rate of 4% during the second quarter of 2014, after contracting by 2.1% in the preceding quarter. The Federal Reserve Board expectedly announced a cut of another \$10 bn to its bond purchase schedule, and is on course to wind up the quantitative easing (QE) program completely by September. Consumer spending, comprising over 60% of the US economy, grew by 2.5%, while business spending grew by a substantial 14%. The private sector added 218,000 jobs in July, marking the fourth consecutive month of private job growth above 200,000 and the unemployment rate retraced by 1 bp to 6.2%.
3. In what hardly came as a surprise, inflation in Euro zone slowed in July to 0.4%, the weakest reading in close to 4 years. Even though inflation has stubbornly remained below 1% for the last 10 months, this is not expected to jolt the ECB into action just yet. Facing pressure from ever-expectant market participants, the ECB said that “..it could take some time for the economy to respond to the barrage of stimulus..” Unexpectedly though, the unemployment rate fell marginally in June to 11.5% from 11.6% last month. This however, disguises the wide variation in unemployment prevailing across the Euro area (5% in Austria to 25% in Spain).
4. UK’s manufacturing sector grew at the slowest pace in a year in July, as the index registered 55.4 from a revised number of 57.2 in June. The index for new industrial orders fell to 57.8 in July from 60.6 in June. Even as factory payroll increased at the lowest rate in 9 months, momentum in

manufacturing ensured that factory orders remained above the long-term average of 51.5.

5. China's official manufacturing PMI jumped to its highest level since April 2012. However, HSBC/Markit's China Manufacturing PMI dropped from 52 June to 51.7 in July, clearly at variance with the government data. Outlining subtle signs of a possible slowdown, the index tracking the steel industry saw new domestic and exports orders shrink to 48.2 in July from 55.7 in the previous month.
6. On the domestic interbank market, the rupee-dollar exchange rate traded in the range of Rs 60.06 – Rs 61.19 per \$, ending the week with a loss of 88 paise for the rupee to close at Rs 60.19 per \$. The forward premium levels across maturities of 1-month, 3-month, 6-month and 12-month are 8.27%, 8.38%, 8.40% and 8.04% respectively as against 8.05%, 8.48%, 8.49% and 7.82% in the previous week.

VIEWS

1. Traders who have been itching for “action” in the financial markets got ample ground on the back of positive economic data coming out of the US. On a day, which brought good news for Main Street, stocks dropped across major international exchanges (Dow has now wiped off its YTD gains). International markets, from commodities to currencies, which had remained benign for the last few months, witnessed an abrupt spike in volatility mid-week, albeit with some signs of recovery towards the end of the week.
2. From the perspective of cross-border trade, improved economic activity in the US, coupled with a slowdown in China, bodes well for the Indian economy. The Chinese economy continues to emit ambiguous signals. The People's Bank of China (PBoC), under covert directives from the government, has been resorting to what many have suspected to be a subdued form of QE. The fact that local government expenditure rose by 16% during the first half of the year, even as tax receipts fell by 4%, is

fresh evidence of weaknesses and inherent contradictions surfacing in the Chinese economy.

3. Several major international currencies have weakened below their erstwhile floors against the US dollar. During the week, the EUR had fallen to 1.3369 against the USD and the GBP to 1.6887 levels before staging recoveries. \$ 1.33 per EUR could prove to be a crucial level for the EUR. However, we do not expect the major non-USD currencies to move out of our projected bands as given below:

\$ 1.62 – 1.72 per GBP,

\$ 1.32 – 1.42 per EUR, and

JPY 95 – 105 per \$.

4. On the domestic interbank market, the rupee also weakened vis-à-vis the dollar, in line with the secular strength of the dollar abroad. Although the rupee-dollar exchange rate moved past the psychologically important level of Rs 61 per \$, the Reserve Bank of India did not appear to be willing to jump in to protect any specific level. This is in sharp contrast to the several occasions in recent months when a level of Rs 60.40 was rumored to trigger central bank intervention. Perhaps RBI is unwilling to indicate explicitly any ceiling for the dollar against the rupee. In any case, we believe that too much should not be read into what could well be a temporary aberration. Indeed, it should be seen as an important lesson in the need to keep near-term exposures fully hedged to prevent being unduly hit by sudden short term bouts of volatility. We see the current level as an opportunity for exporters to hedge their receivables, while we continue to advise importers to use OTMF options (i.e. with a strike rate worse than the forward rate) to hedge their dollar payables.
5. While the recovery in monsoon has been swift and quite evenly so, the RBI would want to wait for more definitive data before taking a stance on interest rates. We expect status quo on policy rates in the upcoming monetary policy announcement to be made on August 5.

DOMESTIC MARKETS

FOREIGN EXCHANGE MARKETS

SPOT EXCHANGE RATES

	INR/Currency	
USD		61.19
PDS		102.93
EUR		82.16
YEN (100)		59.63
SFr		67.55
DKK		11.02
CAD		56.06
AUD		56.98
SGD		49.08
CNY		9.90

FORWARD EXCHANGE RATES

Month-end	INR/USD	Premium % p.a.
Aug-14	61.54	7.92
Sep-14	62.00	8.57
Oct-14	62.43	8.31
Nov-14	62.82	8.31
Dec-14	63.28	8.31
Jan-15	63.71	8.33
Feb-15	64.10	8.33
Mar-15	64.53	8.37
Apr-15	65.00	8.41
May-15	65.36	8.32
Jun-15	65.75	8.26
Jul-15	66.11	8.11

CURRENCY SWAPS

	2-Year	5-Year
\$/USD	8.01	8.00

INR/USD CURRENCY OPTIONS*

Strike	1-mth Option on USD 1, price in paise	
	Call	Put
60.00	168	6
60.50	126	13
61.00	89	25
61.50	58	45
62.00	37	73
62.50	22	108

Strike	3-mth Option on USD 1, price in paise	
	Call	Put
60.00	263	18
60.50	223	27
61.00	186	38
61.50	152	53
62.00	121	72
62.50	95	94

INTEREST RATE MARKETS

	2-Year	5-Year	10-Year
GOI BOND	8.40	8.48	8.75

INTEREST RATE SWAPS

	2-Year	5-Year
OIS	8.00	7.91
MIOCS	8.01	8.00

INTERNATIONAL MARKETS

FOREIGN EXCHANGE MARKETS

SPOT EXCHANGE RATES

	Against USD
PDS	1.6821
EUR	1.3427
YEN	102.61
SFr	0.9059
DKK	5.5528
CAD	1.0916
AUD	0.9312
SGD	1.2468
PKR	98.75
CNY	6.1795

PDS 3mth CURRENCY OPTIONS*

(Prices in US cents)		
Strike	Call	Put
1.66	3.07	0.99
1.68	1.86	1.86
1.70	1.04	3.04

EUR 3mth CURRENCY OPTIONS*

(Prices in US cents)		
Strike	Call	Put
1.32	2.82	0.53
1.34	1.40	1.40
1.36	0.63	2.63

YEN 3mth CURRENCY OPTIONS*

(Prices in US cents)		
Strike	Call	Put
104.58	2.24	0.43
102.58	1.12	1.12
100.58	0.40	2.39

INTEREST RATE MARKETS

OFFSHORE CURRENCY

	1 MONTH	3 MONTH	6 MONTH	12 MONTH
USD	0.16	0.24	0.33	0.57
EUR	0.09	0.18	0.27	0.44
PDS	0.50	0.56	0.72	1.07
YEN	0.09	0.13	0.18	0.34
SwFr	0.00	0.02	0.08	0.20

INTEREST RATE SWAPS

	2-Year	5-Year	10-Year
USD	0.75	1.89	2.69
EUR	0.36	0.67	1.40
PDS	1.37	2.21	2.75
YEN	0.21	0.29	0.70
SwFr	0.12	0.35	1.03

OTHER MARKETS

COMMODITIES		EQUITY INDICES	
NYMEX crude (\$/barrel)	97.9	DIJA	16,493
GOLD (\$/ounce)	1,294	FTSE	6,679
COPPER (\$/ton)	7,077	DAX	9,210
ALUMINIUM (\$/ton)	1,964	NIKKEI	15,523

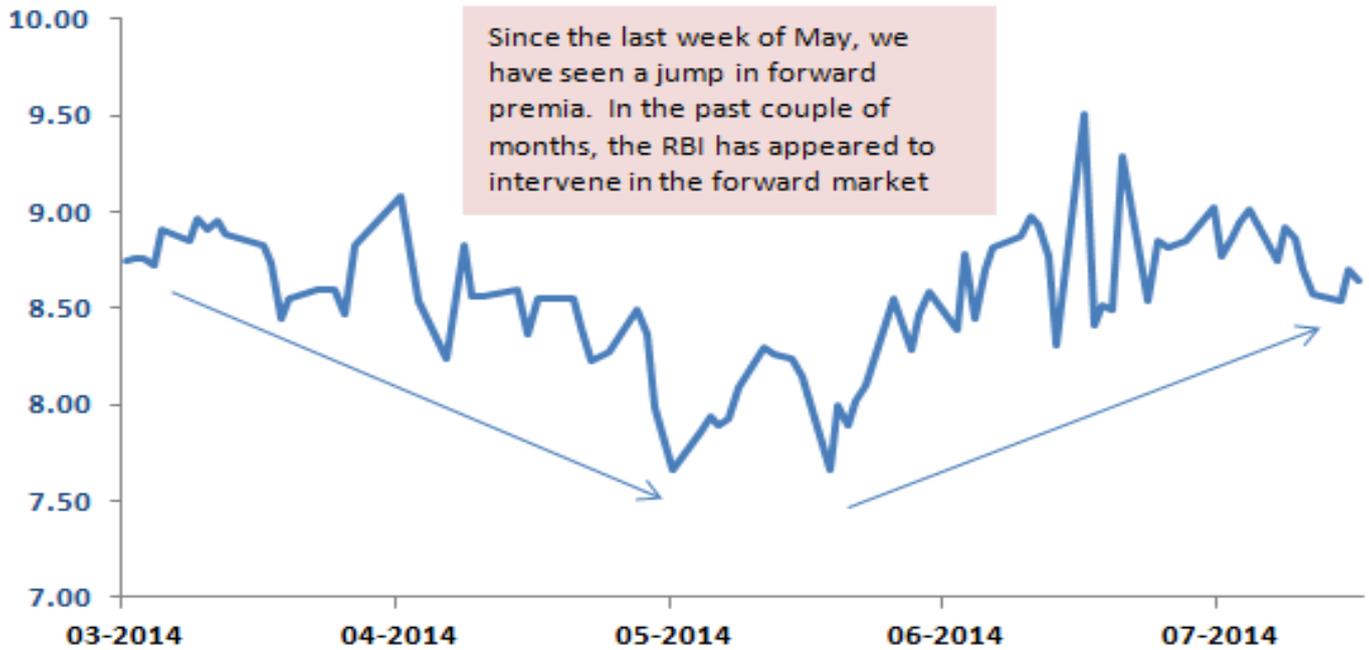
Information herein is believed to be reliable, but AVRCO does not warrant its completeness or accuracy

* indicative only

for payables

Office: 9, Sumer Kendra, Ground Floor, Pandurang Budhkar Marg, Behind Mahindra Towers, Worli, Mumbai – 400 018
Tel. Off.: +91 22 24913034 Tel. Fax: +91 22 24913044

**6-month USD/INR forward premium
(Mar'14-Jul'14)**



**RBI's outstanding net forward position
(USD billion)**

