Currency Risk Management Report

(for the week ended January 15, 2016)

A.V.RAJWADE & CO. PVT. LTD.
RISK MANAGEMENT CONSULTANTS
Forex, Interest Rates & Derivatives

Rajwade Treasury Consultants LLP
Risk Management Consultants
Forex, Interest Rate & Derivatives

NEWS

1. The British pound was the cynosure of the international foreign exchange markets – it fell to its lowest level in 5 ½ years vis-à-vis the US dollar and dropped for the 8th successive week against the euro (its longest slide since 1999). The US dollar also strengthened once again against the commodity currencies – Australian $ (1.3%) and Canadian $ (2.6%). It also strengthened marginally against the euro (0.3%), the Japanese yen (0.4%) and the Swiss franc (0.6%). However, the Chinese Yuan and the Singapore $ gained slightly (by 0.2% each) against the greenback.
2. The British pound has been hit by a spate of bad news on the economic and political fronts. The continued decline in oil prices – UK is one of the few European countries that is a net exporter of oil—and sluggish retail sales have worsened the pound's prospects, and the Bank of England's decision to keep interest rates unchanged (with the inflation rate close to zero and wage growth slowing down) has further undermined sterling. Besides, on the political front, talks of Brexit (British exit from the European Union) are gaining popularity, but are seen to be bad for British business.
3. Meanwhile, international oil prices (both WTI and Brent) have dipped below the psychologically important barrier of $ 30 per barrel. Stock markets around the world have tumbled, with the U.S. Standard & Poor's 500 Index plunging to the lowest level since August 2015. The Stoxx Europe 600 Index fell by 3.4% during the week, and is over 20% lower than its record high of April 2015 – the classic definition of a bear market. The MSCI Emerging Markets Index has dropped by 4.2% over the week. Shares in Shanghai entered a bear market for the second time in seven months, dropping more than 20% from its December high and sinking below its low during the depths of the $5 trillion rout during August last year.
4. Bond yields too are moving lower – treasuries extended gains as economic data and earnings added to concern that global growth is faltering. Gold prices have jumped as investors reeling from practically every market seek a safe haven. However, the Bloomberg Commodity Index, which measures returns on 22 raw materials, has declined by 1.4% to its lowest level since 1991.
5. On the domestic interbank market, this week the ₹/$ exchange rate ended with a loss of 97 paise for the rupee at Rs 67.60 per $, having traded in a band of ₹ 66.70 - 67.71 per $. The forward premium across the maturities were in the narrow range of 6.3% - 6.4% p.a. The March end forward rate is ruling at ₹ 68.44, a premium of 6.32% and the ATMF volatility for March end is 6.50% and indicative option premium would be 75 paise per $. As of January 8, 2016, the forex reserves stood at $ 348.9 bn, down by $ 1.5 bn over the week. In the first fortnight of 2016, FIIs have net sales of Rs 7,605 crores as per SEBI data.

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

VIEWS

1. In the 1990s, a German professor, Schulmeister, had undertaken a study of the foreign exchange markets. Using a sophisticated computer and assisted by several research students, he came to the conclusion that no set of economic fundamentals could be used to predict future rates. He also stated that the theory of chaos could be applied to the forex markets – essentially, that temporary imbalances can have permanent effects and small changes can lead to disproportionately large consequences. Will the recent movements in the rupee-dollar exchange rate reflect this theory? A fall in the Chinese yuan triggered by a 15% fall in the Chinese stock market has not only led to a global sell-off in equities and commodities but has also pushed the Rs/$ rate above Rs 67.50 per $. Should we change our script of rupee appreciation by the end of this quarter?

2. Certainly, several pundits are confidently predicting that Rs 70 per $ is round the corner. Chartists believe that an important barrier (resistance point) has been broken, and that Rs 67.30 is the new floor for the rupee and that the previous record high of Rs 68.85 per $ is going to be breached shortly. Are we then whistling in the dark when we stubbornly believe that such predictions based on recent movements are inherently flawed? In order to understand our belief, two facts need to be borne in mind.

   - Firstly, in terms of "flows", we are likely to witness the largest quarterly current account surplus in our post-independence history if the international Brent oil price (to which our oil import basket is linked) stays below even $ 40 per barrel. This will ensure that even with outflows due to FIIs selling in the domestic stock markets, there will be a substantial Balance of Payments surplus. This in turn means that sooner rather than later the RBI will have to buy dollars to prevent rupee appreciation.

   - Secondly, in terms of "value", if one is to take into account RBI's reported interventions in the market it appears that even now it is monitoring the six-currency WPI-based REER (real, i.e. inflation-adjusted, effective, i.e. trade-weighted exchange rate) index, which shows the "neutral" value for the rupee at Rs 63.50 per $. Clearly, we have to worry about under-valuation, not over-valuation. Experts calling for a sharp rupee devaluation are relying on the CPI-based REER indices – the 36-currency index points to a value of Rs 74 per $ while the 6-currency index points to a value of Rs 81 per $. None of them are discussing the inflationary impact of such a sharp rupee fall, which would require further rupee decline, pushing the economy into a vicious inflationary cycle.

3. Corporate treasury managers are in a difficult position. With the rupee showing no signs of stability, much less appreciation, each passing day worsens the crisis. Uncovered payables become unaffordably expensive and any past decision to sell dollars looks increasingly foolish. However, it is important at such times to remember that when one is managing risk two emotions to eschew are panic and greed. While near-term payables (exposures maturing within a week) should be hedged with forward contracts, we advise using option contracts for payables. It would be prudent to continue selling dollars so that one does not miss the peak (which will be known only after it is gone).

4. We are not changing our ranges for any of the non-$ currencies, as follows: $1.42 – 1.54 per GBP, $1.03 – 1.15 per EUR and JPY 115 – 125 per $.

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

January 15, 2016

CRMR

DOMESTIC MARKETS

FOREIGN EXCHANGE MARKETS

SPOT EXCHANGE RATES

	₹/Currency
USD	67.60
GBP	96.40
EUR	73.79
JPY	0.5775
CNY	10.26
CHF	67.40
DKK	9.88
CAD	46.48
AUD	46.48
SGD	46.91

FORWARD EXCHANGE RATES*#

Month-enc	₹/USD	Premium % p.a.
Jan-16	67.72	6.48
Feb-16	68.09	6.39
Mar-16	68.44	6.32
Apr-16	68.82	6.52
May-16	69.19	6.45
Jun-16	69.54	6.43
Jul-16	69.87	6.38
Aug-16	70.25	6.36
Sep-16	70.60	6.35
Oct-16	70.93	6.35
Nov-16	71.31	6.34
Dec-16	71.64	6.29

CURRENCY SWAPS

	2-Year	5-Year
₹/USD	6.76	6.91

INR/USD CURRENCY OPTIONS*

	1-mth Option on USD 1, price in paise	
Strike	Call	Put
67.50	--	25
67.75	--	33
68.00	--	43
68.25	40	--
68.50	30	--
68.75	25	--

	3-mth Option on USD 1, price in paise	
Strike	Call	Put
67.50	--	35
68.00	--	50
68.50	--	70
69.00	80	--
69.50	60	--
70.00	40	--

INTEREST RATE MARKETS

	2-Year	5-Year	10-Year
GOI BOND	7.27	7.65	7.72

INTEREST RATE SWAPS

	2-Year	5-Year
OIS	6.84	6.89
MIFOR	6.76	6.91

INTERNATIONAL MARKETS

FOREIGN EXCHANGE MARKETS

SPOT EXCHANGE RATES

	Against USD
GBP	1.4260
EUR	1.0915
JPY	117.05
CNY	6.5858
CHF	1.0030
DKK	6.8400
CAD	1.4545
AUD	0.6875
SGD	1.4410
PKR	105.00

3-MONTH CURRENCY OPTIONS*

Option on EUR 1, price in US cents		
Strike	Call	Put
1.07	3.60	1.30
1.09	2.50	2.10
1.11	1.60	3.20

Option on GBP 1, price in US cents		
Strike	Call	Put
1.41	3.50	1.90
1.43	2.35	2.75
1.45	1.50	3.90

Option on JPY 100, price in US cents		
Strike	Call	Put
115.00	1.50	3.00
117.00	2.20	2.00
119.00	3.10	1.20

INTEREST RATE MARKETS

	OFFSHORE CURRENCY			
	1-Month	3-Month	6-Month	12-Month
USD	0.43	0.51	0.85	1.15
EUR	0.22	0.15	0.07	0.05
GBP	0.51	0.59	0.75	1.04
JPY	0.05	0.08	0.11	0.22
CHF	0.79	0.75	0.68	0.61

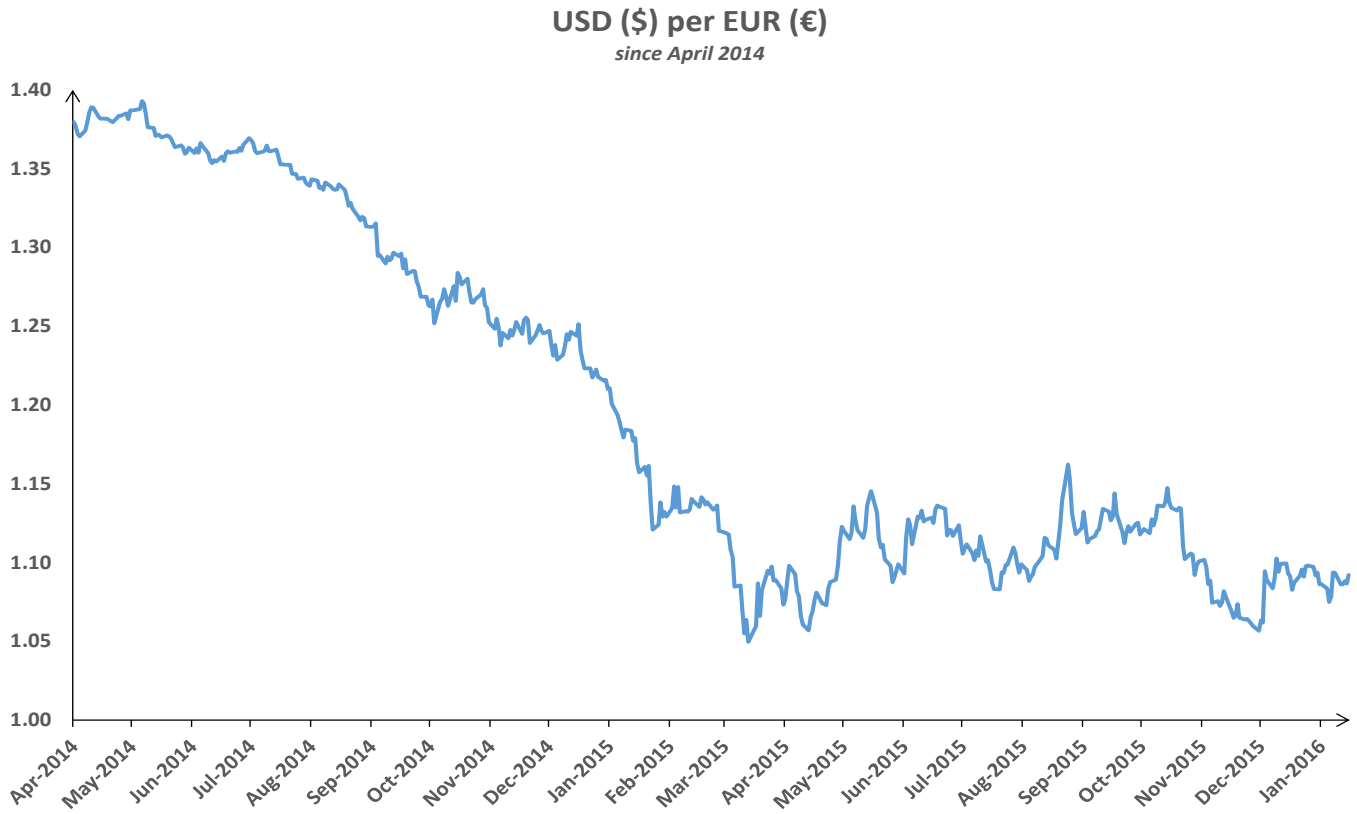
	INTEREST RATE SWAPS			
	2-Year	3-Year	5-Year	10-Year
USD	0.92	1.09	1.37	1.87
EUR	0.07	0.01	0.23	0.87
GBP	0.83	0.97	1.22	1.68
JPY	0.11	0.11	0.16	0.40
CHF	0.74	0.68	0.46	0.08

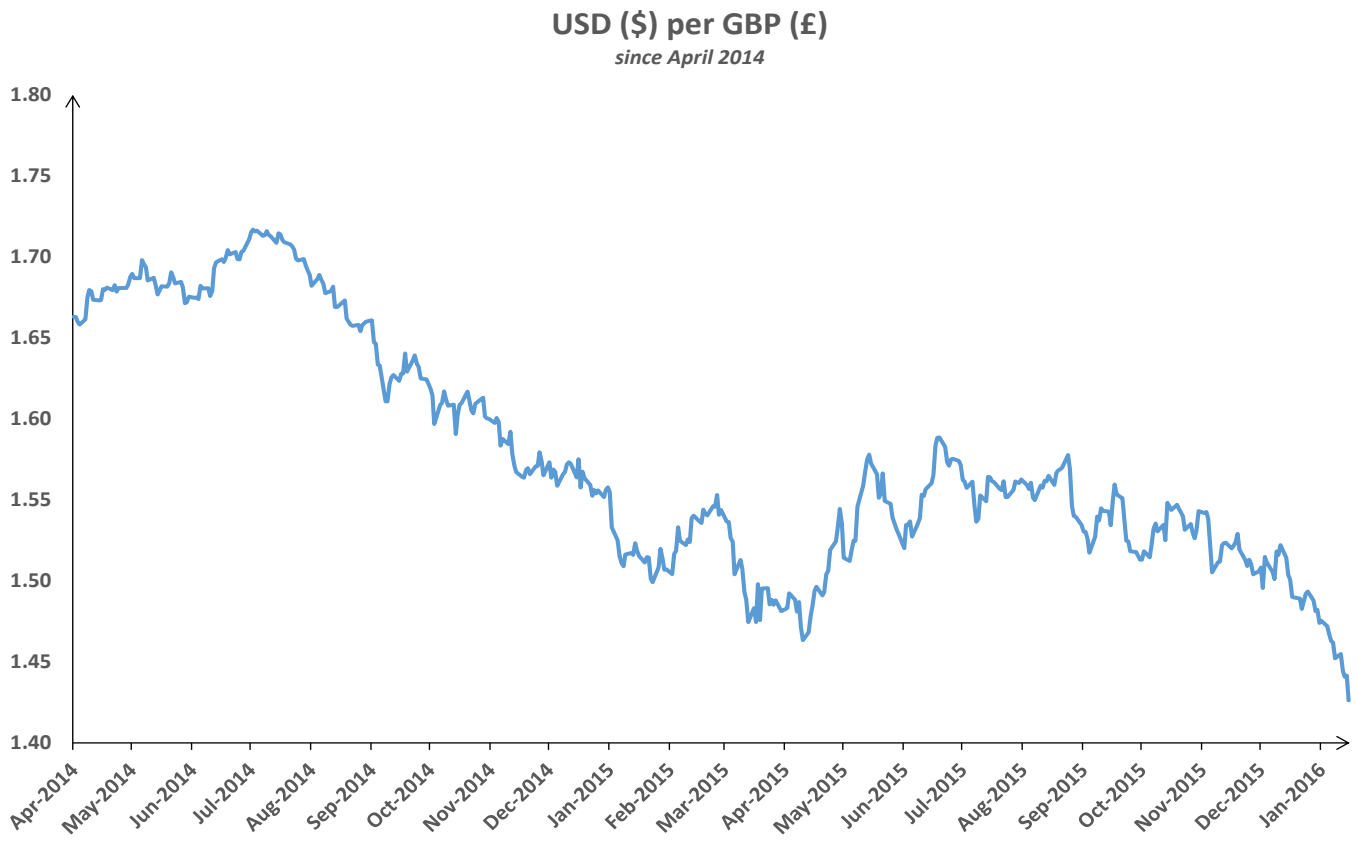
OTHER MARKETS

COMMODITIES		EQUITY INDICES	
Crude Oil ($/barrel)	28.94	DJIA	15,988
Gold ($/ounce)	1,088	FTSE	5,804
Copper ($/ton)	4,310	DAX	9,794
Aluminium ($/ton)	1,467	NIKKEI	17,147

** indicative only* *# for payables* *Minus*

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





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