Currency Risk Management Report

(for the week ended May 27, 2016)

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RISK MANAGEMENT CONSULTANTS
Forex, Interest Rates & Derivatives

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Risk Management Consultants
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NEWS

1. The US dollar index was up 0.5% at 95.70. The index has rallied steadily since a 16-month low (92.0) seen at the start of this month, with increased support by Fed officials over the past couple of weeks or so that US interest rates may rise as early as June. The US dollar over the week strengthened by 1.0% each against the euro and the Danish krone, 0.6% against the Australian dollar and 0.4% against the Swiss franc while it weakened by 0.8% against the British pound and 0.6% against the Canadian dollar.
2. US economy's growth rate for the first quarter of 2016 has been revised upward to 0.8% from earlier estimate of 0.5%, a move mostly driven by better data on inventory and housing. The other data releases indicate a better second quarter – existing home sales rose for the third consecutive month in April and reached their highest level in over a decade, new home sales jumped 16.6% last month to 619,000, the most since January 2008. The demand for durable goods jumped 3.4% after a 1.9% gain in March. Besides, the applications for unemployment benefits fell by 10,000 to 268,000. Applications have been below 300,000, a historically low level, for 64 weeks, the longest such streak since 1973. US crude oil stocks fell 4.2 mn barrels in past week, much more than expected 2.5 m barrels from 541.3 m barrels earlier.
3. Euro area's latest flash purchasing manager's index (PMI) fell to a 16-month low despite attempts by the European Central Bank (ECB) to boost growth and business activity. The preliminary PMI came in at 52.9 in May from 53.0 in April. The PMI is a composite of services and manufacturing activity in the region and the 50-point mark separates expansion from contraction.
4. As per the official report on the short-term impact of Brexit, compiled by the UK treasury, under main scenario gross domestic product would be 3.6% lower after two years than if Britain stayed in the EU. Inflation would be 2.3% higher, unemployment 520,000 higher, wages 2.8% lower, house prices 10% lower, sterling down by 12% and public borrowing would increase by GBP 24 bn. In the worst-case scenario, GDP would drop by 6%, inflation up by 2.7%, unemployment 820,000 greater, wages 4% lower, house price 18% lower, sterling 18% down and borrowing GBP 39 bn higher.
5. On the domestic interbank market, the rupee-dollar exchange rate traded in a range of ₹ 66.96 - 67.77 per $, with the rupee ending the week with a gain of 41 paise to close at ₹ 67.04 per $. The premium levels across the maturities are in the range of 6.00% to 6.50% p.a. As per Reuters poll, India's economic growth accelerated slightly at the start of 2016 on stronger demand. The poll of 26 economists predicted gross domestic product expanded 7.5% January-March, faster than the previous quarter's 7.3% but still well short of the recent peak of 8.3% in mid-2014.

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VIEWS

1. The rupee recovered vis-à-vis the dollar on the domestic interbank market, with the rupee-dollar exchange rate dipping further on the NDF (non-deliverable forward) market to end below the psychologically important level of ₹ 67 per $. It does appear that the bear pressure on the rupee, created in mid-May by a combination of renewed fears of an interest rate hike in the US in the coming months and rumours of dollar purchases for settling a part of the old oil payments to Iran, has receded for the time being. However, the sword of sudden rupee depreciation remains hanging over the heads of corporate treasury managers with dollar payables.

2. As the recent exchange rate movement has amply demonstrated, the rupee remains highly vulnerable to event risk. This is even more so in the first half of the fiscal year, since the current account deficit (CAD) tends to be much higher in the first half of the fiscal year (April – September) as compared to the second half (October – March). For instance, during 2014-15, the CAD was $ 18.4 bn in the first half, which was 69% of the total deficit for the year. Similarly, in 2013-14, the CAD was $ 27.0 bn in the first half, which was 83% of the total deficit for the year. No doubt, to some extent this phenomenon gets influenced by the movement in international commodity prices – after all, two-thirds of our imports (led by petroleum products as well as gold and other metals) are in commodities. However, in most of the last ten years, one has seen a higher CAD in the first half of the fiscal year.

3. Our advice in relation to exposure management is unchanged. Exporters should start selling receivables whenever the exchange rate moves above ₹ 67.50 per $, with more aggressive hedging recommended above ₹ 68 / 68.25 per $. Importers should hedge whenever they can achieve a pre-determined forward rate level (say ₹ 67 / 67.25 per $, or an exchange rate at which the overall interest cost is say 5% p.a. in case of short-term foreign currency borrowings). In any case, it would also be prudent to keep a stop loss level at which a hedge will be taken automatically.

4. On the international front, the Federal Reserve Board Chairperson Janet Yellen has remarked that the Fed will raise interest rates "probably in the coming months". This has once again revived speculation that not only will an interest rate hike happen as early as mid-June but also that there will be two quarter percentage point increases during 2016, as compared to just the one expected by the market (that too later in the second half of the calendar year). Corporates with USD loans at floating rates should consider taking an interest rate swap (IRS) at least to cover the risk for the next 2-3 years – not only is a tighter monetary policy likely to ensue in the coming months but the spread between bond yields and IRS is currently negative, a highly unusual occurrence.

5. We are changing our forecasted range for the British pound to $ 1.42 – 1.54 per GBP. However, the ranges for the other currencies are unchanged, as follows:

   $ 1.06 – 1.18 per EUR, and

   JPY 103 – 115 per $.

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May 27, 2016

CRMR

DOMESTIC MARKETS

FOREIGN EXCHANGE MARKETS

SPOT EXCHANGE RATES

	₹/Currency
USD	67.04
GBP	98.05
EUR	74.55
JPY	0.6081
CNY	10.21
CHF	67.38
DKK	10.02
CAD	51.51
AUD	48.17
SGD	48.58

FORWARD EXCHANGE RATES*#

Month-enc	₹/USD	Premium % p.a.
Jun-16	67.40	6.53
Jul-16	67.75	6.55
Aug-16	68.13	6.45
Sep-16	68.48	6.43
Oct-16	68.79	6.35
Nov-16	69.16	6.31
Dec-16	69.47	6.18
Jan-17	69.80	6.13
Feb-17	70.09	6.08
Mar-17	70.41	6.04
Apr-17	70.76	6.10
May-17	71.10	6.06

CURRENCY SWAPS

	2-Year	5-Year
₹/USD	6.82	7.00

INR/USD CURRENCY OPTIONS*

	1-mth Option on USD 1, price in paise	
Strike	Call	Put
66.75	--	26
67.00	--	35
67.25	--	45
67.50	45	--
67.75	35	--
68.00	28	--

	3-mth Option on USD 1, price in paise	
Strike	Call	Put
67.00	--	54
67.50	--	70
68.00	--	95
68.25	90	--
68.50	80	--
69.00	65	--

INTEREST RATE MARKETS

	2-Year	5-Year	10-Year
GOI BOND	7.12	7.43	7.47

INTEREST RATE SWAPS

	2-Year	5-Year
OIS	6.60	6.74
MIFOR	6.82	7.00

INTERNATIONAL MARKETS

FOREIGN EXCHANGE MARKETS

SPOT EXCHANGE RATES

	Against USD
GBP	1.4625
EUR	1.1120
JPY	110.25
CNY	6.5650
CHF	0.9950
DKK	6.6920
CAD	1.3015
AUD	0.7185
SGD	1.3800
PKR	104.90

3-MONTH CURRENCY OPTIONS*

Option on EUR 1, price in US cents		
Strike	Call	Put
1.09	3.50	1.00
1.11	2.25	1.75
1.13	1.35	2.85

Option on GBP 1, price in US cents		
Strike	Call	Put
1.44	5.00	3.10
1.46	4.00	3.60
1.48	3.00	4.70

Option on JPY 100, price in US cents		
Strike	Call	Put
108.00	1.30	3.00
110.00	2.10	2.00
112.00	3.20	1.20

INTEREST RATE MARKETS

	OFFSHORE CURRENCY			
	1-Month	3-Month	6-Month	12-Month
USD	0.46	0.67	0.90	1.32
EUR	0.35	0.27	0.16	0.03
GBP	0.51	0.59	0.73	1.01
JPY	0.04	0.02	0.00	0.09
CHF	0.76	0.73	0.64	0.52

	INTEREST RATE SWAPS			
	2-Year	3-Year	5-Year	10-Year
USD	1.02	1.16	1.36	1.72
EUR	0.16	0.13	0.02	0.55
GBP	0.84	0.94	1.11	1.55
JPY	0.11	0.13	0.08	0.13
CHF	0.67	0.64	0.55	0.13

OTHER MARKETS

COMMODITIES		EQUITY INDICES	
Crude Oil ($/barrel)	49.33	DJIA	17,873
Gold ($/ounce)	1,212	FTSE	6,271
Copper ($/ton)	4,725	DAX	10,286
Aluminium ($/ton)	1,550	NIKKEI	16,835

** indicative only* *# for payables* *Negative*

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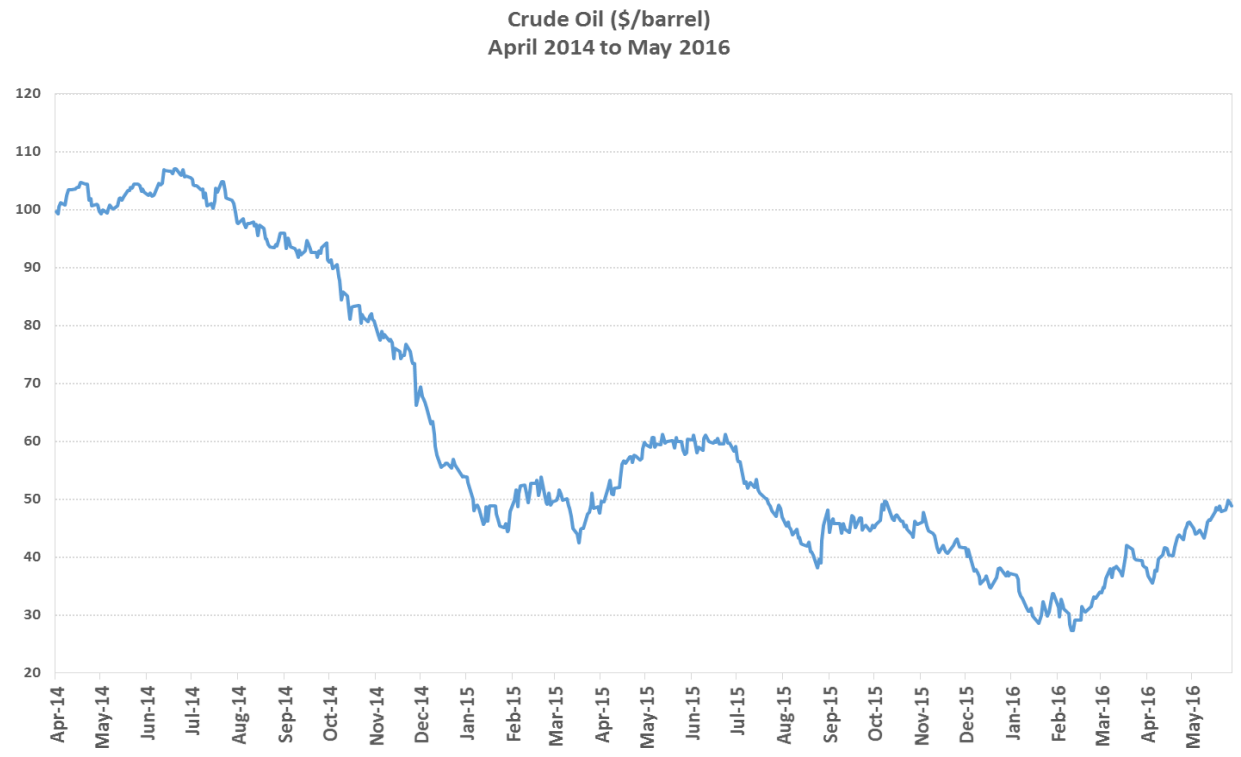

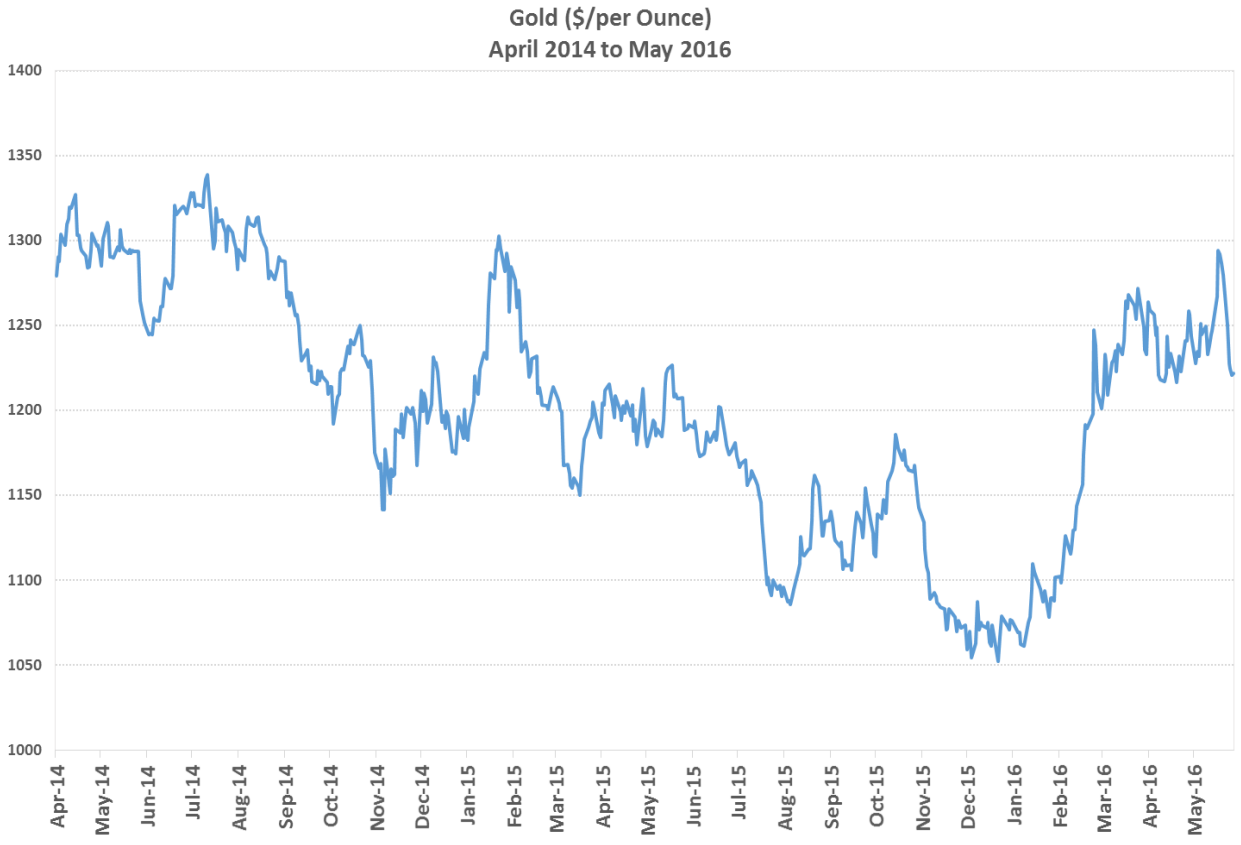

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