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Manis Thanawala: Importers Must Not Expect Rupee Appreciation in 2014

Don't expect much rupee appreciation as India nears elections

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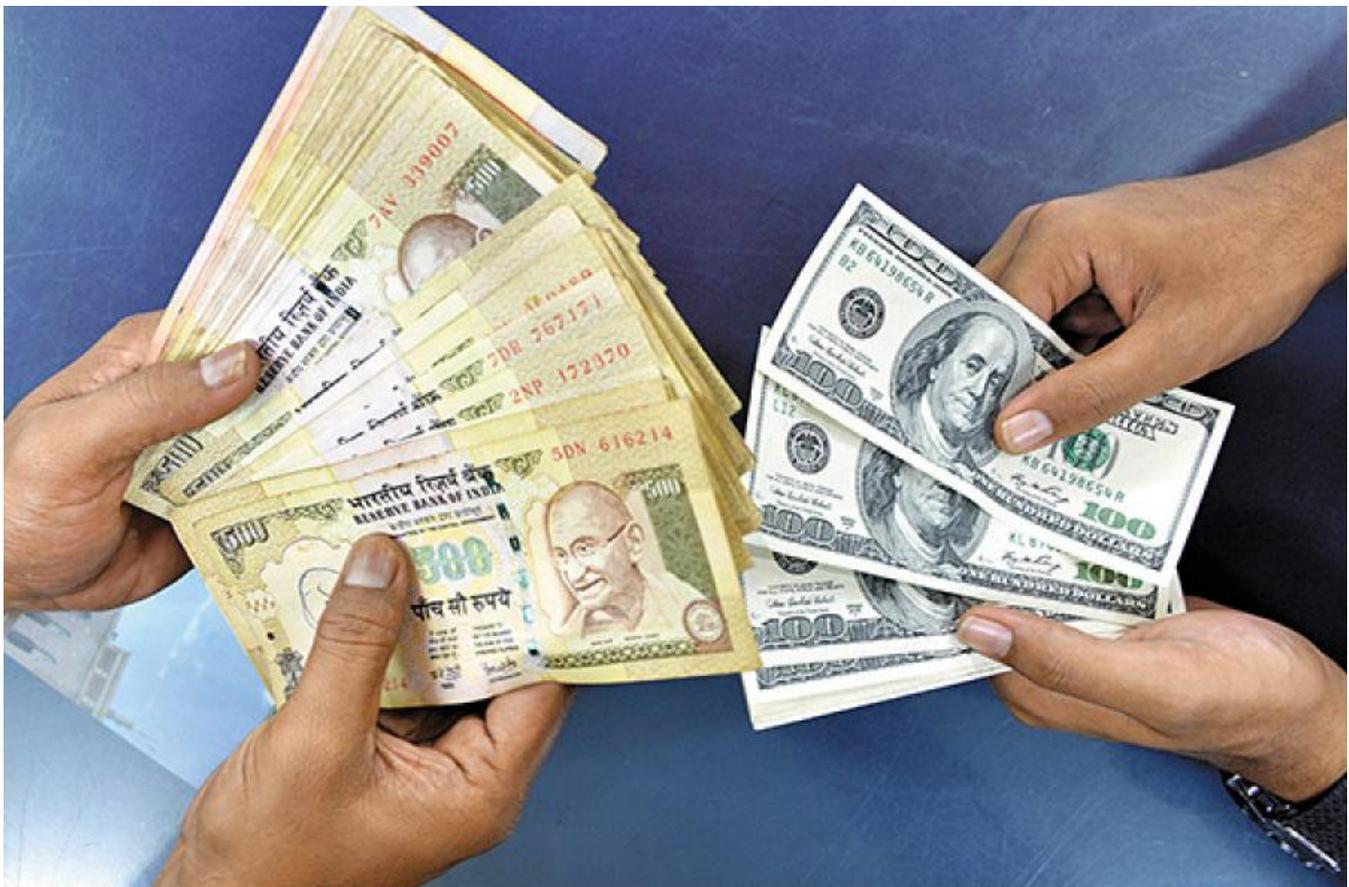


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Ask me if traders in the forex market expected a big fall in the Indian rupee and my answer will be yes. It was the magnitude of the fall that really shocked everyone.

The news of tapering as well as the flight of capital from the debt market did the trick. By the first week of July, the rupee had already touched the 60-mark. The market was full of doom and gloom where some said that it might even touch 75. What is strange is that everyone started to talk about the current account deficit (CAD) and inflation numbers only after the fall and when the rupee touched Rs 61.20, the market truly panicked.



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If you look at the emerging markets in Asia, India is the only economy with a CAD. Thailand, Malaysia, Korea and even Philippines are all current account surplus.

Now 2008 had experienced a global financial crisis where the rupee had become volatile. But 2013 was different. This time it was as much about India because we had a deficit which was being funded by foreign flows and suddenly we had a situation where the guys filling this hole backed out. This had an adverse effect on the exchange rate.

Everyone knows that CAD and FII exits are the starting points for triggers in the forex markets. This is also the time when importers start to panic. In 2008, exporters were hedged through five-year forwards while importers had open positions. When the markets crashed, importers were in trouble. In 2011, there was a small crisis where the rupee moved from Rs 53 to Rs 59. Again, the importers were caught in a mess as they had not hedged their position. In 2013, we had expected that the importers would have learned their lesson but most of them continued to have open positions.

Importers want to cost their commodity at the spot price rather than pay extra for hedging. This way, they under-price their commodity and sell it in the local market. Their objective is to earn the differential between the 2 percent dollar interest rate and the 10 percent rupee interest rate and make money. So when the exchange rate moves, the domestic guy gets wiped out.

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