

## See Continued Volatility In Rupee : Mecklai Fin Services

**NEW DELHI:** When the rupee tumbled 20% against the dollar in four months, between August 9 and December 15, fingers were pointed at foreign institutional investors (FIIs), who were big sellers of Indian stocks. But data for the period shows that FIIs still brought in more money than they took out, though this net figure was about a tenth of the amount in the corresponding period a year ago.

A reading of the other components of 'balance of payments' - which records India's transactions with the rest of the world - shows dollar inflows were reasonable during this period. Their velocity may have slowed because of a grim economic outlook, which would have put pressure on the rupee, but not enough to make it crumble.

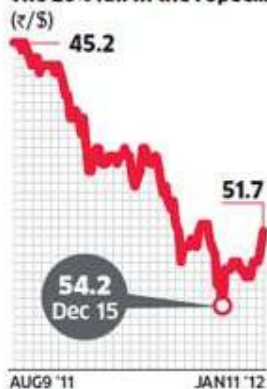
So, then, what explains the slump? On speaking to forex traders, experts, exporters and bankers, a possible explanation emerges: on top of the general weakness, the equal and opposite actions of importers and exporters triggered a storm, and sent the rupee into a freefall.

"Initially, greed and fear drove down the rupee," says Jahangir Aziz, the Asia economist of JPMorgan. Greed among exporters, who did not convert their dollar earnings when they saw the rupee falling, hoping the Indian currency would weaken further and enable them to realise more. And fear among importers, who had left their exposure un-hedged and who rushed to buy dollars when the rupee started falling.

Importers sought dollars, but exporters held them back. The resultant shortage dragged the rupee down in the forward market. And the spot market, which takes its cues from the forward market, followed suit. It was history repeating itself.

### Stuck in the Drop Zone

The 20% fall in the rupee...



...In spite of reasonable dollar inflows...

	Q2	Q3
<b>Trade deficit (I)</b>	43.9	31.1*
<b>Is plugged by</b>		
Services exports**	15.5	NA
Net overseas remittances	16.2	but expected to increase
Net FII infows*	0.3	4.4
Net FDI inflow	4.4	4.1*
Others	7.8	NA
<b>Total (II)</b>	44.2	NA
<b>Balance of payments (I-II)</b>	0.3	NA

All figures in \$ bn SOURCE: Sebi, RBI, Commerce Ministry  
\* For Oct & Nov \*\* Mainly IT \* Equity & debt

## Lesson for importers in the current currency crisis

"Exporters learnt their lessons the last time," says Jamal Mecklai, CEO of Mecklai Financial, which advises on forex risk management. "This time, it was importers."

### Fear among importers

Back in 2007, Indian exporters were the victims when the rupee appreciated 10% in five months to Rs 39 against the dollar. Lulled by the belief that the rupee, and other currencies such as the Japanese Yen and the Swiss Franc, would not appreciate beyond a point, exporters used their receivables to buy complex currency derivatives.

The rupee appreciated more, causing them huge losses. Since then, exporters have preferred to play it safe and hedge their receivables - in other words, lock into an exchange rate.

Say, an exporter is going to receive \$1 after six months and the rupee is quoting at 50 to the dollar today. To protect itself from the prospect of the rupee rising, say, 10% to 45, it locks in at 50. For this, it pays a small fee, about 2% in normal times.

Importers, however, have not been hedging as a matter of routine, including those who borrowed abroad to finance expansion. "My clients (importers) were not listening to my advice at that time (the first half of 2011)," says Mecklai.

"They all believed rupee would not fall beyond the current level. Even companies that borrowed overseas kept their exposure uncovered." The thinking among this set was, why spend 2% on a forward cover when the rupee was stable. The Indian currency had been moving in the 45-46 band against the dollar for a year till September 2011, when it let go.

Forex expert PV Raghunathan says banks also reinforced the view that the rupee would appreciate. "Many banks, especially foreign ones, were aggressively selling to clients that the rupee would appreciate. Importers placed reliance on their (banks') words," says Raghunathan, who has advised ITC and Ashok Leyland, among others, in the past.

When the rupee started falling, importers feared it might sink further. "They all rushed to the market," says Raghunathan. "But there were no dollar sales from exporters to counter this."

Exporters had taken cover much earlier for most of their dollar earnings - at Rs45-47 levels, say forex experts - and had little to offer. With demand for dollars exceeding supply, the rupee crashed.

### Greed of exporters

Exporters aided that fall with their actions. "They speculated by holding on to their export earnings for a longer period," says Raja Shanmugam, a Tirupur-based textile garment exporter. Shanmugam led the Forex Derivative Consumers' Forum, a group of 40 exporters who accused banks of mis-selling derivatives to them in 2007.

---

Exporters have six months to repatriate their export proceeds. Between April and November, when the money from this export-import interplay came into play, exports stood at \$22.3 billion and imports at \$35.9 billion.

As more exporters held back the conversion of their dollar earnings, the rupee fell further. If an exporter sold goods worth \$100 to a US client, at an exchange rate of Rs45 to a dollar, it would receive Rs 4,500.

But if the rupee depreciated to 55 to a dollar, it would get Rs5,500 - Rs1,000 more - for the same \$100 it holds. Exporters did not have the speculative leeway they had in 2007.

After the 2007 crisis, which triggered massive forex losses to exporters and domestic companies with overseas borrowing, the central bank clamped down on complex financial products such as cross-currency derivatives. As a result, exporters could only take forward cover, that too only up to 75% of their average forex turnover in the previous three years.

But even this restricted market offered an opportunity to some exporters, says Shanmugam. "When the rupee depreciated beyond the rate at which the forward cover was taken, exporters re-booked forward cover and cancelled the old one." Say, an exporter initially took forward cover at Rs47 to a dollar.

Now, when the rupee is at Rs50, it sees the currency falling further, and books a new forward cover at Rs51. "They paid cancellation charges and still made a profit," adds Shanmugam.

Speculators had a field day, as the trade deficit increased by 25%. This raised the demand for dollars disproportionately, even as overseas investors brought less money into India, putting pressure on the rupee. The Reserve Bank of India said it would not intervene.

In mid-November, RBI Deputy Governor Subir Gokarn said the central bank does not have the capacity to intervene. Terming this a failure of the RBI's communication strategy, Raghunathan says it further aided speculative tendencies.

### **Restoring balance**

"Whenever there are arbitrage opportunities, there is speculation," says RL Aggarwal, CFO of state-run Oriental Bank of Commerce. On December 15, 2011, the RBI announced a few measures to reduce rupee-dollar speculation that seem to acknowledge this exporter-importer interplay.

---

# Mecklai Financial

WHERE RISK MEETS ITS MATCH

The RBI reduced limits on net overnight open positions and intra-day open positions that banks carry. Two, it reduced the extent to which forward contracts that involved rupees and were used to hedge current account and capital account transactions falling due within one year could be cancelled and rebooked.

Against the earlier forwardcover limit for an exporter of 75% of the average of the previous three financial years' export turnover or the previous year's export turnover, whichever is higher, the RBI reduced it to 25%.

"Speculation has stopped due to the measures taken recently by the RBI," says Aggarwal. Between December 15 and January 13, the rupee has gained 4.6% against the dollar. "You can say this was contributed by exporters' speculation," says Raghunathan.

"But a major portion came from importers not taking cover and then rushing too late." Where does the rupee go from here? "There will be pressure on rupee as I don't see any immediate solution to the euro crisis," says a Singapore-based senior official of a foreign bank.

Adds JPMorgan's Aziz, who earlier worked as an economic adviser in the finance ministry: "Now, it seems that it is largely fear that is driving rupee movements, especially as dollar demand that used to be funded offshore is shifting onshore."

---

*<http://economictimes.indiatimes.com/markets/forex/excessive-greed-and-fear-touted-as-main-reasons-behind-rupee-fall/articleshow/11504476.cms?curpg=1>*