Indian Rupee is under Stress

What is the issue?

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- After a strong 6% appreciation against the ‘US Dollar’ in 2017, Rupee value has depreciated by about 4.5% thus far in 2018.
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- The present slide is on account of rising oil prices and increasing yield significant FII (Foreign institutional Investors) outflows.
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Why are FII’s pulling out?

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- The increased demand for US Dollar is nudging out FIIs to pull out from Indian stock markets and move to destinations of better returns.
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- While as much as $30 billion was pumped into Indian debt and equity in 2017 by FIIs, they’ve currently pulled out a net of $2.3 billion in March alone.
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- US Federal Reserve has signalled last month that it is on course to raise the policy rate at least two more times in 2018 (curtailment of Dollar supply).
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- This has also fed into investor expectations, and precipitated in a 3% rise of yield for 10 year benchmark US Treasury bonds, for the 1st time since 2014.
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What are the trends in global oil prices?

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- Global oil prices are continuing a steady climb on the back of tight output controls marshalled by the OPEC.

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- Notably, Saudi Arabia, the world's largest oil producer, has stated that it is eyeing oil prices in the vicinity of $80 a barrel to meets its budgetary demands.
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- Tensions between Iran and US over the Nuclear Deal pullout would also most certainly prevent any softening of oil prices.
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- Even a possible increase in US shale oil output has been estimated to be insufficient to offset the expected price spike.
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What are the possible impacts for Indian Rupee?

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- Rupee is particularly vulnerable to mounting oil costs given the economy's extremely high dependence on crude imports to meet energy needs.
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- Increase in oil prices has bloated India's crude import bill and widened the trade deficit, which for March 2018 alone was about $13.69 billion.
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- Additionally, the pullout of FII's has also increased rupee supply in the international currency market.
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- All these factors has led to considerable depreciation, which needs to be moderated in order to ease the pressure on import bills.
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- In this backdrop, RBI's massive $423.6 billion in forex reserves does provides some respite, as this might help in dampening Rupee volatility.
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The Bond Market Concept

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What does Bonds Yield mean?

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- Bonds are loan instruments and hence are a safer and "Bond Yield" is the percentage of return that an investor in bonds derives per annum.

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- Let us consider a bond (that is issued by a borrower) at a face value of Rs.1000, with a rate of interest of 10% on the **Face Value**.
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- For the initial investor, the bond yields Rs.100 for his investment of Rs. 1000, which implies his yield is 10%.
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- When bonds are sold in the secondary market, bond yield for subsequent investor might vary depending on the sale price (**Real Bond Value**).
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- But irrespective of the Real Bond Value, interest rates are always based on the 'Face Value' as determined by the primary borrower.
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- If Real Bond Value (sale price) increases over time, then bond yield decreases, as the interest amount will remain the same despite a higher investment.
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- Conversely, if Real Bond Value decreases, then yield increases as a lower sum would be able to get the same interest amount.
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- Hence, Bond Yield and Bond Value hold an inverse relation.
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What factors influence Bond Yield?

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- Market interest rates (banks) are the primary influencers of Bond markets as they are competing investment options for people.
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- An increase in interest rates would reduce the demand for low yielding bonds as people would want to put their money where returns are higher.
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- To sell Bonds when market rates are high, a Bond holder will have to 'lower his/her bond value' to 'increase bond yield and attract investors'.
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- It is to be noted that money is in demand when market interest rates are high.
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- Currently, this is what is happening in the US Economy as the US Federal Reserves has increased interest rates and pledged further increases.
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- Conversely, a decrease in market interest rates would make bonds attractive

for investment and hence lead to a spike in Bond Value due to demand.
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- Also, Bonds are a safer investment option than others, and hence any economic uncertainty would drive investors to buy bonds.
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- These factors would create a spike in bond demand, which would thereby increase Bond Value and reduce Bond Yield.
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Source: The Hindu

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