

## **Indian Rupee is under Stress**

### **What is the issue?**

\n\n

\n

- After a strong 6% appreciation against the 'US Dollar' in 2017, Rupee value has depreciated by about 4.5% thus far in 2018.

\n

- The present slide is on account of rising oil prices and increasing yield significant FII (Foreign institutional Investors) outflows.

\n

\n\n

### **Why are FII's pulling out?**

\n\n

\n

- The increased demand for US Dollar is nudging out FIIs to pull out from Indian stock markets and move to destinations of better returns.

\n

- 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.

\n

- 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).

\n

- This has also fed into investor expectations, and precipitated in a 3% rise of yield for 10 year benchmark US Treasury bonds, for the 1<sup>st</sup> time since 2014.

\n

\n\n

### **What are the trends in global oil prices?**

\n\n

\n

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

- \n
- 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 meet its budgetary demands.
- \n
- Tensions between Iran and US over the Nuclear Deal pullout would also most certainly prevent any softening of oil prices.
- \n
- Even a possible increase in US shale oil output has been estimated to be insufficient to offset the expected price spike.
- \n

\n\n

### **What are the possible impacts for Indian Rupee?**

\n\n

- \n
- Rupee is particularly vulnerable to mounting oil costs given the economy’s extremely high dependence on crude imports to meet energy needs.
- \n
- 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.
- \n
- Additionally, the pullout of FII’s has also increased rupee supply in the international currency market.
- \n
- All these factors has led to considerable depreciation, which needs to be moderated in order to ease the pressure on import bills.
- \n
- In this backdrop, RBI’s massive \$423.6 billion in forex reserves does provides some respite, as this might help in dampening Rupee volatility.
- \n

\n\n

### **The Bond Market Concept**

\n\n

#### **What does Bonds Yield mean?**

\n\n

- \n
- 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.

- \n
- 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**.
- \n
- For the initial investor, the bond yields Rs.100 for his investment of Rs. 1000, which implies his yield is 10%.
- \n
- When bonds are sold in the secondary market, bond yield for subsequent investor might vary depending on the sale price (**Real Bond Value**).
- \n
- But irrespective of the Real Bond Value, interest rates are always based on the 'Face Value' as determined by the primary borrower.
- \n
- 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.
- \n
- Conversely, if Real Bond Value decreases, then yield increases as a lower sum would be able to get the same interest amount.
- \n
- Hence, Bond Yield and Bond Value hold an inverse relation.
- \n

\n\n

## What factors influence Bond Yield?

\n\n

- \n
- Market interest rates (banks) are the primary influencers of Bond markets as they are competing investment options for people.
- \n
- 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.
- \n
- 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'.
- \n
- It is to be noted that money is in demand when market interest rates are high.
- \n
- Currently, this is what is happening in the US Economy as the US Federal Reserves has increased interest rates and pledged further increases.
- \n
- 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.

\n

- Also, Bonds are a safer investment option than others, and hence any economic uncertainty would drive investors to buy bonds.

\n

- These factors would create a spike in bond demand, which would thereby increase Bond Value and reduce Bond Yield.

\n

\n\n

\n\n

**Source: The Hindu**

\n\n

\n\n

\n\n

\n

