

The recent rise of Dollar-Rupee has left many people baffled. The common question we have been hearing is, "How can the Dollar rise against the Rupee even while it continues to fall against every other currency?"

We offer a few reasons:

1) Yes, the Yen and Swiss Franc are racing towards parity against the Dollar, and the Euro is at a lifetime high. The Australian Dollar and the Canadian Dollar are also strong. However, just because these currencies are appreciating, it does not naturally follow that the Rupee also should. Although it might be a little politically incorrect to say it in these days of 8%+ growth, the fact is that India is still not "there" as yet. We are (please swallow any false pride), still "developing" and "emerging" while the countries cited above are already developed. A comparison of our infrastructure status against theirs should clear any mental fogs we may have.

2) Barring Australia, Europe, Japan and Canada run a Trade Surplus. We run a Trade Deficit. This is an important point to note because till just a few months ago, our huge Trade Deficit was very well camouflaged by copious foreign investment inflows into "hot" sectors like real estate.

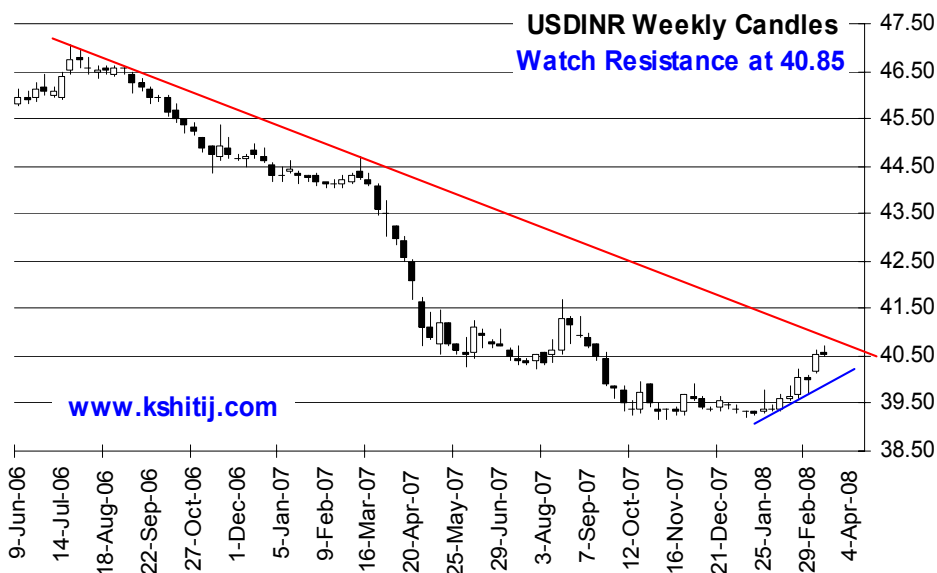
Now that the supply of Dollars has dried up, the demand has suddenly come into focus. When the RBI was shouting from the rooftops warning about the riskiness of global capital flows, there were very few takers for its words. As it turns out, the RBI has been the smartest trader around, buying Dollars above 39.20 back in Oct-2007 to Jan-2008.

3) Finally, while it is an acknowledged fact that capital flows are the main drivers for currencies, we have to see the difference between the kind of capital flows driving the other currencies higher and the kind of capital flows we had been getting. The Euro and Australian Dollar have been gaining because they offer higher interest rates than the USA, where interest rates are declining. The Yen and Swiss Franc which were earlier "funding currencies" have also been gaining because the old yield-searching investments from these currencies into the USA are coming back to these countries. Infact the Swiss Franc is currently yielding more than USD on a 1-Year basis.

How is this different from the situation in India? Remember that capital flows into India are in the nature of Equity investments. Remember that debt flows into India are restricted. Remember that the RBI has put a ceiling on External Commercial Borrowings. That is why, even though interest rates are much higher in India than the USA, the Rupee has not gained.

OK, enough already!

Where does all this mumbo-jumbo leave us? Why didn't someone explain this earlier? Where do we go from here? We put our faith (again) into the charts..., which, incidentally, had warned us of the impending rise in Dollar-Rupee. Please take a look at the technical picture below.



Overall Picture:

A fall below 39.00 has been averted. The question confronting the market now is, "Are we looking at a potential trend reversal, or is the upmove of the last couple of weeks only temporary. At best, in which case, we could be looking at a sideways consolidation?"

Debating A Trend Reversal:

That the market is trading above the 21-week and 200-day Moving Averages suggests that a trend reversal could be in the offing. However a major Resistance at 40.85, on a trendline joining the Highs at 47.0375 (Jul-06) and 44.6875 (Mar-07), needs to be

broken to confirm a full-blown trend reversal. This may take time, it might not happen immediately.

While 40.85 Holds:

Looking at the big picture, given the "rounding bottom" between 40.00-39.00 traced over the last 5 months, the chances of an eventual rise past 40.85 have to be factored in. HOWEVER, such an upside break could be preceded by a consolidation between 40.85-39.80 over the next 2-4 months.

If 40.85 Breaks:

Thereafter, assuming it continues to remain above 39.80-50, Dollar-Rupee could rise past 40.85, to target 41.00/41.20

Another Possibility:

A small variation on the overall theme above would be that USD-INR consolidates within a narrower range of 40.85-40.20 before rising past 40.85, to target 41.00/20.

Conclusion:

Chances of a fall below 39.00 are very low. Even a fall below 39.80 looks unlikely for the next few months. Instead, the chances of an eventual rise past 40.85 have to be seriously considered.

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