Enjoy the Rare Rising Rupee

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MUMBAI – Just when everyone thought that a bear market had begun, up goes the Sensex once again. It even crossed 14,000 briefly and may even make a new high soon. Market watchers are confounded by this recent turn of events.

Investors who had sold stocks in desperation and shifted to "Fixed Maturity Plans" of mutual funds are now regretting their haste. Nobody wants to miss out on a market rally and therefore it is frustrating for most retail investors who have only been observers this time round.

So what went amiss? Well, the unexpected rise in the rupee vis-a-vis the US dollar is the most proximate cause. The rupee has risen by an impressive 8% from around Rs. 44.50 to around Rs. 41 in just around 3 months.

This is how it has impacted different segments :

- FIIs have been pouring money into India for the past few months as a rising rupee increases their dollar returns. Put very simply, if they wished to repatriate their profits in December 2006 they would have to pay around Rs.44 to purchase each dollar, now they have to put up only Rs. 41. Hence even if they make the same rupee returns, the dollar returns have increased merely because of the "Translation Gains".
- The Reserve Bank of India has also been accorded some leeway on the interest rate front. A rising rupee reduces the pressure on India's import bill (though exports also may be hurt) and therefore supply side inflation can be better combated through imports of certain essentials. This has led to the hawkishness policy on moderating inflation and rates have also been left untouched. Stable interest rates are positive for stocks.
- India's economy has now crossed the 1 trillion mark (again due to "Translation Gains"), no mean achievement by any standards. This will increase the "Feel good factor". There are studies which have shown that stock markets in a country show a powerful performance in the first year after the economy crosses this important figure. Hence people are hopeful of a sustained rally.
- Everyone hopes that India's import bill will reduce in dollar terms and this will lead to a reduction in the current account deficit. On the capital account too, our debt burden (both Government and corporate) too will be slashed.

The question on everyone's lips now is .... "Will this rally last?". I too was amongst the bearish camp and was caught unawares by the rally. However, I feel that this rally will terminate once the rupee ceases to strengthen.

After all, a reversal of the trend will lead to the exact opposite effect on our economy. FIIs will stop investing aggressively and may even redeem some money, our deficit may begin rising again, we may be "importing" inflation in the form of higher landed cost of our oil imports, the shares of corporates with heavy Overseas Commercial Borrowing (OCB) exposure will be negatively affected, etc. On the positive side, shares of companies in the software and textiles sectors may appreciate.

For right now, let's just enjoy this comparatively rare phenomenon of a strengthening rupee.

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