Central bank moots ₹ intervention overseas

RBI task force to examine offshore rupee market, suggest policy steps

ANUP ROY
Mumbai, 10 February

The Reserve Bank of India (RBI) is having second thoughts on its currency intervention strategy and may include offshore non-deliverable forwards (NDF) markets in its field of operations.

This is to torpedo the activities of speculators dragging the rupee to record lows.

The central bank, in its sixth bi-monthly monetary policy review, said it would form a task force to examine the offshore rupee market.

The RBI's Statement on Developmental and Regulatory Policies, released alongside the monetary policy statement, said, "The task force will examine the issues relating to the offshore rupee markets in depth and recommend appropriate policy measures that also factor in the requirement of ensuring the stability of the external value of the rupee," the statement said.

The terms of reference for the task force will be given by the end of this month, and they may not include any mention of offshore intervention. But sources say the central bank is thinking of bracing itself to cushion the onslaught of foreign speculators, against whom the RBI is helpless to act. The only way out is to take contra positions against speculators and let them cut their losses.

The RBI, in the same policy statement, said the task force would explore how to "improve residents' access to derivatives markets to hedge their currency risks". And that continues to be the RBI's official stance, basically to help offshore hedgers hedge their currency risks in India.

However, the task force will be free to recommend other interesting ideas though all of it may not be made public.

"The task force is for making policy recommendations; it may come out with a workable proposition for the RBI to operate through NDFs also in a legal, if at all a circuitous, way," said a person familiar with the matter, but he maintained it remained to be seen if the terms of reference to the task force included such a move.

NDF dynamics

The NDF market operates in major financial centres such as Dubai, London, and Singapore. The daily average trade in rupees in such markets is at least $60 billion.

Even as the central bank can intervene in the domestic market and stabilise the exchange rate here, it has no control over the NDF market, which, most often than not, determines how the rupee will open the next day in the onshore market.

NDF is used by foreign portfolio investors taking positions in India, which the central bank is trying to bring onshore. But a sizeable chunk of the NDF market is driven by speculators, which has always been a concern of the regulator.

"It will be a better world for us if there is no NDF market, but we cannot wish it away," D Subbarao, then RBI governor, said in July 2013.

The NDF market pulled down the rupee rapidly to record lows in 2013, and again in September-October last year, it wreaked havoc on exchange rates and on October 11, it reached its lifetime low closing of 74.39 a dollar.

"Oil prices were responsible of course, but frankly, much of it was also speculation," said Abhishek Goenka, managing director of IFA Global, a currency consultant.

In 2013, the RBI and the government were mobilising forces with other emerging markets for a joint operation in the offshore markets. The government reached out to other members of BRICS (Brazil, Russia, India, China, and South Africa) for such an action.

Brazil's then finance minister, Guido Mantega, had said the BRICS nations were contemplating coordinated actions to create a joint bank and joint reserve fund for offshore intervention.

This was after emerging market currencies witnessed a rout on US taper tantrum concerns. Between May and August 2013, the Indian rupee fell 20 per cent to its then lifetime low of 68.87 a dollar in August. In calendar 2018, rupee fell 9.60 per cent.

Brazil said no, as it moved to develop a domestic NDF market (DNDF). The RBI task force will explore developing such DNDFs for India as well, while keeping all options open, sources say.

Merits and demerits

There is no hindrance for the RBI to enter the offshore NDF market anonymously, but it has to do so through an agent. This agent, however, will have to inform the local regulator about the client.

While client confidentiality will be maintained from other market participants, the local regulator will have knowledge of RBI intervention.

Since it is a forwards market, the central bank will not have to shell out big money. The forwards interest for three months, being at 3 per cent, means the RBI can effectively sell just $300 million to support $10 billion worth of trades.

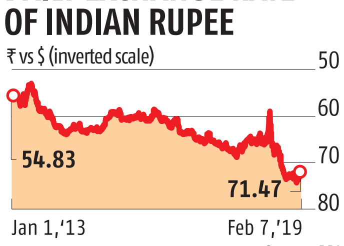
But the central bank can easily scale up such interventions to a few billion dollars through forwards and that can easily deter any speculation. "If the market gets to know that the RBI is there to support the rupee in the offshore market, speculators won't dare take long positions," said Goenka.

However, this could also be counterproductive at a time when the RBI is trying to develop the domestic forwards market.

"If RBI itself builds up volume in the offshore market, then why should a foreigner hedge onshore? He would rather access the NDF market to hedge," said Samir Lodha, managing director of treasury management firm QuantArt Market Solution.

ILLUSTRATION BY AJAY MOHANTY

DAILY EXCHANGE RATE OF INDIAN RUPEE



Source: RBI

Scheme's intention stymied on ground

EXIM MATTERS

T N C RAJAGOPALAN

In 2015, the central government renamed the earlier interest subvention scheme an interest equalisation scheme. And, decided to give a rebate of three per cent on the interest rates for pre-shipment and post-shipment credit.

The scheme covered all export of micro, small and medium enterprises (MSMEs) and by all manufacturers of items covered under 416 tariff lines (mostly labour-intensive and job-generating sectors). However, the scheme was not available to merchant exporters.

Last November, it raised the interest equalisation to five per cent of all MSMEs' export. Last month, merchant exporters were also extended the three per cent interest equalisation. The Reserve Bank of India (RBI) issued the needed instructions to banks from time to time. The idea behind the scheme is to help MSME exporters and those of the specified items to get credit at lower rates, for competing better with entities across the world which get credit at very low interest.

Recently, some concerns have surfaced regarding effective administration of the scheme. Ravi Sehgal, chairman of the Engineering Export Promotion Council, says: "A look at the latest RBI data up to end-October 2018 conveys the issues being faced when it comes to credit. Against gross credit deployment of Rs 434 billion till end-October 2017, the figures dropped (a year after) by 54.6 per cent to Rs 197 bn. While there might be several global factors such as a trade war between the United States and China or uncertainties over Brexit (the United Kingdom's exit from the European Union) hitting export demand, the cost of credit remains a big concern for us."

He said the subdued flow of credit was seen in the engineering segment as well. Year-on-year growth of bank credit to the engineering sector grew by only 4.6 per cent as on end-October. Credit is the lifeline of the industry and exporters and the situation needs to be addressed, says Sehgal.

RBI has asked banks to grant export packing credit to manufacturer-suppliers without export orders or letters of credit in their own name and where goods are exported through State Trading Corporation, MMTC or other export houses or agencies. The instruction recognises that in most cases, the merchants holding export orders deploy their funds only after the manufacturer has despatched the goods or after the latter are shipped and documents negotiated. Till then, the manufacturer has to deploy own funds to procure raw materials and meet the processing costs and overheads. If unable to get funds at lower interest rates, his competitiveness gets eroded. Even so, some bankers are denying the benefit of interest equalisation to manufacturers who export their goods through merchant exporters. Their reasoning is that these sales to merchant exporters are domestic sales, not export that bring in foreign exchange.

Thus, well-intended schemes are not being fully implemented in letter and spirit at operating levels. It is for the government and RBI to ensure enough credit to exporters and transmission of interest equalisation benefits as intended.

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Ficci: Higher Q3 manufacturing production may boost hiring

SUBHAYAN CHAKRABORTY
New Delhi, 10 February

Higher production and a better growth outlook have instilled confidence in manufacturers in the October-December quarter of 2018-19 for ramping up hiring, according to a survey of the Federation of Indian Chambers of Commerce & Industry (Ficci).

The latest quarterly survey on manufacturing portrays a better outlook for the sector in Q3. The proportion of respondents reporting higher output growth in the quarter was 54 per cent, higher than the 47 per cent respondents in the same quarter of the preceding fiscal year.

On the other hand, the percentage of respondents reporting low production dropped marginally to 13.5 per cent, as compared to 15 per cent in the same period of the previous year. As a result, the outlook for the sector slightly improved on the hiring front. While in Q3 of 2017-18, 70 per cent of respondents mentioned that they were not likely to hire additional workforce, this has come down to 65 per cent for Q3 of the current financial year. Going forward it is expected that hiring scenario will improve further, noted the survey.

Responses have been drawn from over 300 manufacturing units from both the large and small and medium size segments with a combined annual turnover of over ₹2.2 trillion, Ficci said. Firms from 11 major sectors, including automobiles, capital goods, chemicals, pharmaceuticals, among others, said they expect order books to remain stable. While 43 of the firms expect higher number of orders, the figure was 42 per cent in the similar period of the previous financial year.

As high as 77 per cent of manufacturers said their cost of production as a percentage of sales has risen, up from 62 per cent. Increased cost of raw materials, such as crude and operational costs such as power and interests have been mostly blamed. In particular, the average interest rates paid by the manufacturers has risen to 10.6 per cent, against 10.2 per cent during the same quarter of last year. Despite the recent cut in repo rate by the Reserve Bank of India, the highest rate of interest remains as high as 17 per cent, a Ficci official said.

Exports remain stuck

However, only a third of all respondents expect a rise in their exports. In the latest survey, global factors such as increasing protectionism have resulted in only 36 per cent of participants expecting a rise in exports for the third quarter of 2018-19, while 32 per cent expect the same growth as the last year. At the same time, rupee depreciation has not led to any significant increase, firms said.

Overall capacity utilisation in manufacturing also remains low at 75 per cent in the quarter in question, same as the last few quarters, according to the survey. As a result, Ficci said future investment outlook, is slightly better at 47 per cent, up from 46 per cent in the previous year. High raw material prices, high cost of finance, uncertainty of demand, shortage of skilled labour, high imports, requirement of technology upgradation, excess capacities, delay in disbursements of state and central subsidies are some of the major constraints that are affecting expansion plans, respondents said.

In sectors such as automotive, capital goods, leather and footwear and textiles machinery average capacity utilisation has either increased or remained almost same in the latest quarter. Based on expectations in different sectors, the survey noted high growth may be seen in capital goods, textiles and automotive sectors.

SECTOR-WISE PERFORMANCE

Average capacity utilisation in Q-3 2018-19	(%)
Automotive, paper products, textiles	84
Capital goods, chemicals, fertilisers & pharmaceuticals	74
Textiles machinery, cement and ceramics, leather & footwear	60

Percentage of respondents expecting higher production in the quarter over last year's quarter	
Q1 2018-19	61
Q2 2018-19	49
Q3 2018-19	54

Source : Ficci Quarterly Manufacturing Survey

CBI questions Kolkata top cop, former Trinamool MP

The Central Bureau of Investigation (CBI) questioned Kolkata Police Commissioner Rajeev Kumar and former TMC MP Kunal Ghosh by making them sit face-to-face at the probe agency's office in Shillong in connection with the Saradha chit fund and Rose Valley scams, officials said on Sunday.

The questioning was done according to the directions of the Supreme Court.

Kumar and Ghosh were grilled in the initial period by a 10-member team of the CBI, the officials said.

The Kolkata Police chief was quizzed for nearly nine hours on Saturday by three senior CBI officers about his alleged role in tampering of crucial evidence in the case, they said. PTI

BJP's Mukul Roy booked for TMC MLA's killing

BJP leader Mukul Roy was among four people booked on Sunday in connection with the killing of Trinamool Congress (TMC) MLA Satyajit Biswas in West Bengal's Nadia district, police said. Roy, a former TMC general secretary who joined the BJP last year following differences with party supremo Mamata Banerjee, denied the allegation, saying the decision to name him in the FIR was "politically motivated". PTI

STATSGURU

Reserve Bank cuts inflation forecast

IN ITS meeting last week, the Monetary Policy Committee (MPC) surprised analysts by voting to cut the benchmark repo rate by 25 basis points (bps). As seen in Chart 1, the repo rate now stands at 6.25 per cent.

With inflation continuing to surprise on the downside (Chart 2), the MPC also lowered its inflation forecasts. As against its earlier projection of inflation to range between 2.7-3.2 per cent in H2FY19 and 3.8-4.2 per cent in H1FY20, it now expects inflation at 2.8 per cent in Q4FY19 and 3.2-3.4 per cent in H1FY20.

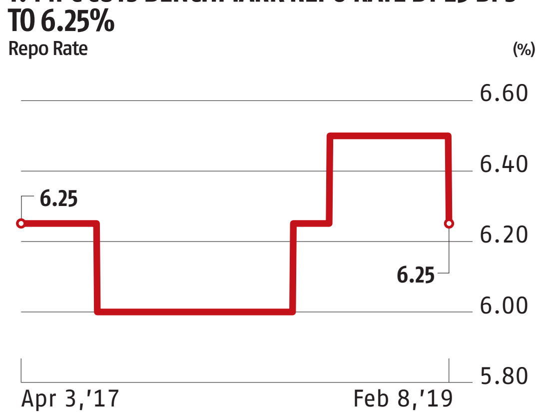
But, even as food prices continue to contract (Chart 3), exerting downward pressure on headline inflation, the MPC noted that a "reversal in vegetable prices could impart upside risk to the food inflation trajectory."

And while the outlook for oil continued to be hazy, crude oil prices have recovered from their December lows, but remain below their peak levels (Chart 4), the MPC also noted that household three months ahead inflation expectations had fallen by 80 bps in December 2018, and one year ahead expectations had declined by 130 bps (Chart 5).

On the growth front, the MPC also noted that "high-frequency indicators of the services sector suggest some moderation in the pace of activity. Sales of motorcycles and tractors imply weakening of rural demand in December" (Chart 6). And though capacity utilisation rates had picked up (Chart 7), and gross fixed capital formation had shown healthy growth off late (Chart 8), the MPC noted that "some indicators of investment demand, viz., production and imports of capital goods, contracted in November/December." Thus to "strengthen private investment activity" and "buttress private consumption", the MPC voted to cut the repo rate by 25 bps and change the stance of monetary policy from calibrated tightening to neutral.

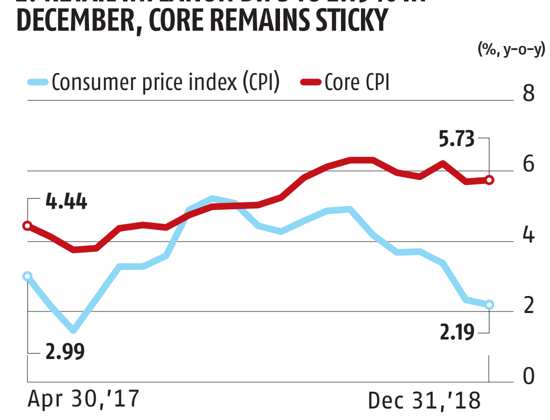
ISHAN BAKSHI

1: MPC CUTS BENCHMARK REPO RATE BY 25 BPS TO 6.25%



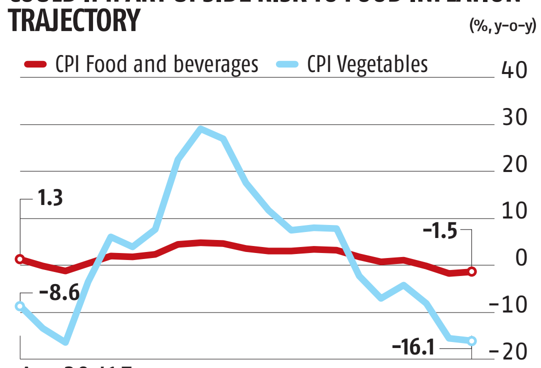
Source: RBI

2: RETAIL INFLATION DIPS TO 2.19% IN DECEMBER, CORE REMAINS STICKY



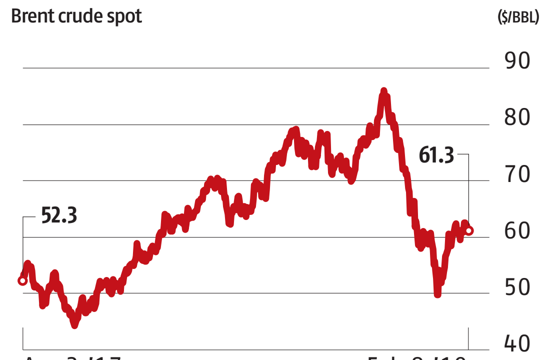
Source: MOSPI

3: MPC FEARS REVERSAL IN VEGETABLE PRICES COULD IMPART UPSIDE RISK TO FOOD INFLATION TRAJECTORY



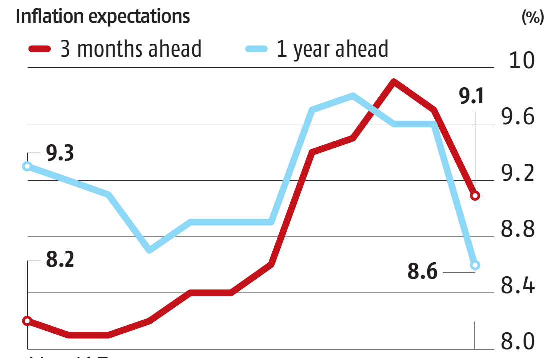
Source: MOSPI

4: OIL PRICE OUTLOOK CONTINUES TO BE HAZY



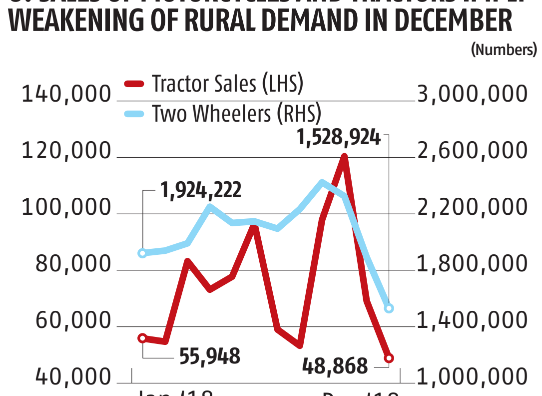
Source: Bloomberg

5: HOUSEHOLD INFLATION EXPECTATIONS DIP



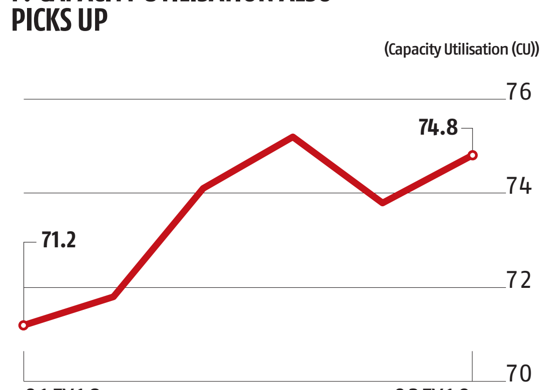
Source: RBI

6: SALES OF MOTORCYCLES AND TRACTORS IMPLY WEAKENING OF RURAL DEMAND IN DECEMBER



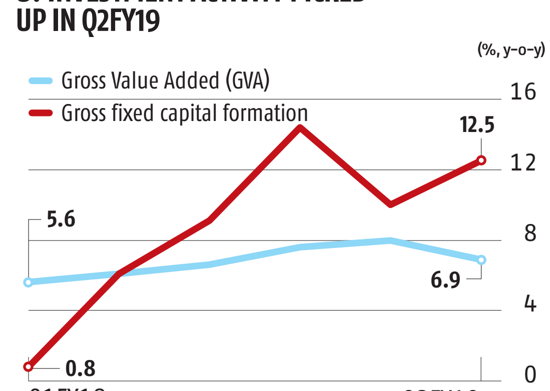
Source: Tractor and Mechanization Association and SIAM

7: CAPACITY UTILISATION ALSO PICKS UP



Source: RBI

8: INVESTMENT ACTIVITY PICKED UP IN Q2FY19



Source: MOSPI

StatsGuru is a weekly feature. Every Monday, *Business Standard* guides you through the numbers you need to know to make sense of the headlines

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