



Currency

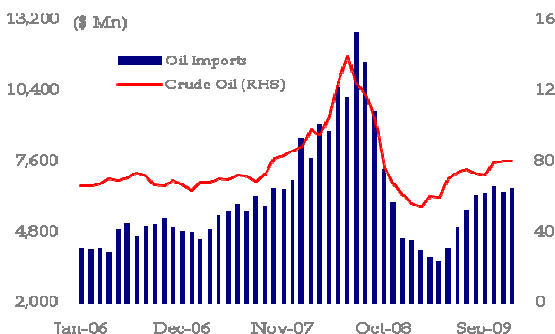
Exhibit 1: INR/USD



Source: Khandwala Research, Bloomberg

The INR has been steadily appreciating versus the US Dollar since bottoming at 52.6 INR/\$ in March of last year. The dollar has since been subject to significant selling pressure as the prospects for the US economy and the scale of the bailout packages caused investors to move away from dollar denominated assets towards traditional safe havens, as was evident from the surge in gold prices last year.

Exhibit 2: Oil prices and India's oil import bill



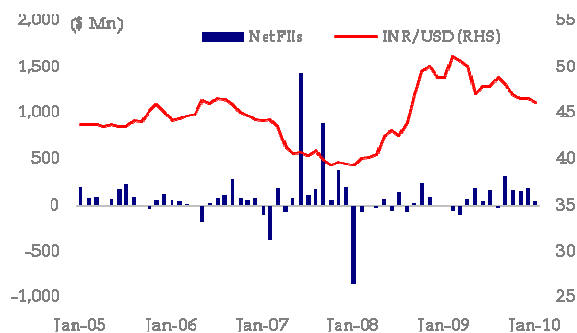
Source: Khandwala Research, Bloomberg

On examining the Indian Balance of Payments, the current account reflects the growing goods trade deficit at 5.8% of GDP, which is offset by the strong surplus on services. India's trade balance is significantly affected by the volatility in oil prices. India imports 80% of its oil consumption, and at its peak, oil accounted for over 35% of all merchandise imports – this figure has since reduced to 25% levels. At \$42 Billion, software exports continue to dominate the services sector, which accounts for about a fourth of total exports.

The steady inflow of NRI remittances, which stood at USD 38 Billion, continues to be a key positive driver for the current account. Disappointing growth in the North American and Euro area markets, coupled with increasing oil prices could adversely affect the current account for CY2010.

The capital account balance remained strong, buoyed by strong currency inflows. Net FDI flows continued to be resilient, with investments channeled primarily to manufacturing (21%), communication services (13%) and real estate (13%). The currency reserves received an additional boost with a \$5.2 billion equivalent of SDR allocation by the IMF.

Exhibit 3: Monthly Net FII Flows and USD/INR rate



Source: Khandwala Research, Bloomberg

Portfolio investment flows have been the most significant contributor to exchange rate volatility. Net FII flows rebounded sharply in 2009 with an \$18 billion inflow after a net outflow of \$14 billion in 2008. FII flows are poised to remain resilient for the year 2010 on strong fundamentals. Firstly, the Indian economy is on the road to clock an 8% growth rate this year – the relative growth differential will offer significant opportunities. Secondly, the expansive monetary policy adopted by the FED provides cheap funding for interest rate arbitrage – yields will continue to rise as the RBI is poised to hike the reverse repo rate.

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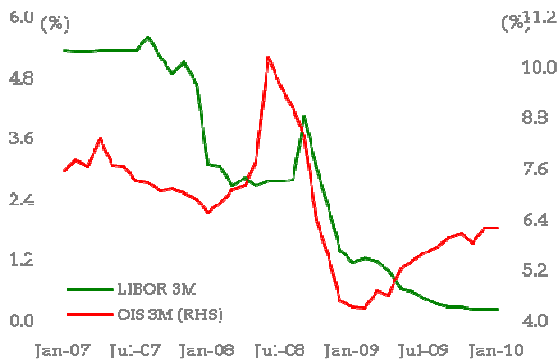


Thirdly, risk indicators such as the OIS-LIBOR spread point to an elevated level of risk appetite, with credit spreads significantly narrowing from a high of 362 bps in October 2008. Lastly, the pro reform policy adopted by the government, coupled

with the prudent stance adopted by the RBI offers the stability that is crucial to attract FII inflows.

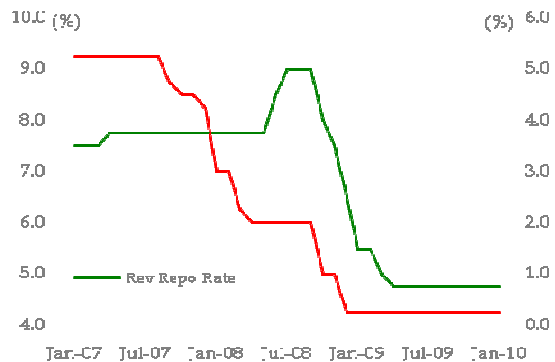
Strong fundamentals are likely to sustain the recent strength of the rupee, which is projected to rise to 43INR/\$ by January 2010.

Exhibit 4: Risk Appetite: LIBOR-OIS Spread



Source: Khandwala Research, Bloomberg

Exhibit 5: Arbitrage: Rev Repo-Fed Funds Rate



Source: Khandwala Research, Bloomberg



INDIA

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