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FX Flash

INR: Geopolitical Flares Weigh

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Dramatic Escalation

Conflicts between India and Pakistan go a long way back and flare up occasionally. USDINR has been relatively resilient to the recent turn of events. It made a decisive rally again today when Pakistan reported that its fighter jets struck down two Indian aircraft in Indian-controlled Kashmir from their own airspace. The Pakistan Foreign Ministry issued a statement saying that “we have no intention of escalation, but are fully prepared to do so if forced into that paradigm. That is why we undertook the action with clear warning and in broad daylight”. The chain of events as listed below started on 14 Feb.

Flow of Events here:

14 Feb – A vehicle-borne suicide bomber attacked a convoy of vehicles that ferried security personnel on the Jammu Srinagar National Highway resulting in the deaths of 40 Central Reserve Police Force (CRPF) along with the suicide bomber. Pakistan-based Islamist militant group Jaish-e-Mohammed (JeM) claimed responsibility for the attack.

18 Feb – Security forces in Kashmir killed a top JeM commander Abdul Rasheed Ghazi in the Pulwama area.

26 Feb – 12 jets of the Indian Air Force crossed the Line of Control (- a de-facto border following the Simla Agreement in Jul 1972 that was meant to end a long drawn conflict between the two nations) and dropped bombs into Balakot, Pakistan. India then claimed that it had destroyed a JeM training camp.

- *India Foreign Minister stressed that the military action was specific to the JeM and request for Pakistan to follow up and dismantle all JeM camps.*
- *Pakistan Foreign Minister Qureshi said that the Indian strikes are a “grave aggression”.*
- *Pakistan Prime Minister Imran Khan said in a statement that Pakistan would respond “at the time and place of its choosing” and rejected India’s claim that it had destroyed a terror camp.*

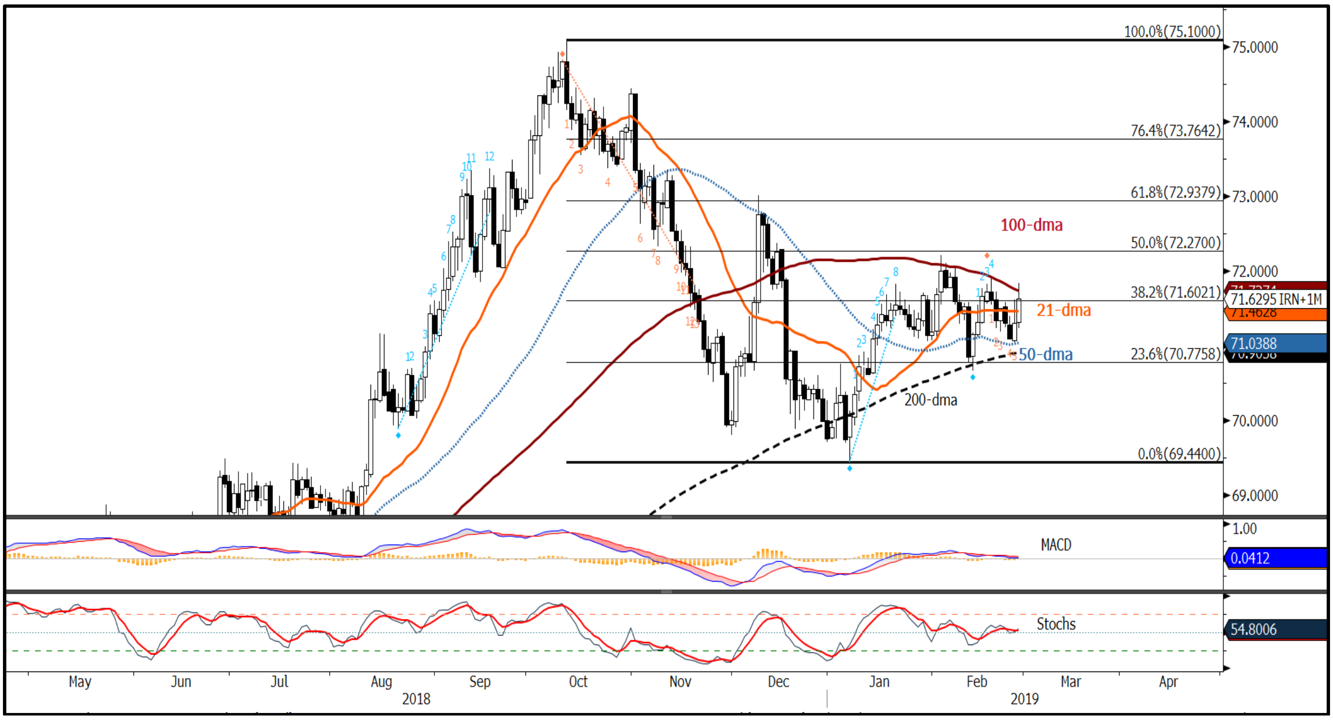
27 Feb (Today) – Pakistan shot down two IAF airjets (as detailed above). An Indian pilot was arrested after ejecting from his jet and landing in Pakistani territory. Latest headline – India shot down Pakistan’s F-16 in retaliatory fire 3Km within Pakistan territory (India ANI news agency).

Source: Bloomberg, ANI

The last time such a similar conflict happened was in Sep 2016, named the Uri attack. However, the rupee displayed quite a bit of resilience then. USDINR spiked to a high of 71.48 this afternoon before easing off to levels around 71.30. We do not rule out RBI intervention to support the rupee. In the absence of other strong cues, a sense of caution permeates the rest of Asia. USDJPY inched lower while other equity markets also registered mild losses. SENSEX is down -0.4%, Karachi is down -3.2%. Hang Seng also came off in reaction to the news. JKSI, STI and KLCI were all in modest red as we write.

The geopolitical tension has escalated rather swiftly upon the decisive actions of the two nations. In the near-term, concerns that the attacks could further broaden and intensify between the two nuclear-armed nations weigh on the currency as well as domestic assets. However, there is also a possibility for this event to unite the nation behind Modi at the upcoming Federal Election against a historical enemy, which could be positive for the rupee into the election (to be held by May 2019).

Base on the average performance of the rupee (against the USD) in the past two Federal elections, INR typically strengthens around 50 days before the event (which has to be held by May 2019). In a backdrop of a Fed pause, we expect the USD, US rates and oil environment to remain benign. We are thus bias to buy the INR on dips and the USDINR to end the first quarter at around 67.



On the daily chart of the 1M USDINR NDF, this pair has been consolidating within the 70.70-72.30 range, bound by the 200-dma and the 100-dma. However, the compression of the 21,50,100,200 dma suggests that there could be a break-out on either side. Resistance is seen next at the 73-figure. A break-out to the downside could push this pair towards Jan low of 69.44 (support).

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