

## General Studies-3; Topic: Resource Mobilization

### Rupee Depreciation

#### 1) Present Situation

- Since the beginning of the year, the Indian rupee has lost about 11 per cent of its value in nominal terms vis a vis the US dollar.
- The rupee touched an all-time low of 72.91 against the US dollar on September 12.
- The currencies of many of India's trading partners, including those in the emerging markets, too have depreciated against the dollar.
- India has been unsuccessful in finding sustainable domestic sources of energy to address the over-reliance on oil imports.

#### 2) Reasons

- Global factors including rising interest rates in the US, high crude oil prices and its impact on emerging markets and the trade war between the US and China.
- FPI outflows.
- The current account deficit and net capital outflows influence the shortage of dollar liquidity, which result in rupee depreciation.
- High import intensity in some key segments like petroleum and gems and jewellery.
- Fall in the currencies of emerging market peers.
- The US Federal Reserve's rate hikes have made dollar assets give more returns.

#### 3) Measures announced by the Government

- The government announced a slew of measures to bring additional capital inflows of \$8-10 billion to arrest rupee depreciation and address the underlying problem of high current account deficit.
- The steps taken by the government include removal of withholding tax on Masala bonds, relaxation for foreign portfolio investments, curbs on non-essential imports and encourage exports.
- This will help in addressing the country's burgeoning current account deficit that hit a five-year high in July.
- It will facilitate the inflow of dollars and de-risk the economy from fluctuations in the exchange rate.
- Other steps such as permitting manufacturing sector entities to avail ECB up to \$50 million with a minimum maturity of one year from the earlier period of three years.
- These steps to strengthen the rupee in the short term are welcome, given the large-scale outflow of capital from emerging markets to the West.

#### 4) Positives

- India's macro fundamentals are in a much better shape today than in 2013 – higher growth, stable inflation and fiscal commitment.
- Contribution of the net exports to growth in the April to June quarter was stronger than expected.
- Indian economy is recovering from the two transitory disruptions in recent years - the Goods and Services Tax (GST) and demonetisation.
- Growth has been gradually accelerating in recent quarters, with strength in both consumption and investment, which have helped the economy.
- India's large and relatively stable domestic financing base limits external vulnerability.

- India's significant build-up of foreign exchange reserves in recent years provides a support buffer to help mitigate external vulnerability risk.

## 5) **Impact**

- Rupee decline against the US dollar is putting pressure on the Current Account Deficit (CAD).
- It would increase the prices of imported goods such as oil and petroleum products, potentially putting an upward pressure on inflation.
- It may hurt India's fiscal deficit as India is a net importer of crude oil.
- Since input products constitute a large part of our imports, more expensive imports are likely to drive inflation upward.
- Demand will fall further due to high prices.
- Rate cut by RBI to stimulate economy will be difficult.
- Costlier trips abroad and foreign studies.
- The domestic tourism could grow as more tourists visit India since their currency now buys more here.
- Developing economies are hit harder since global portfolio investors tend to withdraw from these markets.
- Countries such as Turkey and South Africa have experienced significantly higher rates of devaluation than India.
- The companies which have outstanding debt in foreign currency without hedging will be affected.
- Exports may receive a boost.
- In the medium term, export-oriented industries may also create more jobs.

## 6) **Way Forward**

- The ad hoc steps taken by the government should not deflect attention from the more fundamental reasons behind the decline of the rupee.
- RBI intervention in the forex market is the short-term solution.
- Reducing dependence on imports and attracting consistent foreign direct investment through friendly policies.
- Remove policy barriers that are impeding the growth of export-oriented sectors, in order to find a sustainable solution to the problem of the weakening rupee.