Rupee and reform

Posted at: 17/08/2018

Highlights

- The rupee briefly breached the 70-to-the-dollar mark before closing at Rs 69.89.
- While that still amounts to a 8.6 per cent decline for this calendar year, in which the rupee has been Asia's worst-performing currency, there are reasons not to be overly perturbed.
- The current slide has mainly to do with the turmoil in Turkey, which has weighed on not just the rupee, but most emerging market economy (EME) currencies.

Why?

Primarily

- Today's global scenario — of rising US interest rates and **monetary policy tightening** by major central banks, elevated oil prices, and mounting trade tensions — is such that any adverse economic/geopolitical development, in Iran or Turkey, triggers capital outflows from EMEs and investors seeking refuge in "safe haven" currencies such as the dollar and the Swiss franc.
- The RBI cannot intervene much to defend the rupee in these circumstances. Nor should it try to, having already seen its foreign exchange reserves deplete by over $21.8 billion since end-March.

Secondly,

- The rupee's **real effective exchange rate (REER)** — which is against a basket of 36 currencies after adjusting for inflation differentials vis-à-vis the countries concerned — appreciated by 14.5 per cent between May 2014 and December 2017.
- Since then, it has depreciated by 6.1 per cent, but the REER in July 2018 was still 7.6 per cent higher than when the Narendra Modi government came to power.

What needs to be done?

- With its current account deficit widening from $15.3 billion in 2016-17 to $48.7 billion in 2017-18, and a likely $75 billion-plus this fiscal, India needs a focused strategy for boosting exports. A strong rupee should, if anything, be a byproduct of that effort, rather than an objective in itself.
- Exports apart, the Modi government should not lose sight of the need to maintain macroeconomic stability.
- In episodes of global selloff such as the present one, countries with low inflation and control over twin deficits are less prone to capital flight and currency run.
- They are also more likely to benefit from inflows when the storm has passed. Equally

important is not to resort to protectionism.

The Modi government's record here is far from inspiring. Import tariffs have been raised on more than 400 items during the last two years. This again betrays weakness, panic and faintheartedness — when strength, confidence and commitment to reforms are what matters to global investors.

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