



The rupee problem

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Highlights

- The rupee, which is currently the worst-performing currency in Asia, is finally receiving some help from the authorities.
- The Union government, after a meeting with Reserve Bank of India Governor Urjit Patel, announced a list of measures to arrest the sharp decline in the currency, which has lost about 12% of its value since the beginning of the year.
- These include steps to curb the import of non-essential goods and encourage the export of domestic goods, which will help in addressing the country's burgeoning current account deficit that hit a five-year high in July.
- Other steps such as removing restrictions on foreign portfolio investments and encouraging Indian borrowers to issue rupee-denominated 'masala bonds' were also announced to facilitate the inflow of dollars and de-risk the economy from fluctuations in the exchange rate.
- Further, the term limit imposed on borrowings of manufacturing companies is to be shortened further in order to curb dollar demand.
- The response to the move from the markets will need to be carefully tracked.

Recovery of the Rupee

- Even before the official announcement, the rupee witnessed some recovery against the dollar amidst hopes of favourable government intervention, while stocks and bonds also recovered.
- 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.
- These ad hoc steps to avoid an immediate crisis in the external sector, however, should not deflect attention from the more fundamental reasons behind the decline of the rupee.
- India has been unable to boost exports over the years for various reasons.
- At the same time, it has been unsuccessful in finding sustainable domestic sources of energy to address the over-reliance on oil imports.
- This has meant that the rise in the price of oil has traditionally exerted tremendous stress on the current account deficit and the currency, as is happening now.
- The government needs to think of a long-term plan to boost exports, preferably through steps that 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.

Higher Domestic Inflation

- The depreciating rupee is also a symptom of persistently higher domestic inflation in India over many decades.

- For example, in line with vastly different inflation rates in India and the U.S., the rupee has lost about 60% of its value in the last 10 years against the dollar.
- So this problem cannot be addressed without drastic changes in the style of monetary policy conducted by the RBI, which is an unlikely proposition.
- Until then, the best that can be hoped for is a steady drop in the value of the rupee without any drastic shocks to the economy.

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