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Concerns with Weakening Rupee

Why in news?

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Indian rupee is facing depreciation pressures due to widening Current account deficit.

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What are the concerns with Indian rupee?

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- The depreciation five years ago, precisely on August 28, 2013, remains a watershed as the rupee touched Rs. 68.361 to the dollar.
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- Thus, the worst in terms of volatility in recent years was seen in 2013-14, which saw the highest standard deviation at 3.08 and the coefficient of variation at 5.10 per cent.
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- Subsequently, even though the currency touched 68.777 (on February 26, 2016), this was again not the worst in terms of volatility measured by standard deviation and coefficient of variation.
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- Recently rupee has crossed the 70 mark against the US dollar, it is being seen as a rather quick slide to new all-time lows.
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- India’s debt liabilities are higher at around 51 per cent of GDP as on end-March 2018.
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What are the factors that influence the exchange rate?

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- The movement in the exchange rate is influenced by demand for and supply of foreign currency liquidity (US $ liquidity).
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- In the balance of payments framework, demand for foreign currency is broadly determined by import of goods and services and outflows of foreign capital.
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- The supply of foreign currency is influenced by export of goods and services, worker remittances and inflow of foreign capital.
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- Thus there are three important elements linked to the weak rupee persistent current account deficit, episodes of net capital outflow in terms of speculative and debt capital outflow and predominance of debt capital in forex reserves.
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- The current account deficit and net capital outflows influence the shortage of dollar liquidity, which result in rupee depreciation.
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What are the factors behind weakening rupee?

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- The depreciation of rupee could be linked to the current account deficit because of higher trade deficit contributed by higher import bills.
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- In addition, there were outflows of speculative capital from India due to higher interest rates in the US as the Fed increased the Fund Rate.
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- Further India has significant trade dependency with the US the strength of the dollar also has a marked effect on the rupee.
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What measures needs to be taken in this regard?

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- The RBI, has taken action by containing excessive volatility in the exchange rate without reference to any predetermined level or band.
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- India is a net liability country and should be cautious about building up reserves through debt.
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- India need to further strengthen FDI and promote exports by diversification,

improving the quality of our commodities, and focussing more on developing and emerging market economies.
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- That is the only long term sustainable and viable way to prevent the rupee from falling.
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Source: Business Line

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