SHANKAR IAS PARLIAMENT
Information is Empowering

Indian Rupees and COVID-19

What is the issue?

- Due to the outbreak of Covid-19, the global economy is likely to slip into a sharp recession.
- Also, the economic activity in an emerging-market country like India has been severely affected.

What is the impact of the pandemic?

- The impact of the pandemic on economic activity and the ensuing uncertainty has resulted in a wider sell-off in risk assets.
- Global portfolio managers pulled out over $80 billion from emerging markets in March, 2020.
- Foreign portfolio investors sold Indian stocks and bonds worth over $15 billion in March, resulting in significant volatility in both the markets.
- The benchmark stock-market indices declined by over 20%

What is the status of the Indian Rupee?

- Despite the global turmoil, the rupee has remained comparatively stable.
- It has declined about 6% against the US dollar since the beginning of the year, though the bulk of the fall came in March.

- **Reason** - The Reserve Bank of India (RBI) has been actively intervening in the currency market.
- Foreign exchange reserves of India fell by $12 billion in the week ended in March 20, and is likely to have been used to contain the currency market's volatility.
- Excess currency volatility in times of financial stress can become self-fulfilling and induce greater instability in financial markets.

What are the RBI's interventions?

- The RBI has been intervening heavily in the **currency market** now.
- It managed to accumulate about $68 billion worth of reserves in 2019.
- India's foreign exchange reserves were close to a high of about $490 billion in early March 2020.
- RBI will allow Indian banks, which operate International Financial Services

Centre Banking Units, to participate in the offshore market.
- The RBI is reported to have intervened even in the **offshore market** recently to contain volatility.
- The offshore non-deliverable forward (NDF) market tends to increase volatility in the currency market.

What is the concern?

- The RBI's decision is not in line with the recommendations of the taskforce headed by former RBI deputy governor Usha Thorat.
- The taskforce suggested that removing the separation between the offshore and onshore markets will improve liquidity and price discovery.
- But the taskforce also felt that it was important to bring the NDF market onshore before allowing Indian banks to participate in that market.
- The RBI's move is likely to contain volatility in the offshore market.
- However, the central bank should make sure that it doesn't end up hurting the onshore market in the long run.

What outcome should RBI avoid?

- RBI has done well to contain excess volatility in the currency market.
- But, it is important to note that the Indian rupee is still overvalued in real terms and should be allowed to depreciate.
- The decline in crude oil prices and reduction in the current account deficit will give strength to the rupee.
- The oil price decline in 2014-15 resulted in significant appreciation in real terms. The RBI should avoid such an outcome.

What could be done further?

- When the Covid-19-related economic risks start to ebb, the massive injection of liquidity by large central banks (like the US Federal Reserve) will find its way to emerging-market countries like India.
- This would put upward pressure on the rupee.
- So, apart from containing excess volatility, the RBI should ensure that the value of the rupee doesn't affect India's external competitiveness.

Source: Business Standard