

Rupee depreciation - Comparative analysis

What is the issue?

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The rupee's relentless slide in recent weeks has led to comparisons with the situation that prevailed in 2013.

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What was the 2013 episode?

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- Indian economy was facing a downfall, where it witnessed a record low of rupee value of 68.80.

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- Oil prices had sky-rocketed to \$140/barrel (it is less than \$ 90 today).

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- India imported 80% of the oil used in the country, and with the depreciated rupee, the subsidy burden of importing crude oil loomed higher.

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- The pressure on Indian rupee and on import bill of crude oil was interdependent.

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- The price rise was also caused by the US Fed's 'taper tantrum', which signalled the winding up of quantitative easing (QE) and the hardening of policy rates.

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- Quantitative easing was followed by US, post 2008 financial crisis, to increase money supply in the economy in order to further increase lending by commercial banks and spending by consumers.

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- During 2013, US followed Tapering, which is a system of slowly reducing the amount of money the Fed puts into the economy, which gradually reduces the economy's reliance on that money.

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- This created an adverse impact on FPI investments, wherein there was a reversal of existing stocks as well as a slowdown in fresh flows as less liquidity was available.

- Hardening of policy rates in the US also attracted portfolio investments from emerging markets.
- There were also severe demand-supply mismatches of oil at the global level.
- The situation in India became worse and was very well compared with the historical economic crisis of 1991.

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How does India stand today?

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- The recent depreciation of rupee is getting compared with the scenario that was prevailed in 2013 and also call for similar solutions.
- But the Indian situation is actually quite different in 2018.
- The position in 2018 is far more comfortable in almost all the parameters except foreign portfolio investment (FPI).

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Economic indicators – Then vs now			
	Financial year (%)	2013	2018
GDP growth	Q1	6.5	8.2
IIP growth	August	4.6	6.6 (July)
CPI	August	10.5	3.7
WPI	August (All, agr, fuel, manufactured)	6.2	4.5
Repo	October	7.75	6.5
10-GSec	October	8.57	8.08
External account			
CAD	Q1 (% GDP)	-4.75	-2.4
Forex reserves	March end to Sept end (\$ billion)	292 to 276	424 to 400
Import cover	Based on Sept end reserves months and previous year imports	6.8	10.4
FDI	April-July (\$ billion)	8.64	16.1
FPI	April-Sept (\$ billion)	-5	-11.2

Source: RBI, MOSPI, CMIE

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- FPI flows have been negative in both the episodes, and this has got to do more with the Federal Reserve driving such actions.

- The continuous increase in interest rates by the Federal Reserve is the main reason for the FPI flows to turn negative now.
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- So the RBI was expected to increase rates this time to even out the interest rate differential between the two regimes.
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- The other parameters like the CAD, import cover, FDI and other indices look healthier than before which gives a great deal of confidence to the policy makers.
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What are the concerns?

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- Oil factor - It remains to be seen whether India will be able to strike a deal with Iran within the US overall framework of sanctions.
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- This combined with the OPEC reaction to lesser oil from Iran will determine the direction of oil prices.
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- Also, if US is not able to supplement supplies with its own shale reserves to matchup oil supply, then the price could go up further.
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- The US-China trade war will continue to keep the dollar stronger and make the rupee volatile.
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- Import tariffs - Import tariffs on several goods have been increased to lower the growth in imports.
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- But since the quota system became tighter after the WTO was set up, there aren't too many other steps that can be taken to improve the CAD of India.
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- Forex reserves - Currently with forex reserves at around \$400 billion, import cover is comfortable.
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- But the decline in reserves of around \$25 billion this year can be attributed mainly to the RBI selling dollars of around \$15-16 billion to stem the rupee's fall.
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What should be done?

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- RBI recently allowed forex borrowings for working capital by oil marketing companies(OMC) under the automatic route with immediate effect.

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- All the state-run OMCs will now be able to raise external commercial borrowings (ECBs) for working capital purposes with a minimum average maturity of three to five years from all recognised lenders under "the automatic route".

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- Under the liberalised norms, individual state-run refiners are allowed to borrow up to USD 750 million, while the overall borrowings are capped at USD 10 billion.

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- In addition to the liberalised norms for oil companies, a sovereign bond or NRI bond could also be made to increase foreign currency inflows.

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- But such bonds are expensive and are repayable and hence the future risk also needs to be weighed appropriately.

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- India has no control over the extraneous factors like trade wars, Federal Reserve actions and the rising prices of oil.

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- But the RBI needs to hold control over the fundamentals within our economy that are driving the rupee further.

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Source: Business Line

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