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Depreciation of Emerging Market Currencies

What is the issue?

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- In recent times currencies of emerging economies has witnessed a significant fall in its value.
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- The depreciation of a host of emerging market currencies suggests that there is a global factor at play.
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What is the status of emerging market's currency?

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- The value of the rupee against the dollar has fallen by more than 5% since the beginning of 2018, and the currency now trades at its lowest in more than a year.
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- Other emerging economies like Indonesia, Argentina, Mexico and Turkey have seen a fall in their currencies.
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What is the reason behind the fall of currencies?

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- The U.S. Federal Reserve is expected to tighten its monetary policy stance by taking steps towards slowing down the growth in U.S. money supply.
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- A slowdown in U.S. money supply growth affects the value of other currencies in two ways.
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1. Interest rates in the U.S. will begin to rise as the Fed’s demand for various assets begins to drop.
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2. Fed begins to tighten money supply, the availability of dollars in the global market is likely to turn scarce, compared to other currencies.
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- Both these factors affect the price at which traders, who try to speculate on future retail demand, are willing to buy the dollar using other currencies.
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What are the implications for India?

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- The fall in the value of the rupee means that buyers are now having to shell out more rupees to purchase dollars.
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- The fall in the nominal value of a currency in itself does not suggest that its holders are worse off.
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- If the real value of the dollars bought with the currency were to increase sufficiently, their effective purchasing power would still be intact.
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- In the present case, however, the depreciation of the rupee is due to a fundamental change in investor attitude to the rupee for the worse.
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- Depreciation of the rupee could affect the expected returns of people who invest across borders.
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- A stronger dollar will causes a rush among investors to sell their assets in India and invest the money in the U.S., where they could earn higher returns.
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What measures needs to be taken?

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- One major factor determining a currency’s exchange rate is its relative scarcity vis-à-vis other currencies.
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- Since central banks are the sole suppliers of national currencies, they can influence the value of their currencies by appropriately regulating their supply.
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- Another factor that determines a currency’s exchange rate is the benchmark interest rate, which can be used as a tool to directly attract capital into the country and prop up the value of its currency.
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- The Reserve Bank of India can affect both the money supply and domestic interest rates simultaneously through its monetary policy stance.
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- Yet another common way to prop up a currency is through the direct intervention of the central bank in the forex market.
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Source: The Hindu

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