

# **India's Currency Practices - US Signals Caution**

#### What is the issue?

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- US Treasury Department's recent semi-annual report has warranted India to be placed on the 'Monitoring List' for currency practices.
- The move is largely unjustified as RBI interventions were on account of a surplus capital account and not for undervaluing the Rupee.

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## Why has India intervened in foreign exchange markets?

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- India has been frequently intervening in foreign exchange markets through RBI which means that it is purchasing more foreign exchange lately.
- **The Concept** RBI pumps in Indian Rupee and buys foreign currency from the international markets which increases rupee supply internationally.
- This reduces the demand for rupee and thereby reduces the rupee exchange rate, which helps in arresting any upswing in rupee value.
- It is to be noted that a strong currency would make exports costlier and create losses for export dependent local businesses.
- Contrarily, when there is a big depreciation of rupee, India's imports will become expensive and lead to domestic inflation.
- In such a scenario, the RBI sells its foreign exchange reserves and drains out rupee liquidity internationally, which will push the exchange rates upwards.
- Thus, the interventions are buffer mechanisms in RBI's arsenal to ensure that the currency neither gets overvalued nor gets undervalued.
- Current Stats Net annual purchases of foreign exchange reached \$56

billion in 2017, which is equivalent to 2.2% of the GDP.

- $\bullet$  These interventions were to ease a strong Rupee Rally (appreciation) in the backdrop of a massive inflow of FDI and portfolio investments. \n
- But despite these intervention, rupee appreciated by over 6% against the dollar and by more than 3% on a real effective basis in 2017.
- Significantly, India's Forex reserves have been continuously rising (presently \$424.86 billion) due to frequent intervention since 2013.
- **Regulations** Value of free-floating currency isn't supposed to be tampered with except in exceptional cases (rapid fluctuations), because appreciation and depreciation are balancing mechanisms in international trade.
- IMF would've usually deemed the currency of counties that undertake such interventions as undervalued, but it has refrained currently as India has a 'Current Account Deficit' (CAD) that is as high 1.5% of its GDP.
- $\bullet$  Notably, RBI maintains that the value of the rupee is broadly market-determined and that interventions are only when there is undue volatility. \n

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# What does the US report say?

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• India had a significant bilateral goods trade surplus with the US, which totals to \$23 billion in 2017.

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• US has 3 criterions based on which it placing a country in the 'Monitoring List' for currency practices. They are -

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- $\bullet$  Bilateral trade surplus of over \$20 billion with the US  $\ensuremath{^{\backslash n}}$
- Frequent interventions in the Forex Market
- $\bullet$  IMF's contention of that the currency is being undervalued  $\ensuremath{\backslash} n$

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- Hence, as India meets 2 of the 3 stated aspects, the US Treasury Department has warranted placing India on the aforementioned "Monitoring List".
- Notably, 5 other countries namely China, Germany, Japan, Korea and Switzerland are already on the list.
- The US has maintained that the list is to aid in monitoring and combating unfair currency practices and encourage policies to address trade imbalences.

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### Is the US move justified?

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India does indeed have a trade surplus with the US, but unlike China, it still
has a large trade deficit overall - which implies that Rupee is still
overvalued.

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• A recent assessment by the IMF has also held that the rupee is actually moderately overvalued and 'closely aligned to its fair value over the long term'.

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- $\bullet$  The accumulated foreign exchange reserves were largely due inflows into the capital markets and hence India doesn't qualify as a currency manipulator. \n
- Also, RBI is projected to merely purchase 0.6% of GDP as Forex, which is well below the IMF ceiling (2% of GDP) for being labelled a currency manipulator.

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### How does the future look?

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• RBI's forex reserves now covers only 11 months of imports, which is actually below pre-2008 (global financial crisis) level of maintaining a 14 month buffer.

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 $\bullet$  Also, the Current Account Deficit (CAD) is set to rise to 1.9% of the GDP.  $\ensuremath{^{\backslash n}}$ 

• More significantly, share of portfolio investments has jumped to 120% of forex reserves from pre-crisis level of 70% - which calls for jacking up reserves.

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- US listing has currently caused the rupee to fall sharply by 29 paise against the US dollar to close at 65.49 in one day.
- $\bullet$  However, forex dealers don't expect a sharp fall as the RBI then props up the rupee by selling dollars from its reserves.  $\mbox{\sc h}$
- Hence, experts opine that RBI will continue with its interventionist approach at appropriate times, despite being placed on the US watch list.

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**Source: Indian Express** 

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