Responding to Weakening Rupee

What is the issue?

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- The rupee has hit historic lows against the dollar in recent weeks.
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- It is not a huge concern, but needs a well thought-out strategy for response.
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Why is it not a concern?

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- India's external accounts look far more secure.
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- This is primarily because the foreign exchange reserves are in the comfort zone.
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- They had dipped below $300 billion in 2012-13, but in 2017-18 they were $424 billion.
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- The current account deficit, too, remains manageable.
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- It is true that the long low in commodity prices is over.
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- E.g. Fuel prices are in a rising trend.
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What are the proposed risks?

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- The prospect of a trade war is seen as disruptive.
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- The merchandise trade deficit has been adequately compensated for.
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- This is in part by payments for services and remittances as well as strong capital inflows.
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- However, there has been concern expressed about all those components as well.
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- E.g. threat of visa restrictions by the US administration could affect IT services revenue.
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- But the revenue from IT and ITeS has been range-bound around $70 billion.
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- Also, rising crude oil prices mean that remittances from the Gulf have rebounded as well.
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- These fundamentals of the macro-economy appear to be strong, ruling out the risks.
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What should India be prepared for?

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- Certainly, there will be increased inflationary risks.
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- The monetary policy committee of the RBI thus may be more willing to raise interest rates.
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- This might in turn hamper the nascent growth recovery.
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- In the short run, the trade deficit will also find it difficult to respond to a depreciating rupee.
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- Despite this, much of India imports, including fuel and electronics, will not be easy to substitute.
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What lies ahead for India?

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- Indian rupee's depreciation is similar to what is happening with many emerging market currencies.

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- However, the consequences of rupee depreciation need a careful handling.
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- This is because, rupee depreciation is an opportunity that must not be wasted.
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- India must increase self-reliance, one way, by further indigenising India's fuel mix.
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- The government's large-scale renewable energy push should be seen as part of this effort.
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- A sustainable external account would require sustained increases in the competitiveness of Indian exports.
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- This requires domestic structural reform, which is also crucial for genuine macroeconomic stability.
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Source: Business Standard

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