# Strengthening Rupee

## Why in news?

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The rupee is gaining strength, with the dollar-rupee rate breaking past the 66-level and went on to mark a 20-month high of 63.93 last week.

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## What are the factors responsible?

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- **UK's referendum -** The British currency took a beating immediately after the referendum. The pound declined 20% against the dollar.
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- **U.S Elections -** Another event that marked a significant shift in the global economic order was the victory of Donald Trump in the US presidential elections. This made the dollar index break.
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- But the rupee was not unduly hassled by these events.
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- **Strong foreign flows -** The initial trigger that helped the rupee break the 66 level came in the second week of March this year after the BJP's resounding victory in the State Assembly elections in Uttar Pradesh.
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- This triggered a strong surge in Foreign Portfolio Investors' (FPIs) interest towards the Indian market.
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- **Weak dollar -** The second factor that has helped the rupee break the key 66 level is the recent weakness in the dollar.
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- The US Federal Reserve's stance on the rate hike front had pushed the dollar index below 100 over the last couple of months.
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- **Trade and deficit -** After falling continuously on a year-on-year basis from December 2014, India's exports are showing signs of recovery since September last year. Exports have surged 35.85 per cent, from $21.52 billion in August 2016 to $29.23 billion in March 2017.

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- Crude oil prices have been hovering around $50 per barrel over the last few months.
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- Gold has been gaining sheen from the geo-political uncertainty between the US and North Korea and from the broader weakness in the US dollar.
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- India’s current account had improved from a deficit of $7.08 billion to $0.3 billion in June 2016.
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- **Current Account Deficit (CAD)** has been widening and is back to $7.92 billion as of December 2016. Given that there is low possibility of the trade deficit to improve in the coming months, there is a danger of the CAD widening further.
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- **External debt -** India’s external debt is also reflecting a mixed picture. While the long-term debt has come down sharply by 6 per cent, from around $398 billion in December 2015 to $372 billion in December 2016.
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- **RBI and forex reserves -** The RBI has been building up its forex reserves consistently. The reserves have risen 7 per cent, from around $344 billion in April 2015 to $369 billion now.
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- Since the rupee has appreciated sharply in a very short span of time, there is also expectation that the RBI will intervene to arrest further strength in the currency. This can involve selling the rupee and buying dollars, which can bolster the reserves further.
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- **Rupee overvalued -** The rupee appears overvalued when the Real Effective Exchange Rate (REER) is taken into consideration.
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- A currency is considered overvalued if its REER is greater than 100 and it is undervalued if the REER is below 100. REER is a measure of valuing a currency against the currencies of its trade partners, adjusted for inflation.
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## What are the upcoming risks?

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- The developments with regard to the US and North Korea will need a close watch.
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- Any uncertainty may trigger a global risk-off trade.
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- The second round of French elections and the UK snap election is up in June. Germany is heading for polls in September.
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- Strong inflows and the weakness in the dollar are positives for the rupee.
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- But the widening deficits, strong outlook for gold and oil prices, which can increase the import bills and over-valuation of rupee based on REER, are negatives for the rupee.
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- Moreover, geo-political tensions and a series of upcoming elections may cause short-term volatility, capping the upside in the rupee.
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**Source: The Hindu**

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