# Tumbledown Rupee

## *The Statesman*

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On 16th August, a day after the stirring speech of the Prime Minister from the ramparts of the Red Fort promising record economic growth, the Indian rupee closed at a record low of 70.15 to the dollar, after touching an intra-day low of 70.40, making it the second worst performing emerging market currency after the Rouble. It has lost over 9% of its value since January this year. While rival political leaders screamed at signs of a fledgling economy, Government functionaries dutifully provided assurance of comfortable forex reserves protect the currency market against undue volatility and asserted the strength and resilience of the macroeconomic fundamentals of our economy to withstand and absorb any shock. The high growth in economy and exports, strong remittances, large forex reserves, and moderate inflation do indeed provide some assurance, but there are clouds over our economic horizon too, which may hurl the economy down a slippery slope.

The rupee has been on a downward spiral since the beginning of the year, forcing the RBI to sell dollars to defend it and in the process depleting the country's forex reserves. The reserves had fallen by $25.147 billion between 13 April and 10 August, from a peak of $426.028 billion in the week to 13 April. In the week to 10 August, the reserves plunged to $400.88 billion, losing a whopping $1.822 billion within just a week. A weakening rupee is sure to put pressure on interest rates and the current account deficit (CAD), which may be further be aggravated by the surging global crude prices, pushing up inflation. Domestic and foreign investors may seek less risky markets, and some investments may fly to safer tax heavens - a process which has already started after the government began pursuing the corporates aggressively for tax. The volatility in the equity market currently being witnessed may further accelerate the FII outflow, thereby further widening the CAD, and there is the risk of a fallout from the trade war the US has launched, not only against China.

Government assurances, as always, are to be taken with a pinch of salt. In December 2017 itself, India's external debt had exceed half a-trillion dollar, in March 2018, it stood at $529.7 billion, 12.4% higher over March 2017. Forex reserves of $400 billion cover 75.5% of the total external debt, with about 52.3% coming up for maturity within the current fiscal.

The recent nosedive of the rupee recalled a time between June 26 and August 28, 2013, when it had plunged from Rs 60.73 to Rs 68.83 against the dollar. In May 2014, after the last Parliamentary elections it rose to Rs 58.6, but continued shedding value gradually until the sharp decline witnessed recently. The trigger for the fall, however, came from a rather unlikely source, a spat between two egomaniacs - the two most volatile and authoritarian leaders of our time, Donald Trump and Recep Tayyip Erdogan, though the latter must claim a larger share of responsibility. An American pastor, Andrew Brunson, who has been living and preaching in Izmir on the Aegean cost of Turkey for nearly a quarter-century, has become a pawn in this game. After the failed coup attempt against Mr. Erdogan, one afternoon in the late summer of 2016, he was summoned to the police station and detained on the charge of terrorism. USA swiftly demanded his unconditional release and Erdogan in turn demanded that Fethullah Gulen, a Turkish Muslim cleric living in the United States, an enemy he perceives being behind the 2016 coup, be handed over to Turkey in exchange for Brunson. Brunson has been framed to terrorism charges on behalf of Turkey's Kurdish rebels and also Gulen, though 'evidence' for the charges is still being collected. Both USA and Turkey happen to be NATO members.

Turkey has been through economic and political turmoil for quite some time now, ever since the failed coup attempt gave Mr. Erdogan an excuse for repressing and purging all opposition. He has extended a vice-like grip over every arm of the Government, silencing not only rivals but also the Press. With inflation exceeding 15% and CAD exceeding 5% of GDP, and his refusal to increase bank interest rates to cut inflation, Turkish economy is in dire straits. Cheap money from banks is being used to finance construction projects executed by his crony friends and for executing ego-projects like a bridge over the Bosphorus, a vast airport in Istanbul and his own 1,100-room, $615m palace in Ankara. High domestic interest rates have forced businesses to borrow externally, soaring the country's external debt, and the combined result has a been a steady fall in the value of the Turkish Lira which lost almost 40% of its value since January 2018, till the crisis hit on 10th August, following Mr. Trump's doubling of tariff on Turkish steel and aluminum products, which wiped out $40bn off Turkey's stock-market, plummeting the Lira by 20% against the dollar. As a major debt crisis looked imminent, Mr. Erdogan retaliated by increasing tariff by up to 140% on American products including cars, tobacco, cosmetics and alcohol and called for a boycott of all US electronic goods, but it is his country that is paying the higher price in this economic war. Since then, the country's Central bank has been forced to take some corrective measures to cut money supply, and boosted by a $15bn investment pledge from Qatar, the Lira has recovered somewhat, but a deep and protracted recession is probably staring at Turkey, which may perhaps relax Mr. Erdogan's dictatorship and eventually set the economy free.

Trade is one way through which a country's economic turmoil and currency crisis get exported to its trading partners, and the other is through its commercial lenders. The first is not significant for Turkey which accounts for only 1.3% of the world's commodity trade, but commercial lenders have a global financial network and it is through them that the contagion spreads. This has led to the fall of Euro, as Eurozone banks have advanced about $150bn to Turkey. Emerging markets also panicked without much reason as nervous investors became weary everywhere, leading to fall in the value of Indian Rupee, South African Rand and Argentinian Peso. While the Turkish contagion is unlikely to affect the Indian Rupee in the long run, it has once again exposed the chinks and risks in our economy, despite the hollow assurances by the mandarins of Finance Ministry. There is not much room for manoeuvring anyway, as indicated by the swift action by Argentina in raising the interest rates immediately.

Exchange rates, a function of demand and supply, are vulnerable to external developments. Rupee may get impacted by a depreciation of the Chinese renminbi (RMB), a likely fallout from its ongoing trade war with USA, which will make our imports of Chinese electronics, telecom equipment, machinery etc. cheaper, but to retain the competitiveness of our exports, the rupee must be allowed to depreciate. The rupee is perhaps a little overvalued, given our higher inflation above that of our major trading partners, our low labour productivity and net positive imports. An overvalued rupee naturally stifles exports, hurting the MSMEs especially which supply inputs to the exporters. Given that 80% of our fuel needs are met by imports, a surge in the oil prices, increase in the US bond yields or outflow of capital can severely upset the forex and currency equilibrium, which can only be partially corrected through measures like attracting foreign inflows through NRI bonds. A better solution is to manage inflation and interest rates, which will automatically attract foreign capital, but the worst consequence of failure to manage is decelerating growth which will affect jobs, which no Government can afford.

Fiscal deficit, CAD and inflation are the three major determinants of the exchange value of a currency. When governments sacrifice macroeconomic stability for populism, currency comes under siege, as we have seen so often in the past. India's 2013 currency crisis was precipitated by 4.8% fiscal deficit, 9.46% inflation, and 3.6% CAD. Forex reserves were then just enough to cover 6.6 months of imports, and short-term overseas debt was at one-third of forex reserves. Today we have fiscal deficit of 3.5%, CAD 1.9% and inflation 4.2%, and import cover of 11 months. But our short term foreign debt exceeds half our forex reserves, and a single global trigger may upset the apple cart, as demonstrated by the Turkish turmoil. Rupee is probably undergoing an overdue correction, but the erosion in its value indicates the extent to which we have been mismanaging our economy ever since independence when a rupee fetched a dollar. The deficits resulting from our wars with China and Pakistan led to its devaluation to Rs 7.57 in 1966, from which level, in five decades, it has fallen to Rs 70 now. Executive accountability is an illusion in our system, but complacence and denial can only lead to disaster.