Government Steps in to Curb Rupee Fall

With Rupee racing past 72 against dollar government has decided to intervene with a number of steps to curb the currency slide and current account deficit.

- The rupee is currently the worst-performing currency in Asia.
- It has lost about 12% of its value since the beginning of the year. It is now around the 72 level; it was just under 64 at the beginning of the year.
- Major reasons for rupee fall includes rising crude oil prices, US-China trade war, domestic inflation and widening current account deficit. Due to the boom in U.S. economy, investors are flocking back to America due to the massive decrease in corporate taxes and an increase in interest rates by the US Federal Reserve.

Steps taken by Government

- Manufacturing companies borrowing up to $50 million through External Commercial Borrowings (ECBs) will be able to do so only for a one-year term as against the three-year term allowed earlier.
- The government will review mandatory hedging condition for infrastructure loans. Doing away with mandatory hedging will reduce demands for dollars.
- Removal of exposure limit of 20% of foreign portfolio investments (FPI's) corporate bond portfolio to a single corporate group, company and related entities and 50% of any issue of corporate will be reviewed.
- Encouraging Indian borrowers to issue rupee-denominated 'masala bonds' to facilitate the inflow of dollars and de-risk the economy from fluctuations in the exchange rate. In order to push Indian corporates to take the masala bond route, the government has exempted all such bond issues until March 31, 2019, from withholding tax.
  - Removal of restrictions on Indian banks' market making in masala bond, including the restriction on underwriting such bonds.
- Steps to cut non-essential imports and increase exports. These include steps to curb the import of non-essential goods and encourage the export of domestic goods, which will help in addressing the current account deficit.

Likely Impact

- These measures are better suited when the sentiment in the global market is positive towards the emerging markets.
- Most of the measures aimed at increasing short-term external debt or in effect worsen the risk-profile of companies could actually be considered negative.
- If several countries devalue at the same time, then no country will benefit from their exports being cheaper abroad. It is a possibility that there is no surge in Indian exports following the current round of devaluation. Neither will there be a huge fall in imports.
  - Crude oil, which is the biggest item in the list of Indian imports, is price-inelastic.
  - Imports from China now constitute a tenth of overall imports. Since the yuan has also depreciated against the dollar, there is not much reason to believe that Chinese imports will be costlier than earlier.
- The devaluation will also increase the prices of imported inputs, particularly those for which there are no alternative domestic sources of supply. This can have some effect on industrial production and may lead to inflation.

- Improvement in external factors (like crude oil prices and trade war) are the pre-requisite for stabilization of rupee, as these are the primary reason for rupee fall.

Way Forward

- India still has plenty of measures left to curb like issuing NRI bonds and raising interest rates, if things don't improve then the government can resort to other strict measures to curb rupee slide. NRI bonds have been tried last time in 2013 when too the rupee was under stress.
- Major reasons behind the decline of the rupee are that India has been unable to **boost exports** over the years for various reasons. At the same time, it has been unsuccessful in finding sustainable domestic sources of energy to address the over-reliance on oil imports. This has meant that the rise in the price of oil can cause stress on the current account deficit and the currency.
    - The government needs to think of a long-term plan to boost exports, through steps that remove policy barriers that are impeding the growth of export-oriented sectors (like Textiles, petrochemicals, auto-ancillaries etc).

Foreign Portfolio Investments (FPI's)

- FPI stands for those investors who invest for the shorter term in a company as compared to Foreign Direct Investors (FDI).
- FPIs generally participate through the stock markets and gets in and out of a particular stock at much faster frequencies.

Price-Inelasticity

- Price-Inelastic means that the demand for a product remains unchanged with the change in price.

Masala Bonds

- It is a rupee-denominated bond issued mainly in foreign markets.
- The first masala bond worth Rs. 1,000 crore was issued by the investment arm of the World Bank, International Finance Corporation (IFC) in November 2014 to fund infrastructure projects in India.
- It puts the risk of rupee volatility on the investor/lender contrary to an earlier time when the issuer of the bond had to bear the risk of falling exchange rates.
- This has made money raising easier for Indian companies who aim to raise capital from international markets in order to diversify and deepen their funding.
- The first rupee-denominated masala bonds were issued outside India by an Indian company(HDFC) in August 2016 which was listed on the London Stock Exchange.