Free Fall of Rupee: Silver Lining for Exports

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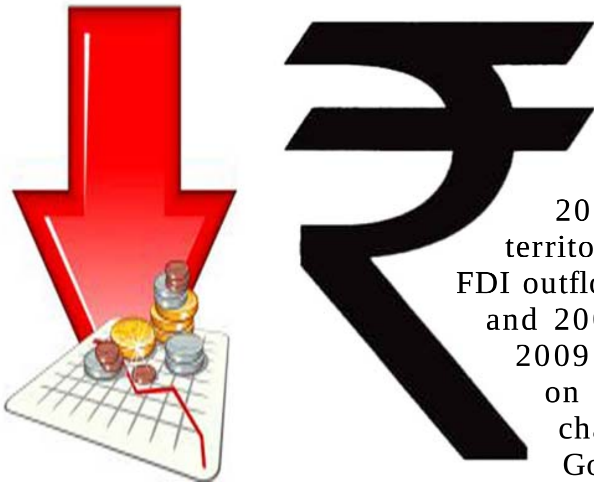
There has been a dramatic turn of events recently in so far as India is concerned; its fast transformation from a fairy tale of a success story, to a failing country has been too fast and too shocking. The country, which boasted of the second fastest growing economy in the world, seems to have fallen to a disgrace of declining GDP growth from 9.4% in Jan-March 2010 to 6.1% in Oct.-Dec. 2011; industrial production plummeting in terms of IIP from 5.3% in April, 2011 to -3.4% in March 2012; Net FII investment inflow drying up from $173.8 million in January 2011 to -10.7 million in May(21), 2012 with its exports spilling over to negative territory in March 2012 accompanied by record FDI outflow from a few million dollars between 2000 and 2008 to $3.1 billion in 2008; $ 7.2 billion in 2009 to $10.9 billion in 2010. Let us not miss out on the double digit inflation, apart from the charge of "policy paralysis" against the Government.



And above all, Indian Rupee has nosedived by almost 20% in value in the last one year with what I would call, an uninhibited free fall almost on daily basis; and our Current Account Deficit has a yawning gap of $116 billion which as per Assocham research study likely to shop increase by a massive 40 % in the current fiscal with our forex reserves being below $300 billion.

While each of the problems referred to above is serious enough to merit total attention of the Government, but all of these together make a rare and formidable combination which is not easy to combat by the Government of the day. This makes the situation scary.

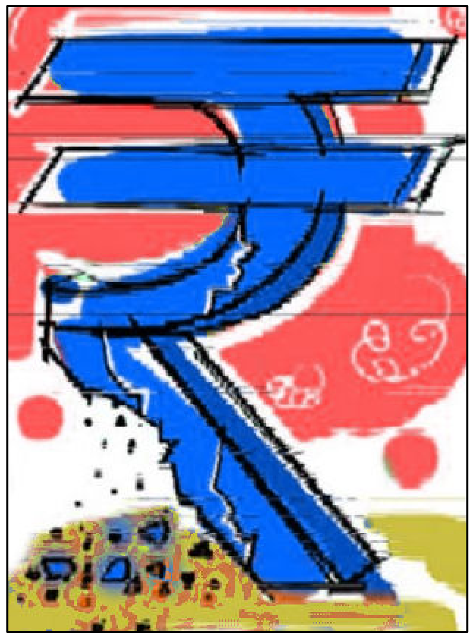
Out of host of unfavourable factors, perhaps the most important and urgent one that is getting most serious attention of the Government is the fast and continuing depreciation of Indian Rupee. The Indian Rupee stands battered with the historical low that it has touched ever over its life-time. There is a serious and growing concern with every notch of depreciation of Indian Rupee, as this has the potential of damaging Indian economy which has already been crippled by a host of factors, as referred to above. Which have been accepted and even articulated by those within and outside the Government?

Never before did the Indian Rupee slide that steeply in that short period of time. It stood at Rs. 56.38 to dollar and if those in trade are to be believed, this slide could continue and touch, even cross Rs. 58 or perhaps Rs. 59 to a dollar. Some analysts forecast the pair to touch 60. Strong market forces in favour of the dollar have created panic," J Moses Harding, Executive Vice-president at IndusInd Bank Ltd, was quoted as saying by Bloomberg News. "The RBI does not have enough ammunition to fight against the tsunami-like ferocious headwinds the rupee is facing."

The Indian currency is likely to continue its downslide and could be in the range of Rs 57-60 in the medium term against the US dollar mainly on account of higher foreign fund outflows, feel experts.

"In the short-run the rupee weakness appears overdone and hence a pullback is expected. However, in the medium term there is a risk of rupee weakness extending to 57 level," Kotak Mahindra Treasury Head Mohan Shenoy said.

The rupee continued its descent to a new low, everyday for 7 straight days, as investors rattled by the shaky Euro zone shifted funds to the safe havens of US and German treasuries while



Finance minister Pranab Mukherjee has said the steep fall in the rupee was a matter of great concern and the Centre was trying to resolve the situation. He said the Centre was trying to resolve the situation. "It is a matter of great concern. We are watching the situation. The Centre is not (sitting) idle. We are trying to resolve (the issue)," Mukherjee told. "This is due to the Euro zone crisis," he said. Mukherjee added, "There is also currency crisis in emerging markets including Brazil." At the forex market, the domestic currency has been falling against the US dollar over the past few days. The rupee threatened to breach the 57-level as it slumped to 56.40 against the American currency -- the fresh all-time low it hit in the seventh straight session as copious fund outflows continued amid Euro zone worries. Dealers said strong dollar demand from importers, mainly oil refiners, on expectation of further strengthening of the dollar, caused the rupee's fall. However, the Reserve Bank did step in to stem the rupee's slide.

Why this Volatility?

Finance Minister Pranab Mukherjee attributes the depreciation of Indian Rupee to Euro zone crisis. Even PHD Chamber of Commerce President, Sandip Somani said, “The exchange rate of rupee against dollar has been severely impacted by the global economic slowdown, especially, in the Euro-zone economies. The current re-emergence of crisis in the European economies has affected the strength of Euro against the dollar.

Is the Euro-crisis a real piece of villain?

The indefensible defence being taken by the Government, including Finance Minister, Pranab Mukherjee that it is the Euro crisis that has triggered the volatility of Indian rupee is not being shared by many in the know of things. True, the US dollar is emerging stronger as compared to Euro, which is beset with its own set of problems of liquidity with some of their member-countries. Assuming that keeping in view the uncertainty of Euro Zone, the Western investors would have pulled out of European countries and would have taken shelter in US treasuries or other investments, but how would this impact Indian rupee, one fails to understand.

On the other hand, India has been misleading its own people by stating that our exports continue to pick up (as per the statement of Minister of State in Ministry of Commerce) notwithstanding that there has been a decline in Indian exports in recent months and which have traveled into negative territory. What is even more significant was that our imports were rising faster than our exports consistently, month after month, year after year, leading to ballooning Current Account Deficit, which almost worked out to something like 60% of forex reserves available with us. The gravity of the situation stood enhanced by more factors arraigned against any hope of reversing this trend. We barely scrapped through our annual export target of $ 300 billion during last fiscal and the prospects of enhancing our exports stand dim in the light of continuing unfavourable world economic conditions.

The State of Indian Economy vs. International Investment

The real reason for the strong and consistent depreciation of Indian Rupee is that the state of Indian economy is in shambles with the result that there has been considerable flight of FDI from the country and foreign investors are not that keen in fresh investment. For this, we need to check on what are called as fundamentals of the economy, which have all along been touted as “basically strong” by the Government, particularly our Finance Minister but let the facts speak for themselves. For this, we need to briefly examine a few acceptable parameters.

Declining GDP

First, there has been consistent decline in growth of GDP, which has headed south from 9.4% in Jan-March 2010 quarter to 6.1% in Oct -Dec. 2011. The GDP growth forecast for the year 2012-13 has been made by different agencies like 7.6% by Ministry of Finance, 7.3% by Reserve Bank of India, 7% by Asian Development Bank, 7 – 7.5% by World Bank and 7.1% by OECD. However, Morgan Stanley has put it at 6.3%. Without trying to usurp a seat on the high table of our national and international forecasters, we humbly place our forecast for 2012-13 at just 6%. It is to be noted that the forecasts by different agencies have consistently been lowered by most of these agencies with depressing regularity.

Plummeting IIP

Our industrial growth has been shrinking. It plummeted from 5.3% in April, 2011 to -3.5% in March, 2012.

Net FII Inflows

The net FII inflows have steadily been drying up but fluctuating widely from $173.8 million in January 4, 2011 to - $10.3 May 21, 2012.

Exports in Negative Territory

Our exports have been flip-flopping and the original target was revised downwards and ultimately settled at $300 billion. Persons no less than the Commerce Minister had expressed his doubts on achieving the target, and it was a celebration time for him to announce, "I am happy to announce that India' exports have crossed $ 300 billion." However, the exports made a rare feat of entering into negative territory in March, 2012. There is nothing very much hopeful on this front, looking to the global economic situation.

Record FDI Outflows

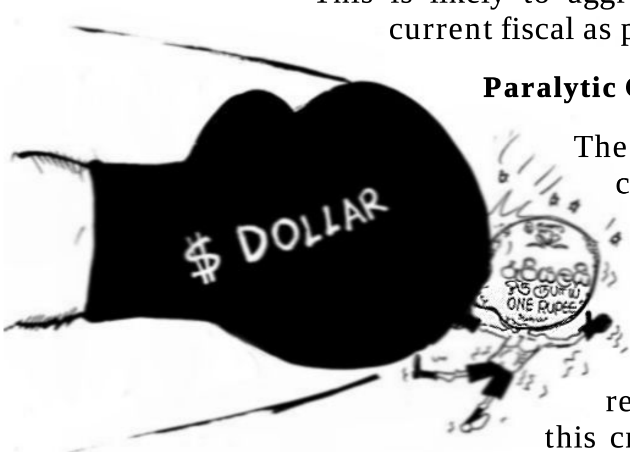
According to a report of Nomura, there has been a steep rise in FDI repatriation – from a few million dollars between 2000 and 2008, this figure jumped to $3.1 billion in 2009 to $7.2. billion in 2010 to $10.7 billion in 2011. The Nomura analysts said, "Global de-leveraging may have forced companies to sell their Indian assets and repatriate funds to their home country." It needs to be noted that this happened when the going was good in India. The situation would have only worsened now.

Double Digit Inflation

One of the important factors that determine "fundamentals of the economy" is inflation, which has refused to moderate to an acceptable level notwithstanding the repeated commitment on the part of the Government to bring inflation under control, which still rules in double digit.

Yawning and Growing Current Account Deficit

Month after month, our imports have been far outstripping our exports, thereby causing a serious and continuing Current Account Deficit. According to the latest information, the Current Account Deficit for April-February 2011-12 has been estimated at $ 166.7 billion, which was higher the deficit of $ 115.2 billion during April-February 2011-12. This is likely to aggravate by a sharp increase by 40% in the current fiscal as per researched by Assocham.



Paralytic Government

The charge of Government being paralytic continues to stick. Kaushik Basu, Economic Advisor to the Finance Minister, who had been in the eye of storm for his remarks on the unlikelihood of Government of India taking major policy decision before 2014, and later on withdrawing those remarks, has once again stated, "I agree with this criticism (Government being lethargic in its policy responses); there has been a slow-down in decision-making because of over-caution on the part of bureaucrats and slowdown in reforms because of the strains of coalition."

Inappropriate Government Decision

A recent attempt by the Government to permit re-opening of income tax assessments up to past 50 years has also not gone well with the foreign investors.

India Inc. Happier with Investment Abroad

Is it not somewhat ironic that while India continues to hanker after FDI, its own India Inc. is happier to invest abroad than at home? According to RBI data, Indians continue to invest increasingly in foreign countries, as the foreign investment figures would indicate. India Inc. invested abroad $ 17.5 billion in 2009, $40.5 billion in 2010, $ 33.9 billion in 2011 and $ 8.3 billion in the first quarter of current fiscal. This single figure should reflect and speak volumes about India's suitability of attracting foreign direct investment, when its own industry and corporate have greater faith and acceptability in foreign lands in terms of investment.

Downgrading of Indian Economy by Credit Rating Agency

India has recently been downgraded from "Stable" to "Negative", which not only reflects the rating of India's financial standing, but points out to its weak investment climate.

With all these negative factors lined up, how can one expect anything different than what is now happening on the value of Indian Rupee.

Role of RBI in Checking Depreciation of India Rupee

The Central bank said it would act only when there could be some impact. "We want to be sure that when we take any action, there is some scope for impact," **Subir Gokarn**, Deputy Governor at the Reserve Bank of India, said in Kolkata. "We also have to keep in mind that every option has some pros and cons. And we don't want to be doing things that will end up being somewhat costly or destabilizing at some points."

In a recent interview, **Kaushik Basu** was asked if RBI has done enough to stem the Rupee's fall and that if RBI is being too predictable in is approach to tackle the Rupee's woes. He said, "RBI's response to the recent Rupee depreciation has been balanced and aptly measured. The bulk of the recent exchange rate depreciation is not India-specific problem but has global roots. You have to take my views on these seriously because I have in the past criticized RBI. And I have also refused to put all the blame for all our trouble on the global economy."

What does India Inc Say?

Deepak Parekh, Chairman, HDFC, says, "The magnitude of the crisis is similar to 1991. India is no longer the flavour of the month. FIIs are not looking at India anymore. They are disappointed at the lack of reforms, the absence of efforts to contain the large fiscal and current account deficit and the retrospective tax laws. India's image has taken a beating."

Adi Godrej, Chairman, Godrej Group feels, "It is important to get the reforms process moving. The Government needs to announce more steps (after the petrol price hike) and RBI needs to maintain a favourable monetary policy regime."

R.C. Bhargava, Chairman, Maruti Suzuki observed, “I do not think the economy will go to 8.5-9% levels, but it won’t slip below 6% either. While Government policies are contributing to the present sate of the economy, other factors are responsible including external.”

Vikram Kirloskar, Vice Chairman, Toyota Kirloskar Motor, hopes “We want to see a vision from the leadership which will give people the confidence that we are moving ahead.”

Mehul Choksi, CMD, Gitanjali Gems, acknowledges, “The Rupee slide is due to our own policy-related problem. There is enough liquidity in the system, but people do not want to invest because of our wrong policies.”

The Thin Sliver Lining

The thin silver lining is too evident to need an announcement. A depreciated Indian Rupee would now enjoy a cutting price edge over other competitors. So does Kaushik Basu, who says, “I must point out that what is getting overlooked is that depreciation is also an opportunity – the opportunity to explore more. Till recently, everybody used to envy China flooding the world with its goods using the leverage of its depreciated currency. Canada gained massively in the global market when the Canadian dollar used to be weaker by over 25% vis-à-vis the US dollar. ..... So while taking steps against excessive depreciation what we must do and are not doing enough is to get our exports booming. We need to remove hurdles, bureaucratic and otherwise, to achieve this.”

Our Views

Having said above that the thin lining is too evident to need an announcement, which has also been endorsed by Kaushik Basu, I must say that we need not forget “to remove hurdles, bureaucratic or otherwise”, which is not easy to come by, thanks to our post-Independence babu culture.

Further, the long line of problems arraigned against us which have been mentioned above (and these are too many to be repeated here), need the urgent attention, thoughtful and considerate consideration – and above all action, without which the noble thought of thin silver lining would stand blurred.

Above all, we need not forget, in our euphoria of our better price competitive edge, that quite a few other countries have also depreciated and would to that extent offer further competitive prices in the limited pie of international trade, of course, especially garments.