Why the rupee is under pressure? It's impact on Indian Economy.

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Abstract- Amid the geopolitical tensions and increases by the Fed to combat U.S. inflation, the rupee has been on a downward spiral. Slowing exports and an inflated import bill have also weighed down the local currency. In order to iron out sharp volatility in the rupee, the RBI has dipped into its reserves, which however has led to a fall in import cover

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Introduction -Till recently, the rupee was recording fresh lows every other day. Persistent foreign portfolio outflows and a widening trade deficit are largely blamed. While the import bill balloons, the falling rupee has not helped boost exports either.

Several currencies have taken a beating in the wake of a long-drawn war in Ukraine and the steep hike in interest rates by the U.S. Fed to rein in inflation. The rupee slid past the 80 mark earlier this month and has weakened by about 7.5% so far in 2022. Historically strong currencies such as the pound and the euro have also depreciated by more than 11%. Several Asian currencies such as the Korean won, the Philippine peso, and the Thai baht have weakened by more than 10% this year. Meanwhile, the dollar index, which gauges the greenback's strength against six major currencies, rose to a 20-year high.

India's rupee is likely to remain under pressure due to high prices of crude oil and other commodities, and may stabilize at around 79-80 against the US dollar in the near term, say experts amid limited headroom available with the Reserve Bank to check the weakening of the domestic currency.

The currency has slumped over 5 per cent this year after Russia's invasion of Ukraine sent international crude oil prices soaring to a decade high. On Monday, rupee ended at a fresh all-time low of 78.34 (provisional) against the US dollar. The previous all-time low was at the 78.32 level recorded on Thursday.

For a nation that is 85 per cent dependent on imports to meet its oil needs and 50 per cent for gas requirements, soaring international energy and commodity prices have worsened its external finances. India's crude oil imports bill had more than doubled in May to USD 19.19 billion.

Also, the continuing FPI (Foreign Portfolio Investments) outflows has put the Reserve Bank of India (RBI) in a situation where it cannot go all out to strengthen the rupee as it needs to hold on to forex reserves to meet the import requirements.

An article published in the RBI's latest bulletin has cautioned that in case of an adverse global scenario, potential portfolio outflows can average up to 3.2 per cent of GDP or USD 100 billion (Rs 7.8 lakh crore) in a year.

The article, titled 'Capital Flows at Risk: India's Experience' further said in a 'black swan' event comprising a combination of shocks, potential portfolio outflows can rise to 7.7 per cent of GDP According to NSDL, foreign portfolio investors sold a net of $28.48 billion in local securities during 2022.

After the Philippine peso and the Thai baht, the rupee was the third-worst performing Asian currency in recent months.

Amid concerns expressed in certain quarters on depreciating rupee, RBI Deputy Governor Michael D Patra last week said the central bank will continue to intervene in the forex market to check volatility and ensure there are "no jerky movements".

Patra, however, retreated that the RBI will not set any level for the domestic currency against the US dollar.

Commenting on the rupee movement, Ranen Banerjee, Leader, Economic Advisory Services, PwC India, said the demand for dollars is going up owing to India's rising value of imports and FII (Foreign Institutional Investments) outflows.

"We are likely to see the exchange rate in the range of 77.5 to 79.5 depending on the movement of oil prices and other commodity prices as those have begun softening owing to two factors -- risk of demand slowdown with hawkish actions of central banks to control inflation and cheaper oil from Russia leading to possibly lesser demand of Brent and WTI from China and to an extent also from India," he said.

AditiNayar, Chief Economist at ICRA, said the policy tightening by the US Federal Reserve amid the risk aversion environment is expected to strengthen the US dollar, thereby imparting a depreciating bias to the INR against the USD.

"...a run-up in crude oil prices from current levels poses a risk to the INR. Amidst the global headwinds, we expect the INR to trade between 77.0-80.0/USD in the remainder of H1 FY2023," she said

On whether the RBI can check the rupee slide, QuantEco Research said, "we believe the RBI has adequate firepower from the forex perspective. Despite the recent drawdown of reserves, the import cover holds above 11 months."

Further, the research firm said that despite the 5.3 per cent weakness in the rupee in 2022 so far, the pressure on the local currency appears moderate when seen from the peer perspective -- most emerging market currencies have come under severe pressure amidst a rising global rates environment and heightened geopolitical uncertainty.

DilipParmar, Research Analyst at HDFC Securities, opined that the central bank is having enough reserves and options to stabilize the rupee. However, the direction of the USD-INR will be determined by the demand-supply matrix and currently, the demand for the dollar is very high.

"We believe the rupee could stabilize at around 79.50 and expect more depreciation from here on as the market is pricing in higher interest rates and weaker growth," he added. GaurangSomaiya, forex and bullion analyst at MotilalOswal Financial Services Limited, said the rupee could continue to depreciate against the US dollar but the pace could be slow with the RBI's active interventions.

"We are of the view that USD-INR is headed towards the 80-mark in the next couple of quarters if inflation related concerns continue to remain high. FIIs, if (they) remain net sellers, too could contribute to the slide in rupee," Somaiya said.

The country's foreign exchange reserves declined by $5.87 billion to $590.588 billion in the week ended on June 17, the RBI data showed.

The merchandise trade deficit in May 2022 was estimated at $24.29 billion as against $6.53 billion in May 2021.

The deficit for April-May 2022 was estimated at $44.69 billion as against $21.82 billion in the year-ago period, up 104.80 per cent.

Positive and Negative impact of Depreciating Rupee-

Depreciation:

Currency depreciation is a fall in the value of a currency in a floating exchange rate system.

Rupee depreciation means that the rupee has become less valuable with respect to the dollar.

It means that the rupee is now weaker than what it used to be earlier.

For example: USD 1 used to equal to Rs. 70, now USD 1 is equal to Rs. 77, implying that the rupee has depreciated relative to the dollar i.e. it takes more rupees to purchase a dollar.

Impact of Depreciation of Indian Rupee:

Depreciation in rupee is a double-edged sword for the Reserve Bank of India.

Positive:

Boost to India's exports: Weaker rupee should theoretically give a boost to India's exports, but in an environment of uncertainty and weak global demand, a fall in the external value of rupee may not translate into higher exports.

Negative-

Risk of imported inflation: It poses risk of imported inflation, and may make it difficult for the central bank to maintain interest rates at a record low for longer.

Dependence on oil imports: India meets more than two-thirds of its domestic oil requirements through imports.

Edible oil imports: India is also one of the top importers of edible oils. A weaker currency will further escalate imported edible oil prices and lead to a higher food inflation.

Effects of a weak rupee-

Positive:

Positive impact on India's exports: The concomitant depreciation of currencies of some of India's competitors such as South Korea, Malaysia and Bangladesh against the dollar, along with a high import intensity of some of its key export segments (petroleum, gems and jewelry and electronics), is likely to have a positive impact on India's exports.

Boost for domestic demand: Exports become cheaper, more competitive to foreign buyers. Therefore, this provides a boost for domestic demand.

Travel to India gets cheaper: It will eventually benefit the local industry.

More remittances: Those working abroad can gain more on remitting money to their homeland.

Incentivize Indian companies: A cheaper rupee will incentivize Indian companies to export more besides helping them substitute some of the costlier imported goods in the domestic market with local products.

Better yield on foreign investment: Foreign investment both through the secondary market and direct investment into sectors which are relatively sheltered from a weak currency can yield better returns over the long run..

Destination for medical tourism and others: Though India does not attract the masseuse; a weak currency can make the destination attractive for in-bound traffic. Medical tourism can get a shot in the arm.

Boost to Indian companies abroad: A number of Indian companies now have sizable international presence apart from direct exports. A stronger foreign currency helps boost their consolidated numbers

Indirect shelter on account of a weak currency: Import substitutable products get an indirect shelter on account of a weak currency.

Metals, especially steel, were affected by imports from other Asian countries, but a weak rupee has increased the landed price of these products.

A number of sectors and companies that price their products on import parity basis will benefit.

Negative:

Spending decisions of households: The falling rupee is most likely to impact spending decisions of households as certain things may become expensive.

Push up in the price of importing goods: For imports, payments are made in terms of dollars. A depreciating rupee would push up the price of importing goods.

Rise in oil prices: Oil prices may raise further since India imports a major chunk of its oil needs.

Short term inflation: Other imported items like luxury cars, car components or even products that require parts to be imported from abroad like mobile phones and appliances may also become expensive. Thus, it might add to the overall inflation in the short-term.

Rising interest rates: The Reserve Bank has already started undertaking measures to tame inflation. Further hikes in policy repo rates would push up interest costs further. The banks will start raising their lending rates, thereby requiring people to pay higher EMIs on their loans.

Sending more in terms of rupee: In terms of remittances, or the money that people residing abroad send to their families back home in India, it would cost more as they will end up sending more in terms of rupee.

Conclusion- Even as the Indian rupee has fallen sharply against the U.S. dollar, the rupee's depreciation has been relatively lower unlike previous times it is going to benefit country.

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