Stopping the rupee’s free fall

The rupee last week fell to an all-time low of 69.09 against the U.S dollar. The currency has fallen about 7.5% since the beginning of the year, making it the worst-performing currency in Asia. The fall has raised fears of a repeat of the currency crisis of 2013 when the rupee suffered a drastic loss of about 20% in just a few months. Many other emerging market currencies have also witnessed a steep fall in their value against the dollar this year.

The tightening of monetary policy by the U.S. Federal Reserve has caused the price of American debt to fall and yields to rise (bond prices and yields move in opposite directions). This, in turn, has pushed investors to pull money out of India and other emerging market economies in order to invest in the U.S., where they can get higher returns. Foreign portfolio investors pulled out 29,714 crore from India in May, the highest outflow since November 2016. Outflows in the first half of 2018 stood at 47,836 crore, the highest in a decade. The dollar has benefited immensely as a result. The dollar index, which measures the value of the U.S. dollar against a whole host of other major currencies, has risen by about 6.5% since February.

Meanwhile, Indian importers have rushed to purchase oil which is in short supply. This has caused the value of the rupee, which is used to purchase the dollars required to buy oil in the international market, to fall.

Moreover, investors have also been worried about the government’s rising fiscal deficit. A burgeoning fiscal deficit raises the risk of the Reserve Bank of India (RBI) printing rupees to fund the expenses of the government, thus weakening the rupee.

The RBI, which raised interest rates for the first time in more than four years last month, is likely to tighten the supply of money. This may help contain dollar outflows from investors seeking higher yields in the U.S., thus shoring up the value of the rupee. The RBI might also look to intervene directly in the foreign exchange market to prop up the value of the rupee. As of June 22, the RBI had foreign exchange reserves of $407.81 billion, which it can sell in the open market. The Fed, however, is expected to further tighten monetary policy in the coming months, potentially forcing emerging markets like India to raise interest rates further.

This refers to the tendency to form friendships and other forms of interpersonal relationships with people we come across often in our daily lives.

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