Decline of Indian Rupee Hits Economy

This past month has been one of turmoil and volatility in the world economy and the financial markets. In Italy, its longest serving Prime Minister (post-war), Silvio Berlusconi, abdicated his throne, even as the European Union crisis continued. At the same time, the US has been grappling with fears of an impending financial crisis, while its economic recovery still remains slow. In this interconnected world, these trends have also affected the Indian economy, mostly the value of the rupee. Among the currencies across Asia, the Indian rupee has suffered the most, a drop of 15% since the beginning of 2011. At the end of July, the rupee stood at 43.86 relative to the US dollar, versus its current standing 52.15. This is the rupee's lowest ebb since March 2009, when it was at 51.97. Pessimistic projections abound about the currency's future health. Thus, it is not surprising that sentiments are depressed and capital expenditure plans have been put on hold.

Concomitantly, most analysts have predicted that the widening trade deficit will be a major concern for the Indian economy. Monthly trade deficit has alarmingly risen to $20 billion in October 2011 from $ 4.5 billion in October 2010. Exports have dropped while imports have increased sharply for most commodities. Simultaneously, capital inflows have dropped from the last quarter, from $13.4 billion to $5.7 billion.

Being a net importer, a declining rupee increases the burden for a nation that is striving to assert itself as one of the world's leading economies. The sharp rupee decline has added to the government's challenges *vis-à-vis* fiscal consolidation. This at a time when economic activity lacks acceleration and industrial growth momentum has lost its vigour. The sectors that have taken a major hit include Oil, Aviation and Energy while the ultimate losers are people of India, particularly with consumer manufacturers too raising the prices by up to 10%.

The depreciating rupee has worried the finance ministry. Finance Minister Pranab Mukherjee has rightly said that "*RBI intervention (in the forex market) will not help*" and that the rupee was weakened due to the withdrawal of foreign institutional investors (FIIs) from the domestic equity market. At the same time Reserve Bank of India's Deputy Governor Subir Vithal Gokarn at a recent conference said: "*We don't really have a target or a rate in mind. It's moving as per market dynamics. It is disruptive, there is no question. There (will be) impact on our import bill, particularly for energy. It's having an impact on companies and it is a problem.*" Meanwhile, Planning Commission Deputy Chairman Montek Singh Ahluwalia was quoted in an interview to a popular television news channel stating, "*It has been a period of enormous currency volatility and you are going to look at what has happened in the Indian currency market in the light of what is happening globally. I think it will settle down.*"

For the ordinary India, with inflation still high, matters look gloomy. Inflation remains very close to the double-digit mark, and a declining rupee is only adding to the economy's woes. However, the Reserve Bank of India and the finance ministry are putting in a concerted effort to fortify the economy from further shocks and boost investor morale by increasing the cap in various sectors. As reported across business media, the government has decided to raise the cap for foreign institutional investment (FII) in government securities to $15 billion from $10 billion. Also the cap on FII investment in corporate debt has been raised to $20 billion from $15 billion. Overall, it is hoped that the current rupee situation is only the result of the contagion caused by global volatility, and that the strong fundamentals of the domestic economy will in time help India survive the crisis. India's financial regulators have a time-tested reputation for their tight monitoring and prudent interventions, and the industry is banking on this track record at this extraordinary hour. With all hands on board, breaking out from these difficult times may not be an implausible goal.

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