

From New Delhi by Susan B. Maitra and Ramtanu Maitra

The rupee continues to lose ground

Foreign sanctions, economic indecisiveness, and turbulence in the Asian markets are helping to weaken the Indian currency.

On June 10, the Indian rupee reached a new low when it depreciated by over 1% in one day to Rs 42.24 to the dollar. From the flutter it caused, it is expected that the currency will lose more in the coming days. No one here, however, is talking about a free fall of the rupee.

Since the beginning of May, the rupee has lost about 13.9% against the U.S. dollar, and about as much against the major West European currencies, but gained slightly against the Japanese yen. The steady erosion of the rupee's value throughout May did not get much response from the Bharatiya Janata Party-led government in New Delhi. But the sharp June 9 depreciation seems to have woken up financial policymakers and market watchers. Securities and Exchange Board of India (SEBI) chairman D.R. Mehta held a series of meetings with the Foreign Institutional Investors (FIIs) to probe their nervous mood.

Typically, the Finance Ministry brass have put up a brave front, ostensibly to allay fears in the short term. Finance Secretary Montek Singh Ahluwalia said, "The Reserve Bank [India's central bank] has all the resources to prevent any speculative upsurge in the foreign exchange market." He also alluded to "a great deal of foreign exchange volatility in the international market," and urged all not to "focus too much on the rupee."

Finance Minister Yashwant Sinha, who is keenly watching the impact of his widely disliked annual budget, presented on June 1, asserted that the government was in a position to face "any speculative challenge" on the rupee

following the dollar hardening against the yen. Sinha expressed confidence, saying, "A stable market is more preferable and important from our scheme of things than a stable rupee." It is surmised that he would like to see the rupee fall a little further to meet "market demand" and, perhaps, to encourage exports.

The rupee came under pressure due to heavy selling on June 9 and 10 by the FIIs, which were liquidating their investments, mopping up dollars from the market and creating a surfeit of rupees. Cumulative net investment by FIIs had declined from \$9.03 billion at the end of May to \$8.9 billion by June 5. The sell-off and falling rupee have already affected the stock market, sending the 30-share Sensitive Index down 156 points on June 10. Although it is not fully discernible why the FIIs are selling fast and furiously, a few good reasons have been presented by various market analysts.

The 1998-99 budget of Finance Minister Yashwant Sinha has been identified as the main culprit. One market analyst pointed out that the 8% hike in import duties and the absence of any new incentives to encourage foreign direct investment have been interpreted by the FIIs to mean that under the present government, economic liberalization has been given a back seat.

According to a news report, a source at a leading investment bank said that the budget has led the country to a lower growth rate, and that sentiment has turned negative because "one is staring at a 10% inflation rate, alongside a depreciating rupee and later higher interest rate."

Failure to move a sluggish economy, which, at the same time, created fear among the FIIs of a higher inflation rate, was enough to discourage the investors, who are always looking for greener pastures. With the primary market showing no signs of revival and no expenditure clearances for large infrastructure projects in power, road construction, railroad, mining, etc., in sight, it is argued in some quarters that the FIIs will continue to unload their assets in the Indian bourses, and that this would lead to the decline of India's foreign exchange reserves in the short run.

Perhaps Finance Minister Sinha should not be the only one to blame for the depreciating rupee. India's nuclear tests in mid-May invited sanctions from the United States, India's leading trade partner, and Japan. While the direct impact of these sanctions may be bearable, some indirect consequences are bound to be uncomfortable, unless New Delhi deals with them adroitly. For instance, the World Bank has already postponed consideration of loans totalling almost \$1 billion. The European Union has imposed anti-dumping duties on Indian exports of antibiotics and steel bars.

While it is certain that the country's minuscule foreign trade—India's total trade is close to only \$50 billion—does not make or break the economy, India has a foreign debt of about \$90 billion, and the continuing depreciation of the rupee boosts the debt burden daily. In addition, of course, India is steadily becoming a nation with perpetual trade imbalances. To pay the foreign debt and meet the trade imbalances caused by depressed exports and growing imports, India will require more and more foreign exchange. The Finance Ministry may find no cause to worry now, but Sinha's budget showed no signs of turning back the tide.