Concerns with Rupee depreciation

Why in news?

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The Union government announced a list of measures to arrest the sharp decline in rupee recently.

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What are the measures proposed?

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- **Imports** - Steps would be taken to curb the import of non-essential goods and encourage the export of domestic goods to address the rising current account deficit.
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- The non-essential import commodities will be decided after consultations with concerned ministries and will be WTO-compliant.
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- **FPI limit** - Restrictions will be removed with respect to FPI exposure limit of 20 percent in corporate bond portfolio to a single corporate group or company or entity and 50 per cent of any issue of corporate bond.
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- **Masala Bonds** - Indian borrowers will be encouraged to issue rupee-denominated 'masala bonds' to facilitate the inflow of dollars and de-risk the economy from fluctuations in the exchange rate.
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- Also, the current withholding tax of 5% on Masala bonds issued till March 2019 and the restrictions on Indian banks on marketing and under writing of masala bonds would be removed.
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- **External commercial borrowing**[ECB] – The manufacturing entities will be permitted to avail ECB facility with minimum maturity of one year, instead of the earlier limit of three years.

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What are the fundamental reasons behind the decline of the rupee?

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- **Devaluation** – It generally decreases the price of exports in foreign countries and provides a boost to exports by making them more competitive.
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- Correspondingly, volume of imports in the domestic economy would be reduced by makingimports more expensive.
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- But since several countries are devaluing at the same time, India is neitherbenefitting from their exports being cheaper abroad nor will there be a huge fall in imports.
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- **Alternate Energy** –Failure in finding sustainable domestic sources of energy to address the over-reliance on oil importscreates tremendous stress on CAD.
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- **Inflation** - The depreciating rupee is also a symptom of persistently higher domestic inflation in India.
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- For instance, the rupee has lost about 60% of its value in the last 10 years against the dollarin line with vastly different inflation rates between the two countries.
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- **Ripple effects** – Crude oil price hikes increases the cost of transportation of goods being transported by road, including food items, it creates ripple effects on rising **food inflation** in the country.
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What can be done to overcome this?

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- A long-term plan to remove policy barriers in the promotion of export oriented sectors needs to be framed.
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- Excise duties could be lowered by the Central government when crude oil prices get high, so does the state governments in the form of VAT.
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- The RBI could offload large amounts of dollars and increase its supply to

check the appreciation of the dollar.
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- Also RBI’s intervention in the foreign exchange market from time to time to manage a soft landing for the rupee has to be continued.
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- A well thought out rate increase by MPC should be carried out since it could make FPI’s pull out of Indian stocks and affect the profitability of companies.
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- Borrowing from NRIs by floating **special NRI bonds** with maturity periods of at least three years could also be made to address investment outflow.
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- Thus, though the government has tried to incentivise debt creating capital inflows through its proposed measures, it does not augur well for the economy in the medium- to long-run.
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Source: The Hindu

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