



Depreciation of Emerging Market Currencies

What is the issue?

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- In recent times currencies of emerging economies has witnessed a significant fall in its value.

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- The depreciation of a host of emerging market currencies suggests that there is a global factor at play.

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What is the status of emerging market's currency?

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- The value of the rupee against the dollar has fallen by more than 5% since the beginning of 2018, and the currency now trades at its lowest in more than a year.

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- Other emerging economies like Indonesia, Argentina, Mexico and Turkey have seen a fall in their currencies.

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What is the reason behind the fall of currencies?

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- The U.S. Federal Reserve is expected to tighten its monetary policy stance by taking steps towards slowing down the growth in U.S. money supply.

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- A slowdown in U.S. money supply growth affects the value of other currencies in two ways.

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1. Interest rates in the U.S. will begin to rise as the Fed's demand for various assets begins to drop.
2. Fed begins to tighten money supply, the availability of dollars in the global market is likely to turn scarce, compared to other currencies.

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- Both these factors affect the price at which traders, who try to speculate on future retail demand, are willing to buy the dollar using other currencies.

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What are the implications for India?

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- The fall in the value of the rupee means that buyers are now having to shell out more rupees to purchase dollars.
- The fall in the nominal value of a currency in itself does not suggest that its holders are worse off.
- If the real value of the dollars bought with the currency were to increase sufficiently, their effective purchasing power would still be intact.
- In the present case, however, the depreciation of the rupee is due to a fundamental change in investor attitude to the rupee for the worse.
- Depreciation of the rupee could affect the expected returns of people who invest across borders.

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- A stronger dollar will causes a rush among investors to sell their assets in India and invest the money in the U.S., where they could earn higher returns.

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What measures needs to be taken?

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- One major factor determining a currency's exchange rate is its relative scarcity vis-à-vis other currencies.

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- Since central banks are the sole suppliers of national currencies, they can influence the value of their currencies by appropriately regulating their supply.

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- Another factor that determines a currency's exchange rate is the benchmark interest rate, which can be used as a tool to directly attract capital into the country and prop up the value of its currency.

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- The Reserve Bank of India can affect both the money supply and domestic interest rates simultaneously through its monetary policy stance.

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- Yet another common way to prop up a currency is through the direct intervention of the central bank in the forex market.

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Source: The Hindu

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