Frontier
Vol. 44, No. 37, March 25-31, 2012

COMMENT

Declining Rupee

A DOLLAR WAS PURCHASED IN FIVE rupees in the sixties. At that time India was treated as one of the poorest countries. The Government of India was feeding people with wheat imported from the United States. Today a dollar is purchased for about 50 rupees. Yet India is recognized as an emerging global power. Then India is exporting food grains. Comparison between then and now shows that decline of the rupee and rise of India have gone hand in hand. Reason is that in the past, at least, the government printed notes to make highways and set up factories. Printing of notes led to devaluation of the rupee while establishment of factories led to economic growth. The real question is whether the government will continue to use the printed money for productive purposes.

The *Economic Survey* published by the Ministry of Finance shows Wholesale Price Index of 14.3 in 1970 and 130.4 in 2010. Prices have risen about 9 times in the last 40 years. The rupee has fallen about the same. A dollar was exchanged with five rupees in 1970. Today it is exchanged about 45 or 50 to a dollar. Indeed, the fall should have been a bit less. Depreciation of the US dollar due to inflation in America should have led to some appreciation of the rupee. Other factors appear to have overwritten this latter tendency.

The declining trend of the rupee was arrested in the last ten years because of inflow of dollars, courtesy FIIs. Inflow of dollars led to an increase in the supply of the greenback in India's forex markets, decline in the value of dollar and a corresponding increase in the value of rupee. Thus the rupee was stable at about Rs 45 between 2002 and 2010 despite 7-12 percent domestic inflation.

The steep decline of the rupee since July has less to do with the domestic economy and more to do with global factors. The European crisis has shaken confidence of global investors in the Eurozone. Greece, Italy, Ireland and Portugal do not seem to have any clue about how they will repay the huge accumulated debt. They cannot devalue their way out of the crisis-tied as they are to the common currency. And it is very difficult to reduce wages of government employees or to downsize. They are simply stuck with the huge expenditures committed in the eighties and nineties. They are borrowing yet more and trying to roll over the debt. That is not a solution.

The looming European crisis has led to the global investors jettisoning the euro in favour of the dollar. A strange spectacle is unfolding before the eyes of all. Downgrade of the US securities last year was followed by yet greater demand for the same. That does not extinguish the downgrade. It only indicates that the downgrade in the Euro is much greater. Thus, among the two major currencies, investors are dumping the very-weak euro in favour of less-weak dollar. This has led to huge demand for dollars and appreciation of that currency; and a parallel fall in the rupee as measured against the dollar.

The rupee was not affected much by the American economic crisis of 2008. The rupee retained its parity against the dollar which means that it declined in real terms as the dollar slid. That decline in the rupee was real but went unnoticed. □□□