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Falling Rupee and Devalued Yuan

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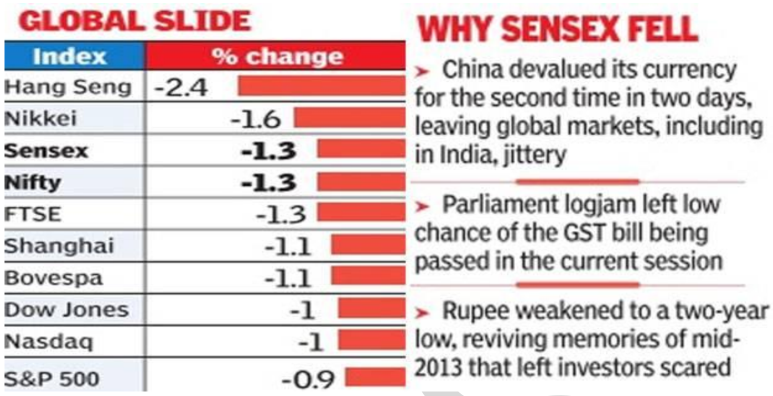
1 Introduction

Recent devaluation of the Yuan by People's Bank of China sent shock waves in the global market. Most of the Asian currencies experienced slide in exchange rates. Stock exchanges across Asia fell sharply in a reaction to the devaluation. Indian currency, the Rupee, fell sharply by approximately 3%. It is worst fall since the currency crisis in 2013. The competitive devaluation by some export driven countries is putting pressure on already fragile global economy. The uncertainty created by devaluation demand planned response to cushion Indian economy from such shocks.

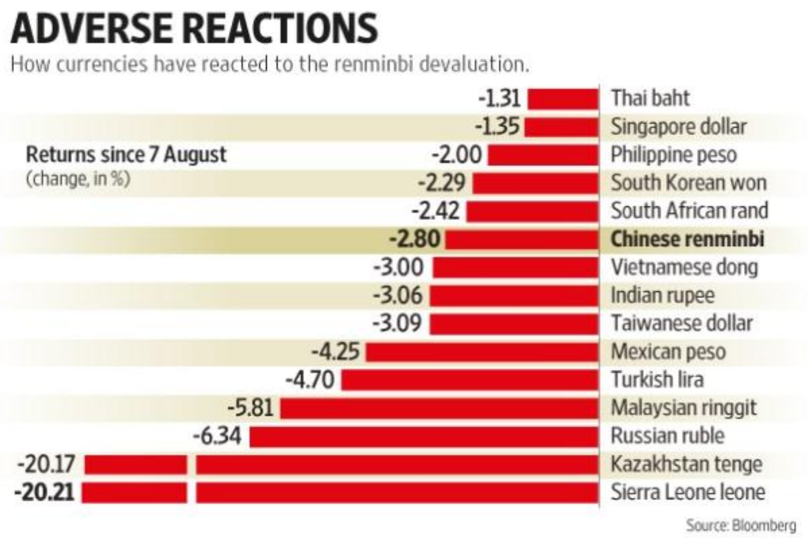


2 Why Yuan devalued

The global and domestic factors mandated the present cycle of devaluation of the Yuan by China.

2.1 Global Factors

- **Trade competitiveness**: Chinese economy is export driven. The recent trend of fall in export worldwide has put this growth story in a fix. A weaker currency is intended to make its manufactured products cheaper for other countries to buy, and help its exporter race ahead of competitors in a world market.
- **Inclusion into Special Drawing Rights (SDR):** Chinese currency is expected to be included in the global basket of currencies in coming months. PBOC has said that the devaluation is a planned move towards making the Yuan more market-determined so that it could shortly qualify for inclusion in the International Monetary Fund's SDRs.
- **Competitive Devaluation:** It is a condition in international affairs where countries compete against each other to achieve a relatively low exchange rate for their own currency. As the price to buy a country's currency falls so too does the price of exports. The current devaluation is seen as a response to Japanese and Korean devaluation in recent past.



2.2 Domestic Factors

- **Failure of Re-balancing Act:** The export-led model gave China record-breaking growth in last two decades is unsustainable given the limited capacity of other countries to absorb the exports. China tried to rebalance decline in exports by driving domestic demand through infusion of debt to infrastructure development. It led to bubbles in stock market and property sector. As rebalancing approach reached its limits, China is trying old tricks of making exports competitive by devaluation.

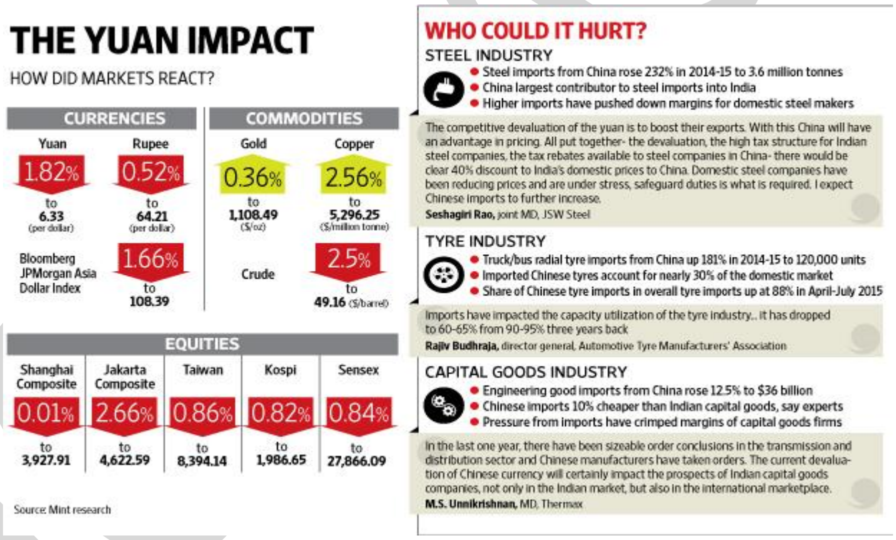
3 Reasons for Rupee Fall

- The rupee's fall reflects anxiety about the negative impact on the Indian economy of the falling Yuan.
- The fall in the Yuan implied that more depreciation could be in the offing. This raised dollar demand globally, including in India, weakening the rupee. As exchange rates are a function of demand and supply, fall in the Rupee is warranted to adjust to the changes market conditions.
- Rupee depreciation is necessary to keep the threat of cheap Chinese imports into the domestic market at bay.
- However, some experts argue that Rupee fall is not exclusively due to the Yuan devaluations. The disappointment over key reforms like Goods & Services Tax (GST) and disruptions in the Parliament aggravated the fall.

4 Challenges and Opportunities for India

4.1 Challenges

- **Trade competitiveness:** Devalued Yuan hurts the Indian exports worldwide. The exports from China become cheaper as compared to Indian goods. It will aggravate situation for already declining exports.
- **Domestic Industries:** Devalued Yuan makes import from China cheaper. It leads to rise in import of cheaper Chinese goods into Indian market thereby hurting the domestic manufacturers and industries. Steel industry, tire industry and range of other consumer as well as capital goods industries will be hurt most.



- **Dumping in Indian Markets:** When goods are sold below cost of production or prices of product in the country where it is produced, it is called as dumping. With devalued Yuan and increased profit margins as compared to Indian goods, dumping of goods from China will be experienced in near future. This adds to the vows of domestic industry.
- **Impact on Foreign Direct Investment:** As China gains advantage in exports, it becomes attractive destination for the foreign investment. The 'Make in India' to boost FDI in India will be hampered in near future in China continues to devalue its currency.
- **Inflationary pressure**: Yuan devaluation will force India to depreciate its currency further to stay competitive in global markets. If depreciated, it will lead to import of inflation into India as input cost for raw material and energy products will rise. The monetary consolidation achieved by the Reserve Bank of India (RBI) will be disturbed thereby dampening investment climate. Decline in investment will affect the economic growth.

4.2 Opportunities

- **Export push:**
  - Depreciation of Indian currency is expected, if Yuan falls further. It will enhance the profit margin for exporters. Information technology, pharmaceuticals, oil products will benefit from this depreciation.
  - The weaker Yuan would help make China's exports more competitive, which would likely to help boost the China's economy and eventually prompt a recovery in economies from where China

imports. Indian exports raw material and range of products to China. They will experience rise in volume in this scenario.

- **Growth differentials**: Chinese and Indian economies are in two different parts of the stage. China is consolidating, having grown with an aggressive pace for over 15 years. India is embarking on a growth phase that can last for the next decade. So, they are in a completely two different segments of growth. So, from an economic point of view, India is really well positioned to deal with volatile market conditions.

5 Response to the Devaluation by India

- **Steps taken by the Government:**
  - To protect exporters, Government must provide concessions to manufacturers and industries. Exporter's associations are already up in arms for more concessions to stay competitive in international market.
  - Government should activate anti-dumping measures to prevent flooding of Indian markets with cheaper Chinese goods. Government hiked the import duties on steel product to protect domestic manufacturers from devaluation.
  - India could emerge as a more stable investment opportunity if it is able to pursue economic reforms and improve its business climate. Government's decision to relax the foreign investment norms in 15 sectors is welcome step to deal with Yuan Devaluation.
- **Steps taken by RBI:**
  - RBI must curb the currency swings with help of accumulated foreign exchange reserves. It will cushion the corporates exposed to the currency volatility.
  - The policy rates must be reviewed in light of the current trend. When globally rates are almost negligible, having high rates may end up attracting hot money, which will desert quickly on developments such as devaluation of the Yuan.

6 Conclusion

India is quite well-positioned to benefit from the current - and, possibly, ongoing - global uncertainty. The long overdue restructuring of PSU bank management is a welcome move; Goods and Services (GST) would be another. Strong Macro-economic indicators and less reliance on trade with China will benefit India in near future. India needs accelerate the reform process to make the domestic atmosphere favorable for investors.