India: Plummeting rupee sparks fears of current account crisis

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India's currency is again trading below 60 rupees (Rs.) to the U.S. dollar—a level widely considered a significant "psychological benchmark."

On June 26, the rupee hit an all-time low of Rs. 60.76 to the dollar. As a result of intervention by the Reserve Bank of India, positive investor reaction to the government's announcement that it will double natural gas prices as of April 2014, and Unilever's decision to buy up all outstanding shares in its Indian subsidiary, the rupee rose in value late last week. But India's currency has resumed its slide this week, again breaking through the 60 rupees to dollar benchmark.

Since April, the value of the rupee has depreciated by more than 10 percent.

India's Congress Party-led United Progressive Alliance (UPA) government has responded to this slide by putting on a brave face. It insists that India's economic fundamental are strong and has pledged to quickly bring forward further "economic reforms"—a euphemism for social spending cuts and further concessions and incentives for investors and speculators.

Behind the scenes, however, there are increasing fears within ruling class circles that the rupee's plummet could cascade into a current account crisis. In May, a commentator in the *Business Standard*, noting that India's current account deficit is now the highest it has been since 1991, said that if Indian Prime Minister Manmohan Singh "left office tomorrow, he might be remembered less for his response to the crisis of 1991 than causing the crisis of 2013."

In a revealing comment that underscores the government's dependence on and subservience to foreign capital, Finance Minister P. Chidambaram declared last month, " I could not agree more with Fitch when it said more reforms are needed."

Fitch refers to the Fitch Credit Rating Agency. Along with other global credit rating agencies, it has been placing relentless pressure on India over the past two years to dramatically accelerate measures to reduce the government's burgeoning budget deficit at the expense of working people and to remove all remaining barriers to foreign investment. Fitch, Moody's and the other rating agencies have repeatedly threatened to downgrade India's sovereign credit rating, which currently stands at one notch above junk bond status. Investors, meanwhile, have voted with their dollars. In the 2012-13 fiscal year, which ended March 31, Foreign Direct Investment (FDI) was off 38 percent from 2011-12.

In recent weeks Chidambaram has declared the government is committed to increasing the prices of domestically produced natural gas and coal and to lifting caps on FDI in the pharmacy, telecom, media and military manufacturing sectors.

Since coming to power in 2004, the UPA has aggressively pursued a rightwing pro-market and pro-foreign investor agenda, slashing taxes for big business and pressing forward with Public Sector Unit disinvestment. At the same time, it has sharply increased the burdens on workers and the rural poor by repeatedly hiking the price of petrol, diesel and cooking gas. Last September, facing what it thought was an imminent threat of a credit rating downgrade, the Congress-led UPA introduced a package of "big bang reforms," including opening up the multibrand retail sector to foreign giants like Wal-Mart and Carrefour.

While international capital warmly applauded the "big bang reforms," their impact on financial markets and investment inflows proved short-lived.

Recent weeks have seen a widespread selloff in Asian currency markets because of fears that US monetary authorities may scale back the availability of dollar funds at near-zero interest sometime next year. But the rupee has the dubious distinction of being Asia's worst "performing" major currency. It has also fallen sharply with respect to other currencies such as the Euro, the British Pound and the Japanese Yen.

India's central bank, the Reserve Bank of India (RBI), intervened in the FOREX market several times in June, selling dollars so as to drive up the value of the rupee. But the RBI is not in a position to mount a sustained intervention.

It has seen its reserves fall to around $290 billion from an all-time high of $321 billion in 2011. This is barely enough for 7 months of imports and is down significantly from 2008, when the RBI possessed enough reserves for 15 months of imports. In contrast, the Chinese regime has accumulated a mountain of $3.2 trillion in foreign currency reserves.

Despite the severe hammering the rupee has sustained, a recent report released by the Japanese brokerage firm Nomura Securities claimed that the rupee is still overvalued by a massive 17 percent. If true, this indicates that the rupee should be trading at over Rs. 70 to a dollar, which would represent a decline of over 60 percent from the 44 Rs. to a dollar level at which it traded as recently as July 2011.

According to press reports, foreign investors sold a net $7 billion of Indian debt and equity in June putting significant pressure on the rupee.

The immediate cause of the steep fall in the value of the rupee were the recent remarks by U.S. Federal Reserve Chairman Ben Bernake that if "economic conditions" in the US continue to improve the US's central bank might scale back its "Quantitative Easing" (QE) program, beginning in 2014.

The fact that a mere suggestion by Bernake that the Fed could scale back QE created such havoc in the Indian FOREX markets reveals the utter dependency of the Indian economy upon the flow of short-term funds from financial speculators who are parasitically dependent upon the Fed to keep providing what amounts to gambling funds to make quick profits.

The other financial "tool" available to the RBI to bolster the value of the rupee is to increase domestic interest rates. But restricting credit would dampen economic activity under conditions where India's economy is already suffering from anaemic growth.

In the fiscal year ending last March, the Indian growth rate fell to 5 percent, its lowest since 2003. Previously, it was taken for granted by the Indian elite that the economy would grow between 8 and 9 percent, a level it considers essential to maintaining social peace.

Because of the steep fall in the growth rate, domestic big business and the Congress-led government have been pressing the RBI to reduce short-term interest rates. But the RBI fears that reducing interest rates will fuel inflation, which is already running in double digits at the retail level.

The rapid depreciation of the rupee greatly compounds this problem. In June, the RBI left the Repo rate, the rate at which it lends funds to commercial banks, at 7.25 percent.

India's CAD (Current Account Deficit)—which is the difference between imports and exports of goods and services and all monetary transactions such as interest earned on investments and deposits—reached a record high of 4.8 per cent of GDP (Gross Domestic Product) in the fiscal year ending March. CAD has increased because India's exports have been hard-hit by the world economic crisis, especially the recession in Europe. India imports 80 percent of its petroleum requirement, machinery and high-end consumer goods, while exporting IT services, jewellery, textiles and iron ore.

Attracting the foreign currency—mainly dollars—needed to finance the CAD has become a preoccupation of the Indian elite. In a desperate attempt to attract foreign funds the UPA government has undertaken several reckless measures such as dismantling regulations which restricted the inflow of "hot money," i.e. short-term speculative funds that can be pulled out as easily as they enter.

The RBI, in its latest semi-annual "Financial Stability" report, expressed unease over both the size of the inflows needed to bridge the CAD and India's increasing dependence on such "hot money": "In addition to the magnitude of flows needed to finance the CAD, the composition of flows, particularly dependence on portfolio and short-term debt flows, represent an added source of concern."

The vulnerability of the Indian economy to a balance of payments crisis is increasingly drawing comparison to the situation faced by the Indian government in 1991. At that time India's foreign currency reserves fell to a level barely enough to cover a few weeks of imports. This prompted the Indian elite to turn to the International Monetary Fund for an emergency loan. In return, the Congress Party government decisively abandoned state-led economic development and moved to fully integrate India into the world capitalist economy by transforming the country into a cheap-labor haven for international capital.

Another major worry for India's elite and one that is being heightened by the rupee's depreciation is the increasing reliance of India's corporate sector on foreign borrowing. India's companies have greatly increased their overseas borrowing, with the aim of taking advantage of record low interest rates in the US, Europe and Japan. But dollar denominated "cheap money" can quickly be transformed by the rupee's slide into massive losses. As a percentage of the RBI's foreign currency reserves, India's short-term debt has increased from a low of 5.1 percent in 2002-03, to 14.8 percent in 2008-09, and 31.1 percent at the end of 2012.