Indian rupee and economy in free fall

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India's central bank, the Reserve Bank of India, mounted a major intervention in foreign exchange markets Tuesday after the India rupee—which has depreciated by more than 15 percent since May—crashed through the 64 rupee per US dollar mark.

Even with the intervention, the rupee closed at a record low of 63.25 Rupees (Rs) to the dollar. This was half a rupee lower than its close on Monday, when the rupee depreciated by 2.3 percent. As recently as the beginning of May, the rupee was trading at around 54 rupees to the dollar.

India's principal stock index, the Bombay Stock Exchange's Sensex, meanwhile, fell by 1.2 percent Tuesday to close at an 11-month low.

While the Congress Party-led United Progressive Alliance is publicly dismissing the rupee's fall as a bad patch and continues to claim that higher economic growth is just around the corner, there is a growing sense of foreboding, if not desperation, in government and ruling class circles.

In the corporate media there is widespread discussion of whether India could soon confront a current account crisis akin to that in 1991, when India was forced to seek an emergency bailout from the IMF.

Over the past three months as the rupee has depreciated, the government has announced a series of measures aimed at attracting foreign capital—including removing or lowering foreign investment caps and further reducing government spending at the expense of working people. But these have failed to arrest the rupee's slide.

The immediate trigger for India's currency crisis were the comments made on May 22 by U.S. Federal Reserve Chairman Ben Bernanke that the U.S. central bank may soon pare back its $85 billion per month bond-buying program. Nervous overseas investors responded by pulling more than $11 billion dollars out of Indian stocks and bonds.

More fundamentally, the crisis is rooted in a dramatic slowing in India's economic growth and its growing, massive dependence on inflows of foreign capital to meet its current account deficit. In the last fiscal year, which ended March 31, India recorded growth of 5 percent, the lowest in a decade, and far less than the minimum 8 percent needed to prevent a rapid rise in unemployment.

Sections of corporate India have been pressing for the Reserve Bank of India (RBI) to abandon its reputed preoccupation with curbing inflation, which at the retail level is currently close to 10 percent, and lower interest rates so as to stimulate economic growth.

Instead, to stop the rupee's slide, the RBI has tightened liquidity, thereby driving up the cost of credit and further undercutting economic growth, and has sold off dollars, drawing down its foreign exchange reserves to about $277 billion.

On Tuesday, the yield on India's 10-year government bond reached 9.42 percent, before falling back to 8.92 percent. The bond yield is the highest rate reached since Aug. 1, 2008 just a month and a half before the eruption of global financial crisis and will mean an already financially beleaguered government has to pay more to borrow money. In recent weeks foreigners have been selling Indian government debt and now reportedly hold just 43 percent of a government limit of $30 billion.

In a further attempt to stem the rupee's slide and the depletion of its foreign currency reserves especially US dollars, the RBI imposed capital controls on August 14. Henceforth Indian corporations—with the notable exception of large government-owned enterprises or PSUs (Public Sector Units)—will not be allowed to invest more than 100 percent of their net worth (assets minus liabilities) outside the country in any year; individuals will be restricted to a maximum of $75,000. Prior to this, the annual ceilings were 400 percent and $200,000 respectively. The import of gold coins, which the government claims has contributed to the current crisis, has been banned.

Speaking last week, Indian Prime Minister Manmohan dismissed the mounting apprehensions of a current accounts crisis, by noting that in 1991 India had reserves equivalent to only a few weeks of imports. "Now," he

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affirmed, “we have reserves of six to seven months. So there is no comparison.”

The reality is very different. India’s economy is exponentially more connected to the world capitalist economy today than 22 years ago and world capitalism is riven by imbalances and contradictions that have given rise to greatest crisis since the Great Depression—a crisis that five years on is no closer to resolution that when it erupted in 2008.

India’s current accounts deficit reached $87.8 billion, 4.8 percent of the Gross Domestic Product, in 2012-13 from a mere $2.5 billion (0.4 percent of GDP) in 2004-05. As a recent article in the *Economic and Political Weekly* observed, this deficit can be traced to India’s merchandise trade deficit that has shot up from $33.7 billion (5.5 percent of GDP) in 2004-05 to a gargantuan $190.9 billion (10.6 percent of GDP) in 2012-13.

India’s exports have stagnated over the past year as the economic crisis has led to a steep fall in demand for goods and services in Europe and North America. The cost of India’s imports, which are dominated by petroleum and gold, have in the meantime shot up, and the fall in the value of the rupee will push them higher still.

Over the past several years, India has financed much of the current accounts deficit through short-term debt. As the *Hindu* observed in an article in late June, the total short term-debt due before March 31, 2014 now amounts to a staggering $172 billion. The payment of this debt will consume over 62 percent of the foreign exchange reserves. In contrast the debts that were falling due within one year back in 2008 March amounted to a mere $54.7 billion, about 17 percent of the reserves at that time.

The crisis enveloping the Indian economy has caused increasing friction between the Congress-led Indian government and the RBI. While the former has repeatedly made known its preference for interest rate cuts aimed at boosting growth, the RBI has resisted, arguing that inflation needs to be contained and that a further erosion of the rupee’s value, will, by driving up energy costs—India’s imports three-quarters of its petroleum—severely dampen growth. Although it has not dared say so publicly, the RBI is also clearly concerned that if it is not seen to be vigorously defending the rupee, its value could plummet sending the entire economy into a tailspin. Also, it is acutely aware of the large foreign borrowings India’s corporate giants have contracted, seeking to take advantage of the much lower interest rates that have prevailed in the U.S. and Europe since 2008. Under conditions where the rupee is rapidly depreciating, such “cheap money” loans quickly turn into their opposite.

The conflict between the RBI and the government reflects the fact the Indian economy is now caught between a proverbial rock and a hard-place, with the Indian elite facing a choice between trying to boost economic growth by letting the rupee slide still further, thereby fueling growth-sapping inflation or defending the rupee by tightening credit and thereby further squeezing economic growth. And in the background looms the threat of a rapid depletion of India’s reserves as foreign capital spurns a crisis-ridden economy.

Mouthpieces of foreign finance capital such as the *Financial Times* are urging the Indian government to seize on this crisis as an opportunity to implement further “economic reforms,” i.e. to intensify the exploitation of the working class, by slashing social spending and dismantling labor and other regulations that stand in the way of investor profits.

In a recent article on the economic problems afflicting India, the paper stated: “Curbing subsidies by raising fuel prices by as much as Rs5-Rs6 a litre would be a reassuring signal that India is committed to tackling the ‘twin’ fiscal and current account deficits now pressuring the currency.”

This step according to the IMF’s (International Monetary Fund) resident agent in India, quoted in the same article: “would give investors a lot of encouragement. It would show that even in the midst of a pre-election campaign [a general election is scheduled for April-May 2014], you have the guts to do the right thing.”

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