

India: Plummeting rupee fuels fears of banking crisis

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After sinking to an all-time low of 65.56 rupees to the US dollar in trading Thursday, India's currency staged a modest recovery, closing Friday at 63.20 rupees per dollar.

While India's corporate media breathed a huge sigh of relief, many financial analysts said a major factor in the rise was a large selloff of dollars by state-owned commercial banks, a move they attributed to instructions from India's central bank, the Reserve Bank of India (RBI).

On Thursday, Finance Minister P. Chidambaram, the RBI's outgoing governor, D. Subbarao, and the man who will replace him next month—former IMF chief economist and US Federal Reserve Board advisor, Raghuram Rajan—held a hastily organized three hour meeting to discuss the rupee crisis.

Following the meeting, Chidambaram and Subbarao held back-to-back press conferences at which they argued that the rupee's decline has been fueled by "excessive or unwarranted pessimism." "There is no cause," declared Chidambaram, "for the panic that seems to have gripped the currency market and that is feeding other markets."

Both the finance minister and RBI governor pledged that India will not introduce further capital controls, "including controls on repatriations" of the earnings of foreign investors. These statements were an implicit admission that the limits imposed last week on Indians transferring assets overseas backfired, as they caused foreign investors, fearful that they might be next, to withdraw funds from India.

Since May, the rupee has depreciated by more than 15 percent, despite increasingly desperate efforts by the Congress Party-led United Progressive Alliance government and the RBI, to arrest the slide. The government has removed or scaled back limits on

foreign investment in a dozen sectors, pledged to accelerate the introduction of other pro-investor "reforms," and announced budget "deficit consolidation" measures, including the doubling of natural gas prices next April. The RBI resisted pressure from manufacturers to lower interest rates to stimulate a badly flagging economy, then in recent weeks tightened credit. On August 14, Indian authorities imposed limits on the amount of money that domestically-owned companies and Indian residents can send out of the country, as well as measures to restrict gold imports.

While the rupee's plummet has been triggered by the expectation that the US Federal Reserve Board will soon curtail its "cheap credit" policies, the more fundamental cause is the sharp decline in India's growth rate and the interrelated fall in long-term foreign investment. With exports hard hit by the recession in Europe and anemic growth in the US, India's economic growth rate fell to just 5 percent in the 2012-13 fiscal year, the lowest in a decade. Foreign investors have soured on India, with a crescendo of complaints about poor infrastructure and the government's reputed lack of resolve in imposing unpopular "pro-market policies," including gutting restrictions on the layoff of workers.

The government has tried to project a public image of calm in the face of the rupee's plummet. But behind the scenes fear, if not outright panic, prevails. The Indian press has been full of warnings that India could soon face a current accounts crisis, due to a mammoth trade deficit and a huge increase in short-term corporate and government debt.

In its March budget, as part of its efforts to convince bond-rating agencies not to slash India's credit-rating to junk bond status, the government pledged to significantly reduce the Current Accounts Deficit

(CAD) from the record high of 4.8 percent of GDP recorded in 2012-13. At the end of July, Chidambaram baldly vowed that the CAD will be held to 3.7 percent of GDP in the current fiscal year.

The continuing fall in the value of the rupee is not only making Chidambaram's vow appear less and less credible, it is threatening India's economic prospects as a whole. The depreciation of the rupee is driving up the cost of India's imports—most importantly of oil (India imports more than three-quarters of the oil it consumes) and of the advanced machinery it needs to equip its export-oriented manufacturing sector—and thereby increasing the country's trade and current accounts deficits while fueling inflation and dampening economic growth.

After it was reported last week that Finance Minister Chidambaram had met with the Indian executive directors of the World Bank, International Monetary Fund, and Asian Development Bank, the press suggested this might be preparatory to seeking IMF support. In an interview with *Le Monde*, former RBI deputy governor Subir Gokarn said an IMF loan was “an option” for Indian policy makers in their current predicament.

The threat of a current accounts crisis is real and mounting, but it is far from the only threat looming over the Indian economy. India's banking system is burdened by a growing number of “non-performing loans.” Moreover, many of these loans are to corporations that have borrowed money in the US and European markets, where interest rates have been much lower than in India. With the plummet in the value of the rupee, these dollar-denominated loans have suddenly become a major liability, threatening to wreak havoc with corporate balance sheets and those of India's banks.

A recent report by Credit Suisse found that ten major Indian business houses, including such stars of India Inc. as Reliance Industries and Vedanta, have total debts of around \$100 billion, a 15 percent increase from last year. “Many companies' loans are 40-70 percent foreign-currency dominated,” observed the report, “therefore, the sharp depreciation of the rupee is adding to their debt burden.”

India's banks have extended these same ten companies loans equal to 13 percent of all the loans on their books—meaning they threaten to be caught in the

same vise.

With these and other major Indian companies struggling due to the world economic crisis, India's state banks, with the RBI's blessing, have systematically “restructured” corporate loans by extending the period of the loan, reducing the interest rate, or by even taking a “haircut.”

Whereas the banks must put aside funds equivalent to 15 percent of “non-performing” loans, they are required to have reserves equivalent to just 2.75 percent of “restructured” loans. According to one banking analyst this amounts to a “giant Ponzi scheme” through which India's banks have hidden huge potential losses.

Even so, the State Bank of India, India's largest bank, reported that its non-performing loans for the April to June quarter increased to 5.6 percent of total loans, a steep increase from 4.8 percent at the end of the previous quarter. This statistic is symptomatic of the whole banking sector, whose “asset-quality” has progressively decreased as the economic growth rate has taken a nosedive.

Whatever the fate of the rupee in the days immediately ahead, it is evident that India is in the maelstrom of the world capitalist crisis. The coming period will see a rapid intensification of the class struggle as the Indian elite and international capital seek to force the working class and rural poor to pay for the bankruptcy and irrationality of the profit system.



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