



De-Dollarization Paves Way for Stronger Rupee

Description

INDIA: The Reserve Bank of India's (RBI) decision to permit the rupee in global trade is a precursor to making it an international currency. The RBI said the move was to "support the increasing interest of global trading companies". Although the convertibility is limited to current account, which means partial convertibility, the attempt by the RBI demonstrates India's readiness to move toward full convertibility .

Even though the decision was taken amidst the alarming fall of the rupee against US dollar, the RBI's decision is a challenge, given the fact that the strong macroeconomic fundamentals will insulate the rupee. The sharp bounce back in the economy with the fastest recovery growth in the world is a case in point. The GDP of India is forecasted to pitch 8 percent growth in 2022-23, after a fall by 7 percent in 2021-22. India is expected to excel Chinese growth, which is forecasted at 4 percent over the same period.

The paradox of the rupee fall against US dollar is that it appreciated against all other major currencies, such as the Japanese Yen, Euro and UK's Pound Sterling. In other words, the reflects that the fall of rupee is not due to the weak health of the economy. The reality lies with the flight of the capital by USA investors in FPI due to high interest rates by Federal Bank. Between February – June 2022, the rupee fell by over 4 percent against the US dollar. On the contrary, it appreciated by 2.8 percent against the Euro, 10.4 percent against Japanese yen and 3.3 percent against Pound Sterling.

De-dollarization has emerged a new wave in the global trade after it was alleged that USA was weaponizing the dollar to exert influence in world political landscape. Trade analysts argued that the imposition of sanctions and the exclusion of SWIFT (Society for Worldwide Interbank Financial Telecommunication) triggered the wave. Currently, 70 percent of global trade is routed through the US dollar and 60 percent of the world foreign exchange reserve is stacked in US dollars.

De-dollarization is a challenge against US dominance in currency-led influence. The Chinese argued that the US dollar gives disproportionate power to exert influence in the global economy. Eventually, the power of US dollar was used to dump the economy of US unfriendly countries. Chinese media Xinhua jeered, “US financial hegemony backfires as countries opt for de-dollarization”.

As a result, the share of US dollar in global foreign exchange reserves tapered. The IMF economist, Desmond Lachman, in an article wrote, “the share of US dollar assets among foreign exchange reserves has dropped to a 25 year low”

The fall of US dollar significance led unfriendly nations like China and Russia to adopt alternatives to the dollar. The Chinese government pressed trade partners, including Russia, to denominate some trade in RMB (Renminbi – a Chinese currency). It established a RMB trading centre in Hong Kong, Singapore and in Europe and created a cross border stock exchange connection programme that denominated some trade and investment in RMB. In 2016, the IMF included RMB in IMF SDRs (Special Drawing Rights), with China emerging as an important global trading partner.

Following suit, Russia accelerated its de-dollarization move in 2014, when the USA imposed sanctions on Russia for annexing Crimea in Ukraine. There are three ways Russia reduced its dependence on the dollar. First, the central bank of Russia cut reserves of the US dollar more than half between 2013 and 2020. Second, Russia held several discussions with China, India, Turkey and members of Eurasian Economic Union (Armenia, Belarus, Kazakhstan, and Kyrgyzstan) to give preference for trade in national currencies. In Q4 2020, Russian exports to BRICS, invoiced in US dollar, declined to 10 percent in 2020 from 95 percent in 2013.

Russia developed its own financial transfer system SPFS (System for Transfer of Financial Messages) – to allow US allies to pay for oil and gas in rubbles, after the USA called for Russian banks to be disconnected from Swift.

A close lens view reveals that a convertible rupee can gain strength at the behest of de-dollarization. As China – one of the top two trading partners of India – is tending towards de-dollarization and Russia is emerging a major crude oil supplier after the current oil shock, de-dollarization wave leverages new opportunity for the rupee to be stronger.

Besides that, a number of benefits can be derived from rupee convertibility. First, internationalization of the rupee will accelerate exports. Exports become more profitable by the convertibility. This is because as the rupee rate will be decided by the market foreign exchange rate and not by government intervention, the market rate is generally higher than official exchange rate fixed previously. Given this, exporters can get more rupees than foreign exchange, for example the US dollar, fixed officially before.

Second, rupee invoicing in trade will insulate foreign exchange risks. The import of crude oil is a case in point. Surge in crude oil imports, one of the major import burdens, is due to unprecedented rise in oil prices and fluctuation in the US dollar. In 2021-22, India’s import of crude oil increased by 93.5 percent in value. But, in quantity, it increased merely by 7.8 percent .

Third, it provides incentives to NRIs for remittances. Eventually, it helps in increasing foreign exchange reserves.

Days are ahead, the rupee could move toward full convertibility. Full convertibility means fully capital account convertibility in Balance of Payments. This opens the market for foreign investors, businessmen and trade partners. It encourages FDI flow and free flow of capital. Local business will have easy access to foreign capital market for loans at comparatively at lower rates.

Nevertheless, there is a catch. The rupee could be eclipsed by global volatility in currency markets. In such a case, it may also act to increase foreign debt.

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