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MC Explains | Will RBI let the rupee adjust to new lows?

The rupee opened at 78.51 per dollar and rose to 78.87 level, an all-time high, on June 28.

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MC Explains Will RBI let the rupee adjust to new lows? Experts say the sharp fall of the rupee can be attributed to the strength of the greenback and lower forward premiums, among others. <http://m.moneycontrol.com/mom>

Moneycontrol explains the reasons for the rupee's depreciation.

How much did the rupee depreciate?

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The rupee opened at 78.85 per dollar and slid to 78.95, an all-time high, during intra-day trade on Wednesday. On a weekly basis, the currency has depreciated 1.2 percent.

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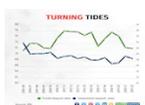


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Why is the rupee in a free fall?

Central banks led by the US Federal Reserve tightening interest rates globally, increases in crude oil and commodity prices, lower forward premiums and weakening forex reserves are some of the reasons experts cite for the rupee's fall.

As [Moneycontrol](https://d.docs.live.net/aec8cdc2fcfb23b8/Documents/The%20one-) (<https://d.docs.live.net/aec8cdc2fcfb23b8/Documents/The%20one->



year%20onshore%20forward%20premium%20narrowed%20to%20220%20paise%20on%20June%202022,%20its%20lowest%20level%20since%20December%202011. the one-year onshore forward premium narrowed to 220 paise on June 22, its lowest level since December 2011. Lower forward premiums push investors into other emerging markets with higher premiums, analysts say.

"Rupee is falling mainly in response to the US dollar strengthening. The US dollar is at a 20-year

high on the back of aggressive rate hikes by the US Federal Reserve. It is not just the Indian rupee, other major currencies like the euro and yen and most other emerging market currencies have weakened against dollar," said Rajani Sinha, Chief Economist at CARE Ratings.

What is the level the rupee can fall to in near-term?

Sinha says high commodity prices and the resultant widening of the current account deficit is putting pressure on the Indian currency.

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"On a-trade weighted REER (real effective exchange rate) basis, the rupee is still overvalued by around 2 percent compared to its long-term average. USD/INR could touch the 80 level in the near term," Sinha said.

Given that the dollar is likely to remain strong, the rupee has room to fall to the 79 level against the greenback, said Kunal Sodhani, assistant vice-president at Shinhan Bank.

"Only a closing level below 78.10 can once again bring the USD-INR pair in a consolidation phase," he said.

What will the RBI's plan of action be to arrest the rupee fall?

Dislocations in forward rates, falling foreign exchange cover, persistently high commodity prices and elevated rupee valuations may cause the Reserve Bank of India (RBI) to reorient its intervention strategy going ahead, securities firm Emkay Global said.

"The RBI has been supporting INR by strong interventions to counter the impact of outflows. This has led to a significant fall in forex reserves, but given a robust accumulation of the forex war chest over the years, INR has still been holding up better than EM peers, albeit with consistent interventions by the RBI," Emkay Global said.

"...allowing INR to gently weaken over time is the right strategy, giving CAD (current account deficit) space to improve. Thus, we believe the RBI may eventually let the exchange rate adjust to new realities, albeit (in) orderly (fashion), letting it act as a natural macro stabilizer..," it added.

Sinha has similar views.

"RBI will continue to intervene in the forex market to cushion the fall of the rupee. However, with all other emerging market currencies weakening against the dollar, RBI will let the rupee also to weaken gradually," she said.

Further rate hikes by the RBI, in line with the rate increases by the US Federal Reserve, will ensure that the US-India interest rate differential is maintained and that would prevent a further sharp weakening of the rupee, she added.

Is the rupee depreciation good for economy?

While the debate on correct valuation of the rupee continues, a steep currency depreciation can have significant impact on trade, create a potential balance of payments crisis and deter foreign investors.

For example, on February 28 (<https://www.moneycontrol.com/news/business/indian-corporates-brace-for-delay-in-receivables-defaults-as-russian-rouble-tanks-8177451.html>), the Central Bank of Russia raised its key lending rate to 20% from 9.50%, the sharpest rate hike since 2014, to compensate for increased depreciation and inflation risks.

"This is needed to support financial and price stability and protect the savings of citizens from depreciation," it said.

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