Caps on dollar outflows could just as easily backfire

Even though finance minister P Chidambaram's FY14 current account deficit (CAD) projection of $70 billion was much lower than the $80-85 billion of analysts, the minister looked the picture of absolute calm as he outlined his CAD-financing strategy on Monday. Analysts had projected a $20-25 billion financing gap for the year—with the FM's $11 billion capital raising programme, the gap looked like it was achievable, provided everything went to plan in the sense of exports rising, FDI coming in as projected, imports compressing, and so on. Indeed, given that other PSUs have also been asked to look at whether they can raise capital, the FM looked like his plans were on track. The problem with RBI's decision on Wednesday to compress overseas investments—to a fourth in the sense that companies can invest just 100% of their net worth as compared to 400% earlier—as well as its decision to slash the amounts individuals can take out each year from $200,000 to $75,000 is that it conveys a sense of panic. Given that outward investment by Indian firms was just $7 billion in FY13—it reached a high of $19 billion in FY09—RBI can't hope to be saving more than a few billion dollars, more so since Wednesday's order does not apply to oil sector PSUs. Individual remittances were $3 billion in FY13.

The markets can, on Friday, see this as a sign of panic, or they can see this as a sign of the RBI and government's resolve to protect the rupee. Given the currency has weakened by R2.12 to the dollar since RBI's first measures on July 15, it suggests markets are driven by a fear of a further fall due to the economy continuing to weaken, of the type suggested by the continuously contracting IIP and, for instance, sales of commercial vehicles and even consumer goods. In just the last five trading sessions, FIIs have withdrawn a little over $1 billion though the increase in 10-year government bond yields was similar to the fall in the value of the rupee—a sign that confidence levels are yet to return. Temporary controls—and that's the way they were packaged on July 16—of the sort introduced don't affect market sentiment, but there is little to suggest how temporary the controls will be, or whether they will be extended further. Why the government didn't get PSUs to raise funds earlier or remove interest caps on longer-term NRI deposits—these are also exempted from SLR/CRR requirements—remains a mystery, but the continuing political stalemate, the government's insistence on pushing its political agenda through the food and land Bills continues to give investors the jitters. As does the reluctance to raise diesel prices quickly, and the refusal of line ministries like the oil and industry ones to clear stuck proposals.