

‘Market-oriented’ yuan spells more trouble for India

Though the official Chinese explanation for the sharp devaluation on Tuesday was that it was a one-off event aimed at reflecting the true value of the currency—vital if the IMF is to accept the yuan in the basket of SDR currencies—the fact that the yuan was allowed to fall for the second day makes it clear the impact is yet to play out fully. While S&P has agreed with the official stand of the Chinese government and said the move is more a structural reform than a competitive devaluation, a move towards more market orientation would suggest the devaluation would continue, even if it may not be as steep as on Tuesday. With exports falling over 8% in July and the economy slowing, China needs a growth engine, and all others including rate cuts and liquidity injection haven’t worked. Indeed, with so many nations devaluing to stay competitive, this is probably a case of China rejoining the currency party after having stayed away from it for a while—the 2% devaluation has to be seen in the context of the real value of the yuan appreciating 9-10% over the last year. While the devaluation suggests the economy is weaker than earlier thought and has sent stock markets across the world into a tailspin, the fall in Asia-Pacific currencies—the Australian dollar fell 1% to a 6-year low, the Singapore dollar to a 5-year low, the Indonesian rupiah and the Malaysian ringgit fell to lows not seen since the Asian Financial Crisis in 1998—suggests a period of volatile currencies even if a full-blown currency war is not on the horizon.

For India, the timing couldn’t have been worse since this will make Chinese exports to India even more competitive and, to the extent there is competitive devaluation by others, the export market gets that much more difficult. The further collapse in commodity prices will also put pressure on banks which are holding, for instance, large loans of steel firms. Not surprisingly, the rupee weakened to its lowest level in 2 years. [RBI](#), however, would do well not to intervene to support the rupee too much—it needs to ensure there is no sudden collapse—since once it is trade-weighted, the rupee has appreciated in even nominal terms over the last year; in real terms, the appreciation is even higher. While this makes a difference in India’s competitiveness in certain commodities, the biggest reason for the collapse in India’s exports—they fell around a sixth in the first quarter of FY16 versus FY15—is really the slowing in global growth. Also, while looking at the export performance, it is important to strip out the impact of commodity prices—about a fifth of India’s exports are petroleum products whose prices have more than halved in the last one year. Once you do this, you find that nearly three-fourths of the fall in India’s exports basket in the first quarter of the year is related to the fall in commodity prices—of petroleum, iron ore and gold. Given that other countries are devaluing, India will have no option but to let the rupee slide. If the rupee falls too much, though, the impact on India Inc’s borrowings will be large. So, RBI will have to remain watchful.

China joins currency party

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