INR Depreciation and Exports: Is there a correlation?

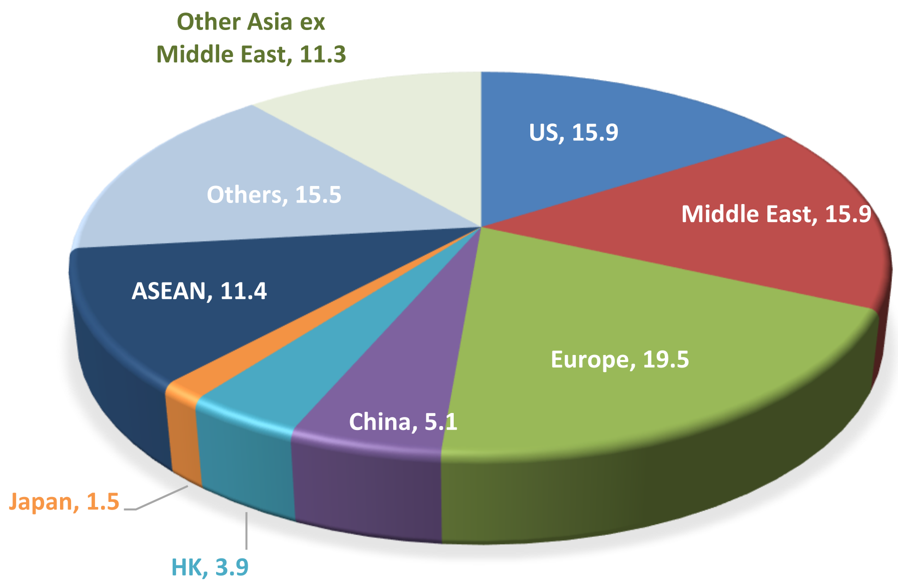
Most of us grew up listening, and hence also believing, this justification or view that Indian Rupee depreciation is critical for exports or export competitiveness of our country. That "INR" depreciation of 3-5% per annum is given" is also another or similar view which most of us would have heard, over the last 20-25 years. There are many such views but let us look at just one more - "INR appreciation is a disaster for Indian economy". It's like there is a near consensus on INR depreciation as sure-fire way to Indians achieving global competitiveness. Makes us sit up and ask - was INR born to depreciate?

Let us first look at India's exports closely - who do we export to or which countries are top export destinations, what do we export and value of our exports.

For the financial year ended March 2019 (FY2019) India exported goods worth USD337bn (Rs.23 lakh crores) and imported goods worth USD518bn (Rs.36 lakh crores). The trade deficit (exports minus imports) was USD 181bn (Rs.12.67 lakh crores) which is huge.

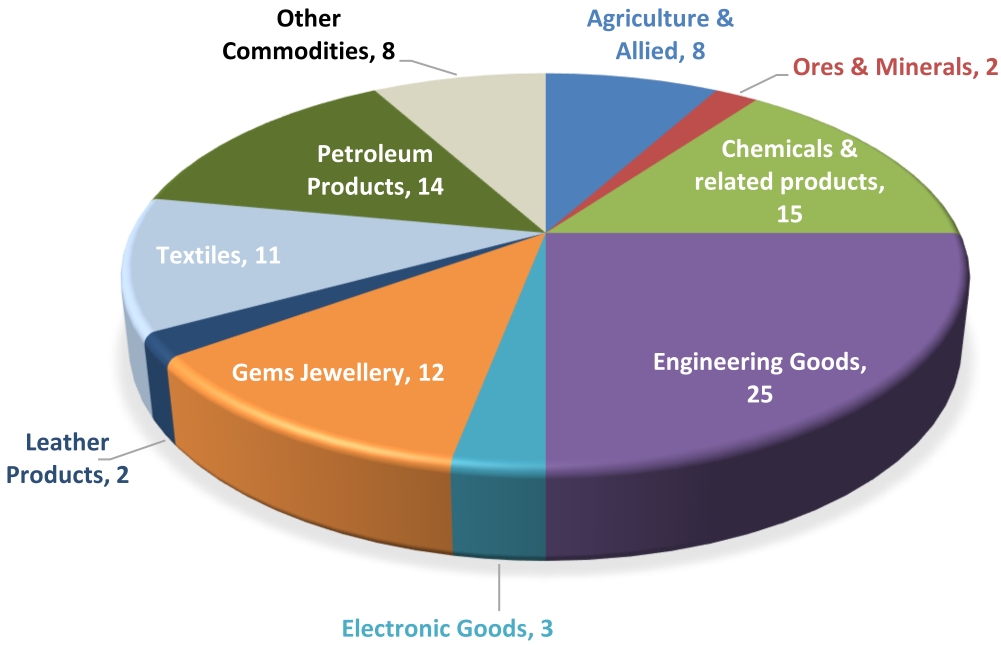
India's top export destinations are the US and Middle East account for 16% each. Europe 19.5%, China 5%, Hong Kong 4% and Japan 1.5%.

Fig: India Exports by Country (in %)



Of the total exports, 8% is agriculture and allied, 2% is Ore and Minerals, 68% is manufacturing goods (including chemicals 15%, Engineering goods 28%, gems and jewelry 12%, leather and leather products 2%, textiles 11%) petroleum products 14% and other commodities 9%. Must add within engineering goods, India also export 3% electronic goods. In my previous note "National Infrastructure Pipeline: A pragmatic approach to achieving USD5trillion economy" I have mentioned about aspirational consumption and need for "Make in India" policy. This 3% electronic goods exports just shows why in this budget emphasis was laid on "Assemble in India". There is an urgent need to make India competitive in this area. With 11% of India's imports or USD55bn (Rs.4 lakh crores) worth of electronic goods being imported every year whereas barely 3% or USD9bn (Rs.1 lakh crores) worth of electronic goods being exported, India's electronic goods imports (or aspirational consumption) is higher than Gold imports of USD37bn (Rs.2.6lakh crores).

Fig: India Exports by Products (in %)



We all know **China is known as "The Worlds Factory"** and there is a near consensus that **"everything is Made in China"**. China is undoubtedly an export powerhouse with global exports of USD2.5trillion (that's an eye popping Rs.1,74,00,000crores or Rs.174 lakh crores).

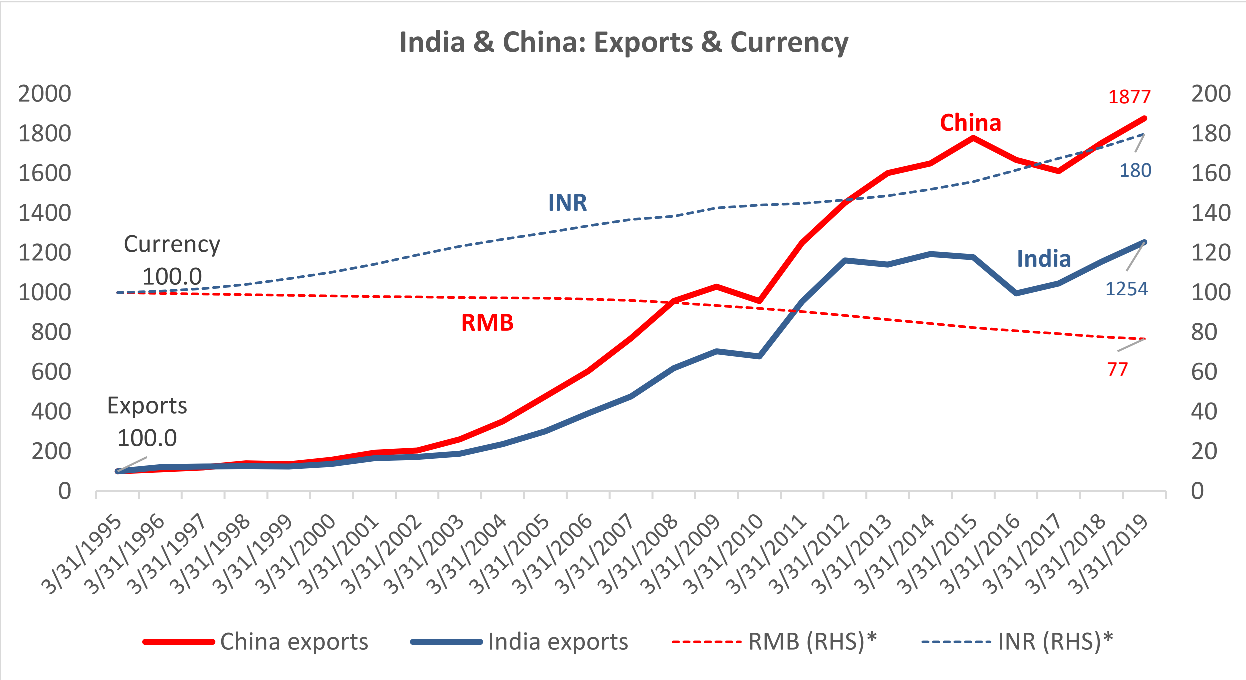
We looked at China's exports and currency versus the US Dollar and India's exports and currency INR versus US Dollar from FY1995 to FY2019. We selected FY1995 as economic reforms started in India in 1992 and believe 3 years is a good period of effects of reforms to start showing up. In FY1995, China's global exports stood at USD133bn (Rs.4 lakh crores), whereas, India's global exports were at USD26bn (Rs. Eighty-two thousand crores).

In FY1995, RMB was 8.6 versus USD (USD 1 = RMB8.6) and INR was 31.4 versus USD (USD 1 = INR 31.4). In FY1995, India's global exports as percent of China's global exports were 20%. In FY2019, China's exports touched a staggering USD2.5trillion (Rs.174 lakhs crores) and

RMB appreciated to 6.7 versus USD (USD1 = RMB6.7). RMB appreciated by 21% during FY1995 to FY2019. Please note, throughout the 25 years period RMB has steadily appreciated versus USD, whereas China's exports have grown exponentially during that period despite the currency appreciation of 21%.

Year	China exports	India exports	CNY (RHS)	INR	IN vs CN
FY-1995	132.9	26.3	8.6	31.4	**20%**
FY-1996	146.1	31.8	8.3	33.4	**22%**
FY-1997	158.5	32.9	8.3	35.5	**21%**
FY-1998	187.5	33.1	8.3	37.2	**18%**
FY-1999	180.8	32.9	8.3	42.0	**18%**
FY-2000	209.6	36.3	8.3	43.3	**17%**
FY-2001	256.8	43.9	8.3	45.7	**17%**
FY-2002	272.1	45.3	8.3	47.7	**17%**
FY-2003	347.3	49.6	8.3	48.4	**14%**
FY-2004	467.9	62.5	8.3	45.9	**13%**
FY-2005	633.8	79.3	8.3	44.9	**13%**
FY-2006	803.6	103.0	8.1	44.3	**13%**
FY-2007	1,024.3	125.5	7.9	45.2	**12%**
FY-2008	1,272.0	163.0	7.5	40.3	**13%**
FY-2009	1,368.5	185.4	6.9	46.0	**14%**
FY-2010	1,272.4	178.8	6.8	47.4	**14%**
FY-2011	1,662.0	251.1	6.7	45.6	**15%**
FY-2012	1,929.7	305.9	6.4	47.9	**16%**
FY-2013	2,128.3	300.4	6.3	54.4	**14%**
FY-2014	2,191.4	314.4	6.1	60.5	**14%**
FY-2015	2,364.4	310.3	6.2	61.2	**13%**
FY-2016	2,216.7	262.1	6.4	65.5	**12%**
FY-2017	2,140.4	275.2	6.7	67.1	**13%**
FY-2018	2,328.9	304.5	6.6	64.5	**13%**
FY-2019	2,494.3	337.0	6.7	69.9	**14%**

In FY2019, India's exports touched USD 337 bn (Rs.23 lakh crores) and INR depreciated from 31.4 versus USD (USD1=INR 31.4) to 70 versus USD (USD1 = INR 70) A depreciation of 123% for INR, whereas, for the same period RMB appreciated by 21%. Moreover, India's global exports as a percent of China's global exports (which was 20% in 1995) dropped to 14%. China's global exports were 5 times India's global exports in 1995, whereas now they are 7.4 times bigger.



(*: Currency value in above chart denotes performance of USD vs RMB and USD vs INR)

The above data and chart beg a question “who does INR depreciation truly benefit?”. From the above it seems that exports, export competitiveness and currency deprecation have little co-relation. By allowing systematic and sustained INR depreciation, the economy appears to have been trapped in a virtuous downward spiral due to higher imported inflation hence higher interest rates, lower real GDP growth, higher input costs for manufacturers, higher prices for end consumers, leading to higher inflation and hence higher interest rates..........an endless downward spiral.

Is it time to explore INR-USD peg? Current foreign exchange reserves are USD 471 bn, of which foreign currency assets (FCA) are USD 437 bn, which are mostly in the form of US Government T-bills and bonds. With US 10 year at 1.60% and India 10 year at 6.44%, there is a cost of holding USD437bn of FCA.

China became “The World’s Factory” initially by being an outsourcing, assembling and manufacturing hub for US and other global manufacturers. Led by demand, soon supply chains and ancillaries grew and from the steep learning curve finally China’s homegrown industry leaders like Xiaomi, Huawei, One Plus, Oppo, Vivo, and others emerged. Today these Chinese companies are industry leaders in India as well as world over taking dominant and enviable market share from US, Japanese, European and Korean majors. This was achieved by first pegging RMB to USD. USD peg gave foreign manufacturers, who set up production units in China to benefit from low cost labour, the confidence that their investment would not lose value due to currency depreciation. What followed as a function of this USD peg was an unprecedented tide of foreign investment which first resulted in China’s forex reserves rising rapidly, currency remained stable, lower imported inflation, GDP growth due to easy availability of capital and outsourcing work from global majors.

Finally, due to the deluge in foreign exchange from exports and foreign investment, RMB eventually appreciated.

Going by this experience of China and success story that their economy became; can efforts be made to ensure a stable INR? Is it time to overcome these apprehensions that our exports will collapse, and exporters wiped out if INR does not depreciate? I am reminded of Bombay Club. The Way back in 1991-1992 Bombay Club had criticized the economic reforms unleashed by the government of the day, arguing that the rapid opening up of the Indian economy would hurt domestic industry since it suffered from poor infrastructure, high domestic taxes, and high interest rates. Internal reforms should precede external reforms. There were also fears that making it easier for foreign companies to invest in India would lead to acquisitions rather than new industrial capacity. Well time has proven Bombay Club wrong and in fact the better managed Indian companies have grown significantly, Indian businesses have benefitted immensely, and new entrepreneurs and businesses have emerged. Corporate India has shown it has the wherewithal to thrive in an open economy, compete with global majors and doesn't need protectionist policies.

Is it time we looked at finding solutions to these challenges to our economy? Just as subsidy is a burden or cost borne even by all those who are non-users of that service or product, similarly isn't allowing INR to depreciate systematically, to help exports a burden, a tax or a cost on all citizens of this country? More importantly, nobody seems to be benefitting from it right now.

Aashish Wakankar
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(Views expressed are personal)