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# EXECUTIVE BRIEFINGS
# ECONOMY & POLITICS: CURRENCY TRENDS

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## Currency turmoil

During the 16th and 17th centuries, the Ottoman Turks set benchmarks in many areas. Their architecture incorporated highly ornamented styles from Western Europe together with important elements from the Orient. In the economy, they encouraged clusters of industrial and manufacturing excellence and welcomed migrants, including Jews, from different parts of Europe who settled in Istanbul and port cities like Salonica. Today's Turkey unfortunately, is setting benchmarks in the wrong areas. Since January 2018, the Turkish lira has lost near half its value against the dollar and sent a limited contagion across other emerging markets. The South African rand, the Brazilian real, the Thai baht, the Chinese renminbi and the Indonesian rupiah have weakened between 5% and 30%. The Argentinian peso has done even worse, losing 75% of its value. In some instances, currencies have declined on account of domestic economic mismanagement stirred on by external factors. Going forward, it seems likely they will remain under varying levels of pressure and adjustments will depend basically on macroeconomic indicators.

The Indian rupee has fallen by 11% during this period and is clearly not alone in its suffering. However, its inflation and fiscal deficit, both of which are important factors influencing currency flows, are moderate and economic growth fairly robust. More importantly, its investment cycle, post GST, is visibly perking up. The question then is, why did the rupee behave as it did?

Over the past 12 months, we have consistently argued that the rupee will come under pressure due to external considerations and that CFOs should, despite costs, hedge open positions. It is now clearly acknowledged that the United States Federal Reserve plays a global role in determining interest rate cycles. Its hawkish stance in recent months has resulted in the reversal of capital flows, especially from emerging markets. In fact, its cheap money policy of the previous decade was the principal reason for the dollar carry trade in the first place. What has further helped the dollar rise is the Trump administration's tax cuts and investment incentives intended to bring capital back to America. Moreover, India's trade deficit has steadily risen over the course of the past two years. This year, it is expected to rise even further, largely on account of a jump in crude oil prices. Unlike several other emerging markets, which are commodity exporting, India remains heavily reliant on imports.

Some analysts believe the Reserve Bank may have intervened to the tune of USD 30 billion in spot and forward markets over the course of the past three months. Such actions rarely work as they only give punters an opportunity to short sell. Allowing the currency to slide is usually the best policy because it really is quite impossible to take on the might of the markets. Many other central banks, including the People's Bank of China, have tried and failed.

The risks, going forward, include the escalation of global trade wars in which India may suffer both direct and collateral damage. Secondly, markets seek political and policy stability and will keenly look for signs of this in the next election. The only forecast for the currency therefore is that it will remain volatile. Meanwhile, unlike India and some emerging markets, Turkey's economy and policy regime continues to set new benchmarks in mismanagement, creating the perpetual threat of a wider contagion. This would constitute a third risk.