Amidst De-Dollarisation, Is There a Global Opportunity for Indian Rupee To Rise?

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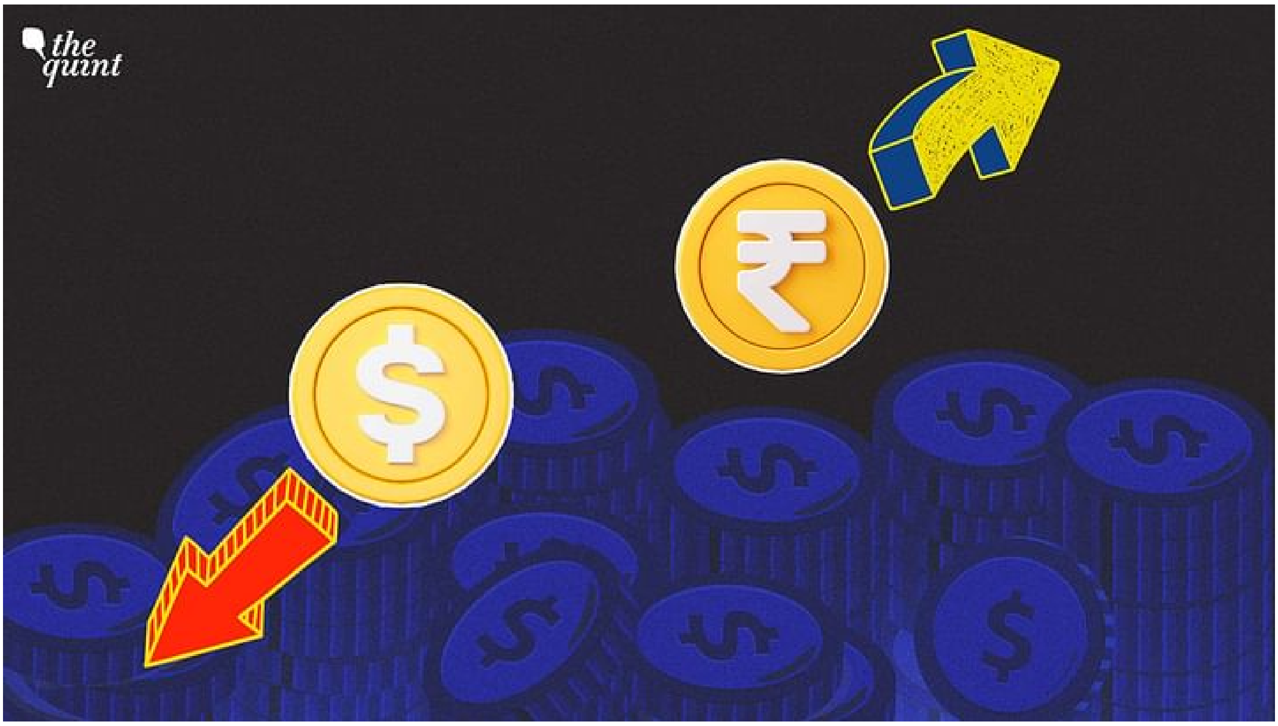

A further deepening of the Russia-China strategic relationship provides opportunities for a more multi-aligned India in an era heightened by rising geopolitical uncertainties and geoeconomic insecurities.

On the trade front, I argued earlier how India can utilize this as an opportunity if it puts increasing focus on its economic strengths and pivot its pro-market reform agenda towards driving more service-based exports (in addition to boosting low-end manufacturing expansion), gaining a more prominent position in the global economic order. A lot happening around the world is aiding India in doing this.

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Can Indian Rupee Do More to Substitute US Dollar?

India has been making attempts to internationalize its currency for a long time.

According to records, India's Reserve Bank of India (RBI) had given permission to "domestic and foreign AD (Authorised Dealer) banks in 60 cases for opening SRVAs of banks from 18 nations" for the purpose of settling payments in Indian rupees, according to Bhagwat Karad, India's Minister of State for Finance.

Russia has been particularly vocal in promoting local currency transactions as part of the larger “de-dollarisation” movement. But there are serious challenges in making this possible.

In the past, during the Cold War, India and the Soviet Union did enter into similar local currency pacts for short-term trade arrangements, when Western sanctions impacted the Soviet Union and inhibited its ability to deal in foreign currencies.

> India tried a similar local-bilateral payments system with Iran when Iran was badly hit by US sanctions. India bought oil from Iran under a US sanctions waiver by depositing rupees in Indian banks. Tehran used these funds to buy food and medicine from India. However, once the waiver lapsed, India had to stop importing Iranian oil. The balances in the accounts dwindled, and now, Indian firms won't sell Tehran rice, sugar, or tea because they may not get paid.

And that’s where the real issue with such a payment system lies.

If bilateral (local) currency trade would be prosperous for both trading parties in the long term, the international financial system wouldn’t have seen the rise of (stronger) reserve currencies like the US dollar (now) or Gold (in the past). Trade requires trust, and trust warrants greater transparency and certainty for mutually beneficial business partnerships to thrive.

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[Explained | The History and Evolution Of The Rupee From Independence to 2022]

Most local currency trading pacts are short-lived. This is also because of exchange rate issues. For example, one unit of the Indian rupee was trading almost around one unit of the Russian rouble before the war. In four weeks right after Russia's military aggression in Ukraine began, the INR-RUB gained 22.68 percent.

An unstable exchange rate (INR-RUB in this case) and a volatile Rupee will create problems for stable financial transactions between the two nations and for all future trades, too. As of now, Indian products are becoming more expensive for Russians to buy and Russian products are becoming cheaper for Indians. The wider the fluctuation in the bilateral exchange rate, the higher the uncertainty in trade.

What is "De-dollarization" All About?

Traditionally, the value of any currency depends upon the assets held by the country issuing that currency. Until about 100 years back, the most sought-after global currency was the British Pound, not the US Dollar. Post-World War I, America, which was relatively unscathed as the war was not fought on its land and received the largest chunk of wartime gold reserves, started replacing the pound as a currency of global trade.

The US went on to execute the Bretton Woods Agreement in 1944, promoting bilateral trade between countries in US dollars. Surprisingly, by the late sixties, holding US dollars was considered more profitable than holding stocks or gold. By 1970, the Bretton Woods Agreement was almost nullified after the London Gold Pool was dissolved, and Asian economies started to grow again.

> On the other hand, the US was facing a negative balance of payment crisis due to massive expenditures during the Cold War and Vietnam War.

In 1971, as argued here, President Nixon canceled the convertibility of the US dollar into gold, thus de-linking it from the value of assets of his country. Thus, *"the value of the US dollar was now dependent on its global demand and not on the assets held by the American government. The introduction of 'Petro Dollars' helped raise the demand for the greenback, and to fulfill the demand, the US started printing more and more dollars"*.

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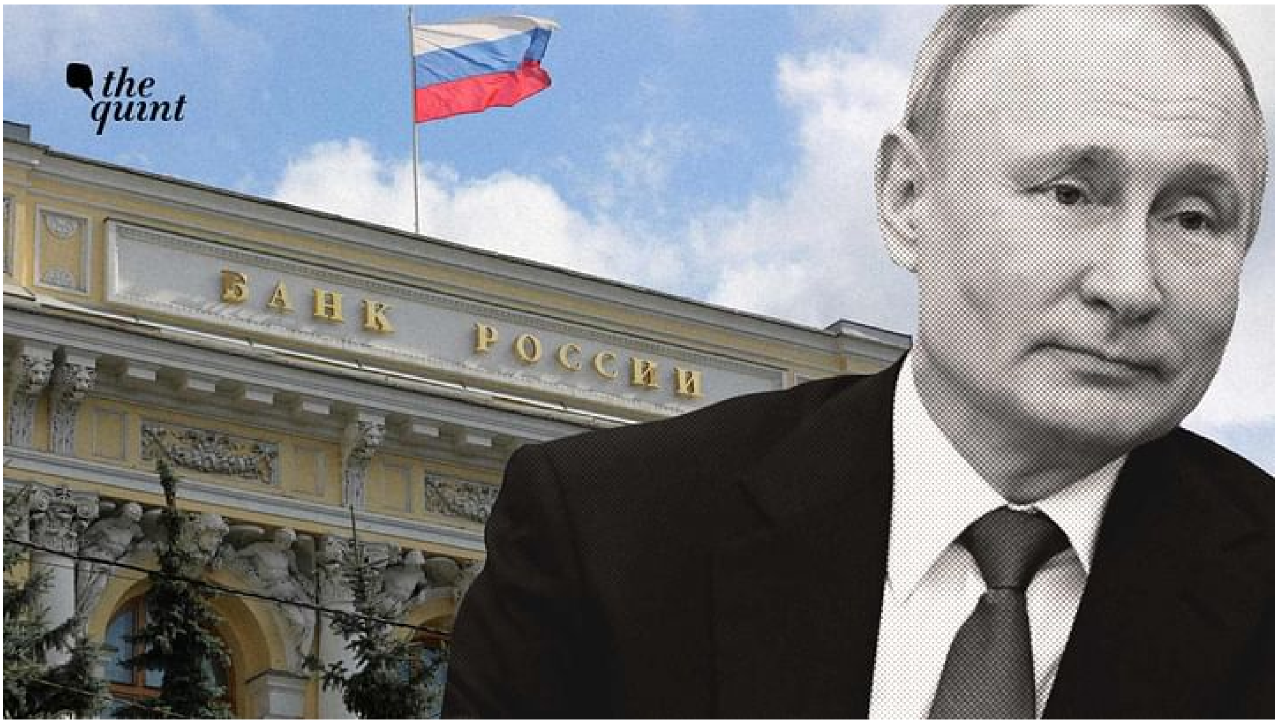

Since America was the biggest contributor to global agencies such as the IMF and the World Bank, all its disbursements were also in US dollars. As a result, developing or underdeveloped countries were forced to trade with other countries in US dollars. By the late nineties, *"nearly 90% of global trade was happening in US dollars. Hoarding increased, and more dollars were printed to meet this demand. Today, as opposed to* *nearly $500 billion of US gold reserves, they have issued hard currency worth nearly $4 trillion and US treasury bonds worth another $38 trillion, which is nearly 80 times the total assets of the US Treasury".*

The Eroding Command of the Dollar

As C. Raja Mohan argued recently,

> "The Sino-Russian dream of building a post-Western order has resonance in many parts of the world, including in Delhi. But the Indian strategic community should not hold its breath. The fault lines within the West are real, but they are by no means fatal. The history of international communism in the 20th century was about building a post-Western order. But those dreams came to naught as Russia and China got at each other's throats and made separate compromises with the West."

Is this time any different?

For one, the economic strengths of great power nations including the US are differently weighted now, as against how the late 20th century was when the degree of American hegemonic influence affected much of global strategic alignments/non-alignments. China wasn't the same economic superpower then as it has evolved to become now, making the world now more bi-polar (and in some cases multi-polar and sub-regionalized).

> The US dollar, an instrument strengthening its financial imperialism project across the globe, is no longer commanding itself as the world's main anchored/preferred reserve currency, as it once did during the Bretton Woods (1945-71) and Post Bretton Woods era (post-1971).

US-led sanctions against Russia, in its war against Ukraine, led Russia and other countries (allying with it or China) to reduce their dependence on the US dollar as their main trading currency and peg currency arrangements in favor of other key bilateral trade partners. But there's more.

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The overall aggregate demand for the US dollar all over the world has seen a major shift too. March 2023 saw a series of US banks failing, bringing an economic bloodbath to America. From Silicon Valley Bank to New-York based Signature Bank, most of these banks crashed, bringing the share prices of other banks down due to a crisis of confidence spilling over. The timing of this couldn't have been worse.

> All these banks have a single story for their failure, which is directly linked to the interest on US Treasury bonds. As the demand for the US Dollar is decreasing in the world, these bonds are also falling, and in order to make them float, banks have no solution but to offer higher interest rates, which burn holes in their liquidity.

Dr. Nouriel Roubini, who predicted the global recession of 2008, predicts another global economic collapse coming, but also cautions, that this time, problems are going to last longer, maybe a decade or more. One of the main reasons for this upcoming recession, according to Roubini, would be *de-dollarization.* Economic historians like Barry Eichengreen warned about this scenario decades ago, seeing the emergence of a multipolar currency landscape due to probable geopolitical tensions and the waning effect of multilateralism.

Intent To Globalise Currency Needs Domestic Macro-evidence

It is one thing to posture and argue for the potential for the Indian Rupee in the international trade, currency, and investment market. The evidence on macroeconomic fundamentals must back those intentions too.

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The RBI’s management of the Indian rupee has also been less favoured by the nature of macroeconomic forces that have shaped India’s economic trends over the past few years. Yes, India’s overall trade volume (as seen from the current account) has expanded but more on imports than exports. Foreign direct investment levels and other private capital investment levels have been at best shaky due to both, external and endogenous (internal) factors.

> Manufacturing-led exports have been low, even though service-based exports from India have a reason. The macro-policy framework by the Indian government seems to be more skewed towards driving ‘manufacturing’ led exports even though there is a stronger case to tap into the potential (quite clearly evident) for services.

How the domestic macroeconomic forces in the near future shape the global demand for Indian Rupee will subsequently address the gap between existing ‘Hope’ vs. ‘Reality’ and make it more bridgeable. For now, the processes of de-dollarization amidst increasing multipolarity (within currency arrangements), as real as it is, for India’s political economy reasons may actually do little to prop up the Indian Rupee as a credible reserve currency (as otherwise evident for other reserve currencies like the Chinese renminbi, Japanese Yen, Euro, etc.)

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