Trade deal signals turning point for rupee

■ JAMAL MECKLAI

THE ANNOUNCEMENT OF the trade deal with the US, effective immediately, lit a delighted fire under the rupee. While it had steadied a bit from its sharp decline on budget day, which provided some comfort, the rupee shot higher, gaining nearly 1.5% from the previous opening, more even than in October last year when RBI shocked the market by intervening aggressively at the non-deliverable forward (NDF) opening.

Over the last year or so, the rupee had become hugely undervalued – according to RBI data, the rupee's trade-weighted real effective exchange rate was 95.3 in December, its lowest level in a decade – under pressure from Trump's tariffs but primarily as a result of the steady erosion in India's attractiveness as an investment destination. So, its sharp turnaround should hardly be surprising.

And the even better news than the instant reduction in US tariffs announced yesterday is that, over the past few months, Indian exporters have quickly broadened their sales destinations – nothing like a crisis to focus the mind: note the hugely unexpected speed of the change. The UAE and, importantly, China have become bigger buyers of Indian goods; other new destinations have been developed in Europe and in emerging Africa, as well as in Vietnam and Malaysia, which have become big markets for marine products. Again, with the newly signed trade agreement with the EU (in addition to the UK, Oman, and New Zealand), export diversification is certain to continue and grow. And with the US now coming back into the picture, we should see exports continue to be strong.

With the US now coming back into the picture, we should see exports continue to be strong

The budget, to its credit, is holding steady as she goes with a continued focus on capex, including the definitive focus on attracting direct investment in the cloud space. The key, of course, will be how domestic companies react to this sudden burst of orange-coloured sunshine, which will determine whether this strong surge in the rupee will be sustained – or even increased – or whether it will, like all the recent surges, revert to type.

The graph shows how the rupee has moved since Dr Malhotra took over as RBI Governor. Clearly, he immediately set to improving the profile of rupee volatility even as it meant battling the market in his first few months. Later, after Liberation Day (April 2, when Trump first imposed tariffs across the world), he must have realised that sentiment had turned sharply, and it only made sense to control the decline.

The next week or so will show whether sentiment has turned back definitively – my guess (hope?) is yes – so that 92 is gone forever. The question is whether RBI will now jump on the bandwagon and take the rupee back below 90 – or, indeed, something like 88, which would provide a buffer for future volatility – to where the rupee would be once more reasonably valued for the economy.

(The writer is CEO of Mecklai Financial)