

# Rupee's real effective exchange rate up at 108.14 in Nov

## Nominal rise strong enough to outweigh impact of unfavourable price differences

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The real effective exchange rate (REER) of the rupee increased to 108.14 in November from 107.20 in October, appreciating by 0.9 per cent.

The nominal appreciation was strong enough to outweigh the impact of unfavourable price differences, according to a report called 'Real Effective Exchange Rate and its Implications for India's Trade Balance' authored by Reserve Bank of India staffers. The article does not represent the views of the RBI, but that of the authors.

REER represents the inflation-adjusted, trade-weighted average value of a currency against its trading

partners and it is often used as an indicator of external competitiveness.

Emerging market currencies were under pressure in November due to outflows by foreign portfolio investors, a strengthening US dollar and rising US yields. The rupee depreciated by 0.4 per cent month-on-month against the dollar: A modest depreciation compared to other major currencies.

Despite heightened global uncertainties, the rupee exhibited the lowest volatility among major currencies.

For India, changes in REER have an uneven impact on trade balance.

## Banks' average daily reserves decline after FIT framework adoption in 2016

The average daily reserves maintained by banks have come down, resulting in freeing up incremental resources that may be deployed for productive purposes after the Reserve Bank of India (RBI) adopted a flexible inflation targeting (FIT) framework in 2016 and introduced automatic sweep in sweep out (ASISO) facility, according to report by RBI staffers. Additionally, the volatility in daily reserves maintenance as a percentage of requirement is significantly lower under the post-ASISO regime, enabling banks to effectively manage daily reserves, it said. The RBI introduced the ASISO facility in August 2020 to offer greater flexibility in managing day-end cash reserve ratio balances. Under this facility, banks are able to pre-set a specific amount (or range) that they wish to maintain at the end of the day. Any shortfall or excess balances would automatically trigger marginal standing facility or standing deposit facility/reverse repo bids under the ASISO facility. **BS REPORTER**

A depreciation improves the trade balance in the short term, while appreciation has a larger impact in the long

term, the report said.

"Our empirical findings on India suggest an asymmetrical impact of

REER movements on India's trade balance, with REER depreciation impact on trade balance being more than an equivalent REER appreciation in the short-run and vice versa in the long-run," it said.

REER depreciation tends to improve the trade balance as it makes Indian exports more competitive, while appreciation makes them more expensive. Several factors, including productivity differentials, terms of trade, government spending, and net foreign assets, influence REER, the report said. Currency movements, coupled with other global and domestic variables, play a significant role in shaping exports and imports.

However, estimating an optimal level for the currency value is challenging due to the constantly changing nature of underlying factors such as macroeconomic indicators and geopolitical uncertainties.

