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What is success, what is excess?

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"Moderation is fatal. Nothing succeeds like excess", so quipped, Oscar Wilde the English playwright of the 19th century.

On February 5, India's minister of state for finance spoke to foreign investors on Bloomberg TV, expressing concern about "excess" rather than "success".

He was worried about the rupee's appreciation against all major currencies, except the US dollar.

Just about six months prior to the appointment of the present governor of India's Reserve Bank of India (RBI) in September 2013, the Indian rupee plunged to an unprecedented depth.

The RBI took corrective steps, much to the discomfiture of the then-government. It raised interest rate and adopted other tightening measures.

The objectives were two: domestic price stability and external stability of currency.

Rising rupee and growing concerns

Now that the rupee is rising, there are reasons for concern, just as there are reasons for joy.

There comes the question of moderation in a flexible exchange rate regime: what is "success" and what is "excess"?

In India and other countries under flexible exchange rate regime, unlike in Fiji and other Pacific island countries, which have fixed exchange rate regimes, value of the currency is determined on a daily basis by free interaction of forces of supply and demand.

If a country indulges in fiscal deficits and finances deficits through money creation, and if it is unable to export more than its imports, its currency depreciates.

Flexible currency is a self-correcting mechanism; however, the costs involved are high. Depreciating currency makes imports costlier.

Rising currency makes imports cheaper but renders exports less attractive to foreigners.

In fixed exchange rate regimes, it is the relative price level that matters.

If the country inflates more than the rest of the world, its price level will rise to that of the rest of the world; its real exchange rate (RER) falls; and its imports become more expensive and exports become less attractive to foreigners.

Depending upon the level of reserves, RER is allowed to fall. If the danger level is about to be reached, the government announces devaluation of currency to arrest further fall.

The devaluation of Fiji dollar of April 2009 is a case in point.

High level of reserves

India’s foreign exchange reserves are at a new high of US$328 billion (FJ$668 billion) crossing the last US$320 billion (FJ$652 billion) mark in September 2011.

It is so, despite the recovery in America. Foreign institutional investors from USA and from Europe and Japan are looking up to India’s big-bang reforms. India continues to receive large capital inflows.

In Fiji, foreign exchange reserves are also rising: FJ$1.84 billion, compared to FJ$1.78 billion in December 2013.

The Fijian dollar has risen against all major currencies, except the US dollar. The RER also rose in December by 1.3 per cent, reflecting some loss in international competitiveness.

My study with USP economist, Pravinesh Chand says rise in foreign exchange reserves, triggered by tourism and remittances, are pushing up Fiji’s RER. Reforms include using up the rising reserves on export promotion and tourism related physical infrastructure, rather than on government consumption.Only reduction in consumption of non-tradables will help in maintaining real exchange rate on an even keel.

The concerns of small or big economies are the same.

Economic theory is neutral to the size of the economy!

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