Rupee devaluation and economy of Sri Lanka

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Introduction

The value of two currencies relative to each other is called rate of exchange. For example, on a given day, one may trade one U.S. dollar for a certain number of British pounds. A currency's exchange rates may be floating (that is, they may change from day to day) or they may be pegged to another currency. A floating exchange rate is dependent on the supply and demand of the involved currencies, as well as the amount of the currency held in foreign reserves. On the other hand, a government may peg its currency to a certain amount in another currency or currency basket. For example, the Qatari riyal has been worth 0.274725 dollars since 1980.

The change in the exchange rate has been called depreciation sometimes, devaluation at other times. What is depreciation of a currency and how does it differ from devaluation? The depreciation of the currency is the adjustment of the exchange rate so that more of your currency is needed to exchange for a unit of the foreign currency. For instance, if the rupee - US dollar exchange rate is Rs. 110 = $ 1 and it changes next week to Rs. 110.75 = $ 1 and the week after to Rs. 111 = $, 1 this is a depreciation of the currency. The opposite phenomenon when the amount of rupees exchanged for a dollar becomes less is known as an appreciation of the currency.

Devaluation is when a country changes its exchange value by a fairly large amount at once. For instance in November 1977, Sri Lanka devalued the currency from about Rs. 5.95 = US $ 1 to Rs. 16 = US$ 1. This was a devaluation of the rupee. Since then the value of the rupee has gone down gradually. This gradual change in the value has been a depreciation of the currency. The rupee had depreciated from Rs. 16 to a U.S. dollar in 1977 to about Rs. 110 to a U.S. dollar, when it was devalued by 3 percent on November 21. The opposite action of reducing the amount of units of a currency to be exchanged for a unit of foreign currency is known as a revaluation.

View of Economists

Economists noted that exports still account for only a small share of Sri Lanka's total economy. Therefore, rupee depreciation will only benefit a small section of the country and will not be the best option for a majority of the people. "If a country is export oriented one option right now is currency devaluation. But Sri Lanka's domestic economy is much bigger than the export sector. The domestic economy is more than twice the size of the export sector. In this case currency devaluation will leave consumers worse off.

One of the reasons why people get the exchange rate issues confused is the terminology itself. A depreciation or devaluation connotes an action that is unfavorable or undesirable. Appreciation of the currency appears a favorable development in total disregard to the functions of an exchange rate. Some get it wrong because they are committed to an ideological position that devaluation is bad economic policy. Oppositions in parliament would generally oppose devaluation or depreciation of the currency as there is political mileage in opposing depreciation, as consumer prices rise.

The confusion with respect to the recent devaluation was even more this time around. There is an additional controversy as to whether the devaluation should have been the responsibility of the Central Bank and whether it is the practice to announce it in a Budget? Was the devaluation effected without the knowledge of the Governor and the Monetary Board of the Central Bank? The all important question is, however, whether the devaluation of the currency would help reduce the trade deficit and ease the balance of payments problem.

Role of Central Bank

It is no doubt the responsibility of the Central Bank to manage the exchange rate. However, despite the massive trade deficit the Central Bank did not allow the rupee to depreciate as the Central Bank took the position that the external finances were sound. Therefore the depreciation of the rupee that was a means of coping with the trade deficit was resisted by the Central Bank. It spent about US$ 1 billion before the devaluation to defend the value of the rupee. There was obviously a difference of view between the approach of the Central Bank and the Finance Ministry with respect to the exchange rate. That was the reason for the devaluation of the rupee by the government. There is continuing pressure to depreciate since the devaluation on the rupee.

Using the rate of exchange between the Lanka Rupee and the USD available for each day since 1973 from Federal Reserve Board with update, one can estimate the depreciation of the Lanka rupee. The older historical year end values from the Central Bank Economic progress report published for the 50th Anniversary of independence of Lanka. Extrapolating back the more recent trend the rapid depreciation in the mid 70's appears to reflect a cumulative correction since about 1960, when Foreign Exchange controls were introduced in Ceylon.

The Sri Lankan rupee dropped 3.2 percent to 113.89 per dollar at 2:27 p.m. in Colombo, according to data compiled by Bloomberg. The Colombo All-Share Index has fallen about 9 percent this year, less than the 18 percent decline in the MSCI Asia Pacific Index. The benchmark slid 1.1 percent today. Sri Lanka’s exports including tea, textiles and gems rose 19 percent in August from a year earlier, compared with a 72 percent gain in January. Europe accounts for 35 percent of the Indian Ocean Island’s overseas sales.

Besides the strengthening currency, local exporters also have had to face the loss of trade privileges previously offered by Europe. The European Union in August 2010 withdrew tariff concessions for Sri Lankan goods due to alleged human rights violations in 2009 during the last stages of the civil war against the Liberation Tigers of Tamil Eelam separatist forces. “Countries that are competing with us have depreciated their currencies,” Rajapaksa said. “To correct this disadvantage, as an incentive to exports, I intend to devalue the currency by 3 percent.”

An advantage to a floating exchange rate is the fact that it tends to be more economically efficient. However, floating exchange rates tend to be more volatile, depending on the particular currency. Pegged exchange rates are generally more stable, but, since they are set by government fiat, they may take political rather than economic conditions into account. For example, some countries peg their exchange rates artificially low with respect to a major trading partner to make their exports to that partner artificially cheap.

When the exchange rate between the foreign currency of an international investment and the U.S. dollar changes, it can increase or reduce your investment return. Because foreign companies trade and pay dividends in the currency of their local market, you will need to convert the cash you receive from dividends or the sale of the investment into U.S. dollars. Therefore, if the exchange rate changes significantly between the time you buy and the time you sell, it can sometimes turn a positive return in the investment itself into a loss for the investment in total, or vice versa.

International investment

International investment returns increase when the dollar weakens in value against another currency, because each unit of foreign currency translates into more U.S. dollars. On the other hand, if the U.S. dollar strengthens against the foreign currency, it translates each foreign currency unit into fewer U.S. dollars and therefore diminishes your returns.

Devaluation occurs in a fixed exchange rate. Depreciation occurs in a floating exchange rate system. Both mean a fall in the value of the currency. e.g. a devaluation in the Pound means it is worth less Euros.

A devaluation of the exchange rate will make exports more competitive and appear cheaper to foreigners. This will increase demand for exports. Devaluation means imports will become more expensive. This will reduce demand for imports. Devaluation could cause higher economic growth. Part of AD is (X-M) therefore higher exports and lower imports should increase AD (assuming demand is relatively elastic). Higher AD is likely to cause higher Real GDP and inflation. Imports are more expensive causing cost push inflation. AD is increasing causing demand pull inflation with exports becoming cheaper manufacturers may have less incentive to cut costs and become more efficient. Therefore over time, costs may increase.

With exports more competitive and imports more expensive, we should see higher exports and lower imports, which will reduce the current account deficit. If demand is price inelastic, the fall in the price of exports will lead to only a small rise in quantity. Therefore, the value of exports may actually fall. An improvement in the current account on the Balance of Payments depends upon the Marshall Lerner condition and the elasticity of demand for exports and imports. If PEDx + PEDm > 1 then devaluation will improve the current account and the impact of devaluation may take time to have effect. In the short term, demand may be inelastic, but over time demand may become more price elastic and have a bigger effect.

If the global economy is in recession, then devaluation may be insufficient to boost export demand. If growth is strong, then there will be a greater increase in demand. However, in a boom, devaluation is likely to exacerbate inflation. The effect on inflation will depend on other factors such as: Spare capacity in the economy. E.g. in a recession, a devaluation is unlikely to cause inflation. Do firms pass increased import costs onto consumers? Firms may reduce their profit margins, at least in the short run and import prices are not the only determinant of inflation. Other factors affecting inflation such as wage increases may be important.

It depends why the currency is being devalued. If it is due to a loss of competitiveness, then devaluation can help to restore competitiveness and economic growth. If the devaluation is aiming to meet a certain exchange rate target, it may be inappropriate for the economy.

Many business use fixed contracts for buying imported raw materials. This means temporary fluctuations in the exchange rate will have little effect. The price of buying imports will be set for up to 12 or 18 months ahead. Exporters may also use future options to hedge against dramatic movements in the exchange rate. These fixed contracts help to reduce the uncertainty around exchange rate movements and mean there can be time lags between changes in the exchange rate and changing costs for business.

Impact of economy

According to many economists, weakening of the currency could actually strengthen economy, since a weaker currency will increase the production, which in turn will uplift employment and raising the economic growth. It is held that increases in demand for goods and services gives rise to economic growth by triggering the production of goods and services. Increases or decreases in demand for goods and services are behind rises and declines in the economy's production of goods. Hence in order to keep the economy going economic policies must pay close attention to overall demand. Now, part of the demand for domestic products emanates from overseas. The accommodation of this demand is labeled exports. Likewise, local residents exercise demand for goods and services produced overseas, which is labeled imports. Note that while an increase in exports gives rise to overall demand for domestic output, an increase in imports weakens demand. Hence exports, according to this way of thinking, are a factor that contributes to economic growth while imports are a factor that detracts from the growth of the economy.

Because overseas demand for a country's goods and services is an important ingredient in setting the pace of economic growth, it makes sense to make locally produced goods and services attractive to foreigners. One of the ways to make domestically produced goods more in demand by foreigners is by making the prices of these goods more attractive.

Traditionally there are three main approaches to devaluation or currency depreciation: the elasticity approach, the absorption approach and the monetary approach. According to the elasticity's framework, devaluation improves a country's balance of trade when the Marshall-Lerner condition is satisfied, i.e., when the sum of the import demand elasticity of the two trading partners exceeds unity. In the absorption methodology, however, the elasticity's do not matter, and the trade balance improves only if the nation's GDP increases faster than domestic spending. In the monetary approach, by contrast, only money demand and supply matter, and devaluation always improve the trade balance. According to the monetary approach to the exchange rate, a devaluation or depreciation decreases the real supply of money, resulting in an excess demand for money. This leads to hoarding and an increase in the trade balance.

Devaluation and revaluation are official changes in the value of a country's currency relative to other currencies under the phenomenon of fixed exchange rate. Whereas in floating exchange rate system, currency appreciation or depreciation result as changes in market forces.

When a government devalues its currency, it is often because the interaction of market forces and policy decisions has made the currency's fixed exchange rate indefensible. In order to sustain a fixed exchange rate, a country must have sufficient foreign exchange reserves (often dollars) and be willing to spend them, to purchase all offers of its currency at the established exchange rate. When a country is unable or unwilling to do so, then it must devalue its currency to a level that it is able and willing to support with its foreign exchange reserves.

When a central bank announces a loosening in its monetary stance, this leads to a quick response by the participants in the foreign exchange market through selling the domestic currency in favor of other currencies, thereby leading to domestic currency depreciation. In response to this, various producers now find it more attractive to boost their exports.

There are two implications of devaluation. First, devaluation makes the country's exports relatively less expensive for foreigners. Second, the devaluation makes foreign products relatively more expensive for domestic consumers, which discourages the imports. It decreases the trade deficit and may increase trade competitiveness of the economy. A government might use devaluation to boost aggregate demand in the economy in an effort to fight unemployment.

Depending on consumer and producer responsiveness to price changes (known as supply and demand elasticities), an effective devaluation should reduce a nation's imports and raise world demand for its exports. Improvement in a country's balance of trade will cause an increase in the new inflow of foreign currency; this, in turn, may help strengthen a country's overall balance of payments account. The total effect of a currency devaluation depends on the actual elasticities of the supply and demand for traded goods. The more elastic the demand for imports and exports, the greater the effect of the devaluation will be on the country's trade deficits and, therefore, on its balance of payments; the less elastic the demand, the greater the necessary devaluation will be to eliminate a given imbalance.

Devaluation often is criticized as an inflationary monetary policy because it raises the domestic price of imports. The underlying cause of inflation is not devaluation, however, but rather excess money creation. Nonetheless, devaluation is an unpopular policy, especially in small countries that are extremely dependent on imports as a source of food and other necessities. A significant danger is that by increasing the price of imports and stimulating greater demand for domestic products, devaluation can aggravate inflation. If this happens, the government may have to raise interest rates to control inflation, but at the cost of slower economic growth. Another risk of devaluation is psychological. To the extent that devaluation is viewed as a sign of economic weakness, the creditworthiness of the nation may be jeopardized. Thus, devaluation may dampen investor confidence in the country's economy and hurt the country's ability to secure foreign investment.

Another possible consequence is a round of successive devaluations. For instance, trading partners may become concerned that devaluation might negatively affect their own export industries. Neighboring countries might devalue their own currencies to offset the effects of their trading partner's devaluation. Such "beggar thy neighbor" policies tend to exacerbate economic difficulties by creating instability in broader financial markets. Devaluation give rise to inflationary pressure because of which, imported good become more expensive both to the direct consumer and to domestic producer using them for further processing.

Exchange rates have different effects in long run and short run of the economy. One reason for the difference is that quantities traded are often slow to adjust to exchange rate movements. Many economists believe that the trade balance in domestic currency terms should drop first in response to a depreciation (or devaluation) of the domestic currency since initially export and import quantities will change little but the price of imports will increase. Over time, however, more will be exported and less imported due to the cheaper value of domestic currency, so the trade balance rises, resulting in what is known as a trade 'J-curve' when the path of the trade balance is plotted over time.

The value of anything is determined by what you can get in exchange for it. Or, on the other hand, what you have to give up obtaining and keeping it. So in effect, the value of anything is its opportunity cost. This holds true for money itself. It is worth what you can get for it... and, what you're willing to give up, in order to get it. Thus, money itself is a commodity and can be used as barter in exchange for other commodities. Purchasing Power Parity (PPP) is the relationship between the currencies of two or more countries and the commodities that can be purchased. Parity suggests that, products that are substitutes for each other in international trade should have similar prices in all countries when measured against the same currency.

The basic idea that supports PPP is that (Ceteris Paribus) any deviation from parity would leave room for arbitrage. An entrepreneur could continuously buy an item in one country, and then sell the same item in another country, making a fortune on the price differential. Because of this profit potential, eventually everyone would get in on this action, until the price differential was eliminated and there were no more profits to be had. This results in the Law of One Price. Any deviations from this parity value should be due to changes in the ratio of imports/exports and/or capital inflows/outflows. These ratios represent changes in demand for the country's currency and will cause the exchange rate to fluctuate above or below parity value.

Economic welfare

Currency depreciation affects the social welfare as well, which depends upon real GDP and the rate of unemployment. If there is unemployment along with a high trade deficit, then currency depreciation unambiguously raises welfare, even though the price level rises and inflationary pressures escalate. This is because in this case outputs as well as employment go up, while the trade deficit disappears.

On the other hand, if the nation is already at full employment, devaluation simply raises the price level, lowers aggregate spending, improves the trade balance, but has no impact on overall welfare. However, the weakest sections of society, the retirees, the minimum-wage earners, the older workers, etc., suffer, because their nominal incomes remain fixed while prices go up.

A word about the choice of terms, though incorrectly used synonymously to denote a drop in currency value with respect to other currencies, ‘devaluation’ and ‘depreciation’ have different implications. ‘Devaluation’ means official lowering of the value of a country's currency within a fixed exchange rate system, by which the monetary authority formally sets a new fixed rate with respect to a foreign reference currency. In contrast, depreciation is used for the unofficial decrease in the exchange rate in a floating exchange rate system. Under the second system central banks maintain the rates up or down by buying or selling foreign currency, usually USD.

Under its previous fixed value system, LKR has undergone two major devaluations. First was in 1965, under the Dudley Senanayake government. The immediate reaction of the then opposition was to coin a new term ‘rupiyala baaldu karanavaa’ underlining the negative bearing of the move. It was further devalued in 1977, when the newly elected, market oriented government under the leadership of President J. R. Jayawardena found no other way to bridge the huge gap between the nominal and real exchange rates.

Pro-devaluation economists are correct in saying a lower LKR improves our competitiveness in the short run. We fully agree. It is basic economics. That is why China pegs Yuan (CNY) to USD, despite the pressure not to. The problem is devaluation is no free lunch; it comes with a massive price tag. To take the most straightforward example, devaluation will immediately skyrocket all loans in foreign currency, further burdening a debt ridden nation. So the question is not whether devaluation improves exports, but whether it does so to a level that justifies the price tag.

Situation in Sri Lanka

Sri Lanka’s rapidly devaluing currency has seen adverse effects with many import industries struggling to keep up with the rising costs. The International Monetary Fund recently expressed concern that the Sirisena administration would struggle to meet its fiscal deficit target of 4.4 percent of GDP this year because of government hikes in wages and spending. Populist policies have often put pressure on Sri Lanka's public finances - an issue that analysts say needs to be addressed to restore investor confidence now that the elections are over. Sri Lanka's foreign debt accounts for 48 percent of total government debts of 8.2 trillion rupees ($58.7 billion), putting the onus on the government to pass revenue-raising measures to stabilize the public finances.

The International Monetary Fund (IMF) last month delayed the final two instalments of its loan to Sri Lanka, demanding the devaluation of the rupee. After the IMF postponed the instalments, worth $US400 million each, due in June and December, Koshy Mathai, the fund's residential representative said no timetable had been fixed for the completion of its review.

The IMF's demands flow from the conditions it imposed when the Rajapakse regime obtained a $2.6 billion bailout loan in July 2009 to avert an imminent balance of payments crisis. The financial emergency was a result of the worldwide economic breakdown that began in 2008, compounded by the Rajapakse government's heavy borrowing for military spending. The austerity measures dictated by the IMF included slashing the budget deficit from 10 percent of gross domestic product (GDP) in 2009 to 5 percent by 2012.

The Central Bank sold foreign exchange worth $416 million in July and $300 million in August to prevent a rupee depreciation. Aitken insisted that "the Central Bank should henceforth limit its intervention." He said the IMF was making this demand because of uncertain external developments—that is, the global economic turmoil produced by the European debt crisis as well as recessionary trends in the US and other major economies.

The Central Bank states it has $8.1 billion in foreign reserves, sufficient for more than five months' imports. However, a considerable portion of the reserves consist of foreign borrowings. The bank obtained another Euro Bond loan of $1 billion last month at a high interest rate in order to repay previous loans.

Economists have also expressed concern over the trade deficit, which expanded by 70 percent to $4.25 billion in the first half of 2011, compared to last year. In the first six months of this year, imports rose by 46.5 percent to $9.3 billion while exports increased 35 percent to $5 billion. Global price increases for essential goods have been a major factor in the deteriorating trade deficit. The average import price of crude oil was increased by 43.9 percent in June 2011, compared to a year earlier. Wheat and sugar prices have also risen.

The government is increasingly reliant on remittances from Sri Lankan workers overseas—worth about $4 billion in 2010—to bridge the trade deficit. Most of these workers are domestic servants in Middle Eastern countries, subjected to oppressive working conditions. The uncertain political situation in those countries is a growing threat to this source of income. The government has highlighted the economy's high growth rate, which the Central Bank has forecasted to be 8.5 percent. The IMF estimate is 7.5 percent, with the fund pointing out that export markets will be affected by the world slowdown during the last quarter of 2011.

Pressure of IMF

There is no doubt that the IMF will tighten the noose, compelling the government to implement its demands, while cutting spending, including on welfare measures. Further attacks on living conditions will trigger explosive struggles of the working class, youth and the poor. That is why the government is keeping intact its police-state regime, as shown by its recent adoption of essential services provisions to replace emergency regulations. Sri Lanka sharply depreciated the rupee in 2012 after the central bank generated a balance of payments crisis by keeping interest rates down with printed money while credit demand rose sharply due to state fuel subsidies. Though the rupee fell from 110 to 130 to the US dollar, there has been no sharp increase in exports.

Export become price competitive after currency depreciation mainly due to impoverishing workers through a fall in real wages, but if external demand is weak, such impoverishment does not lead to higher export growth. Exports fell from 10.55 billion dollars in 2011 to 9.77 billion dollars following depreciation of the rupee in 2012 and grew back to 1.39 billion dollars in 2013. The 2011 figures were exceeded only in 2014 in dollar terms amid falls in dollar commodity prices. Analysts have pointed out that Sri Lanka's protectionist policies meant that industrialists have got used to exploiting domestic customers with high prices and are not competitive or innovative to cater to other markets.

Even where there are surpluses of basic agricultural goods such as rice, they cannot be exported due to bad quality which has been promoted by import tariffs. Sri Lanka has suffered high inflation, 'foreign exchange shortages' and currency depreciation ever since a so-called soft-pegged Central Bank which try to control both inflation and exchange rate simultaneously was set up in 1952. The central bank cut policy rates in April in the midst of balance of payments troubles on claiming that domestic inflation was low. But economists have pointed out that a monetary authority that targets an exchange rate already has an external anchor (the pegged exchange rate) and cannot target a domestic anchor (inflation index) at the same time without rushing headlong into a balance of payments crises.

The rupee has been battered and credit surged over the past year as the monetary authority released liquidity and then monetized debt outright as the budget deficit deteriorated. Excess liquidity in money markets remains high at 75.8 billion rupees. The rupee has hovered around 141.00 to the US dollar, and briefly dropped lower, after the Central Bank stopped quoting daily reference rate on September 04 after devaluing the peg to 134.75.

The positive impact in the trade channel is the price decline of some key imports of the country. Oil, wheat and sugar prices have dropped and as a net food importer this price decline is beneficial to Sri Lanka’s economy. The oil price decline is especially crucial. The high oil price aggravated our trade deficit and it is now cooling down. This will create a more positive impact on our trade balance. The negative impact is the drastic decline of tea and rubber prices. With the declining commodity prices these prices too are on the same trend. At the same time due to the recession in the US and EU economies, the demand for these two products and apparel will drop.

Conclusion

The Rupee depreciation is very important at present for export industries to be competitive to hold the markets, because the domestic cost of production has gone up and industries are in a difficult situation. Interest rates, electricity and wages have gone up while cutting down of cost and productivity increase is limited.

In this situation the only option is to depreciate the currency or else industries will have to gradually close down. If the debt repayment is the concern against depreciation, a prudent debt management policy is very important without depending on the exchange rate to cushion it. With regard to finances, our financial system is not diversified and sophisticated with a number of instruments and therefore it is insulated from the global financial system.

Usual discussions on the fall in the rupee bring up macro-economic matters such as slowing economic growth, corporate earnings and market volatility. For the common man, the falling rupee is going to hit where it hurts the most-the pocket. From essentials such as food and education to foreign vacation and the swanky gadget you plan to buy, the falling rupee will hurt you in more ways than one.

High inflation has been pinching you for more than a year now. Now, the weakening rupee has made crude oil, fertilizers, medicines and other goods, which Sri Lanka imports in large quantities, costlier. Though these items are not for our daily consumption, they impact our finances indirectly. For instance, since India depends on imports for a large part of crude oil it consumes, a weak rupee will influence petrol and diesel prices. "Fuel being directly connected with the cost of transportation, prices of goods that are transported from one part of the country to another, such as food, are bound to rise. This will have a direct impact on the household budget.

The impact of rupee depreciation on the production sector will be due to higher cost of imported raw materials. The companies will be facing cost pressures. The rupee depreciation has added to their woes. They will have to revise prices. Many others will increase prices in the coming months.

Not only is the rupee falling, for some, the pay cheque may shrink as well. Every industry which is dependent on imports will have to face an increase in cost of production and operations. In order to nullify the increase, these companies will have to rationalize costs within their control. One of this will be human resources. So, either lesser number of people will be hired or the salary bill will be kept constant or reduced. The falling rupee is bad news for itinerant Sri Lankans and vacationers to a foreign country. "Air fares are going up due to an increase in fuel surcharge. The stay will be costlier by at least 3-5%. Also, shopping can become expensive by 5%. Eating out will also be costlier by the same percentage.

However, that holiday package you booked in advance before the rupee fell is safe. The impact of rupee depreciation will not become evident immediately as most people usually make travel plans well in advance. The travel cover, mandatory in some cases, may cost more as well. "At present, travel policies' benefits are denominated in US dollars. The depreciation of the rupee will not impact customers but will cost re-insurers more. But if this trend continues there is a strong case for upward revision of premiums.

The depreciation of rupee has impacted the automobile sector in three ways. First, input costs have raised as these companies use imported components. Second, some companies will have to pay higher royalty to foreign parent firms. Third, many have foreign currency loans in the form of external commercial borrowings and foreign currency convertible bonds. The imported paperback, your favorite pizza and the latest laptop will also become more expensive. "There is an increase in the cost of imported books as well as the cost of sourcing them. In most cases they are trying to absorb the increased cost, but there may be scenarios where the end-user will get impacted.

Electronic consumer goods such as computers, televisions, mobile phones, etc, with imported components will also become costlier. International food chains which run outlets in Sri Lanka are not denying the impact on profitability. The depreciating rupee has had a significant impact on our capital expenditure as we import a lot of special kitchen equipment. There has been an indirect impact too as a small part of inputs are imported by our suppliers. If the trend continues, they will be forced to pass on some burden to customers.

The economy is a system; we can’t do whatever we want in one area without having impact in another area. The stability of rupee depends on the balance between the inflow of dollars (or foreign currencies) into the country and the outflow of dollars. And private sector credit growth is important to achieve higher GDP growth; ensuring private sector credit growth is not possible if the balance between inflow and outflow of dollars breaks negatively which means inflow of dollars reduced in compared to outflow. Economies do not crash due to low GDP growth but crash suddenly due to monetary disturbances. That was what happened in Argentina in 1999, in the United States and Europe in 2008. That was what was about to happen in Sri Lanka amidst high GDP growth, in the middle of the year 2012, due to severe devaluation of rupee.

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