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South Asia: Tackling Rising Prices and Falling Currencies Together

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Summary

High inflation in South Asia is hurting the people by increasing prices and reducing earnings. Depreciating currencies magnify the adverse impacts. The twin problems of rising prices and falling currencies must be tackled together. Mobilising more dollars from non-resident populations through attractive bank deposits and high-yielding bonds should be considered.

Global prices have risen to unprecedented highs in the last few months as the world grapples with absorbing the impact of disrupted supply chains and shortages of essential products following the continuation of COVID-19 and the prolongation of the Russian-Ukraine conflict. South Asia is experiencing these strong inflationary headwinds as much as the rest of the world.

Sri Lanka, which is now 'bankrupt' and battling its worst economic crisis, has the highest inflation rate in the region (Table 1). Pakistan – the region's second-largest economy and in deep financial distress – is right behind Sri Lanka. Nepal – another regional economy with precarious macroeconomic conditions – comes next. India and Bangladesh, while not experiencing critical macroeconomic conditions yet, have inflation that is far more than their target rates. Even the small economy of Bhutan is experiencing soaring prices (Table 1).

Table 1: Inflation in South Asia

Country	Inflation (%)	As on
Bhutan	5.95	May 2022
Bangladesh	7.56	June 2022
India	7.01	June 2022
Maldives	2.46	May 2022
Nepal	8.56	June 2022
Pakistan	21.3	June 2022
Sri Lanka	54.6	June 2022

Note: Inflation data for Afghanistan is not available after June 2021.
Source: Trading Economics (https://tradingeconomics.com/country-list/inflation-rate?continent=asia)

The perils of high inflation are well-known. Its worst impact – and the biggest worry for the region – is the effect on the poor. South Asia has experienced a sharp rise in the number of 'new poor' after the onset of the COVID-19 pandemic, resulting in the widespread loss of jobs and livelihoods. High prices will further worsen the economic conditions of the poor and low-income, as they face exacerbating food insecurities and high living costs.

High inflation also adversely impacts businesses by increasing the costs of production. On the other hand, it reduces the consumers' purchasing powers as they experience a faster rise in expenses over those in incomes. Such conditions are greatly adverse for the South Asian economies hoping to make a quick rebound after the economic contraction forced by the COVID-19 pandemic.

Policy options for the region are limited in tackling inflation. Except for contractionary monetary policies that imply raising interest rates, there is hardly room for policy intervention. The Reserve Bank of India (RBI) has already hiked interest rates. The risk of such a policy is that it would make bank credit and loan servicing more expensive. High interest rates might reduce consumer demand and thereby force a decline in prices. At the same time, however, lower consumption, after a point in time, will begin affecting the economy's growth momentum.

The depreciation magnifies the inflation problems in regional currencies against the United States dollar. As import bills rise and currencies weaken, foreign exchange reserves are being deployed to finance imports and defend the falling currencies. This is clearly a situation that is not sustainable for long.

The problem of inflation cannot be addressed by overlooking the problem of currency depreciation. Both are interlinked, given that their origins can be traced to supply shortages arising from the Russian-Ukraine conflict that have augmented earlier deficiencies created by COVID-19 disruptions.

Sri Lanka and Pakistan might experience a turnaround in their economic fundamentals as soon as their foreign exchange reserves are shored up by financial assistance from the International Monetary Fund and other donor agencies. Other South Asian economies such as India, Bangladesh, Nepal and Bhutan need to explore different options. These should focus on increasing the inflows of the dollar in the economy. More dollars would reduce the pressure on their exchange rates, augment foreign exchange reserves and check domestic prices by enabling more imports.

How can the dollar inflows be increased? It might be an opportune moment for India and other regional economies to introduce policies to mobilise more resources from their diasporas. Offering higher interest rates on fixed deposits held in foreign currencies by local banks can be a viable option for mobilising these resources. The other option is to issue non-resident bonds. These bonds can pull surplus savings from the diaspora into local fixed-income securities and augment reserves. Given that interest rates in the region have already been hiked or will be soon, the non-resident bonds will be appealing, given their attractive returns and the prospects of long-term yields. The virtuous impacts of these policies need to be considered seriously.

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