*Trade War: Is it a Prelude to Deglobalisation?**

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I am delighted to be here today and am grateful to the Forex Association of India (FAI) and the organisers of this conference for inviting me to speak to this gathering. I am also happy to be in Singapore, a country which truly epitomises all that can be called achievements of globalisation, and a country with which India had and continues to have multifaceted engagement covering cultural, ethnic and economic spheres. FAI, a body of forex market professionals who intermediate between the supply and demand for foreign currency and act as 'price givers' to the rest of the economy has been active in promoting transparency, professionalism and ethical conduct in the forex market since 1979. I commend them for the role they have played and hope that they will continue to do so in future with utmost efficiency and fairness.

The forex market is unique in several ways. A foreign currency is essentially a commodity outside its jurisdiction and therefore has attributes of an asset. But the exchange rate, the price of the foreign currency normalised to the home currency is an important macroeconomic variable that ought to be determined by economic fundamentals and influences behaviour of economic agents. Principally because of this twin nature, the exchange rate exhibits great volatility and decouples from its value indicated by the economic fundamentals that calls for policy response. I must add that the only thing next to extreme volatility that disorients a forex trader is a situation of very low volatility!

It is ironical that amidst several disruptive factors, the volatility in the global foreign exchange markets has been quite low in recent times. In fact, the JPMorgan Global FX volatility Index has been at its lowest since 2014. Market participants have seen this as a lull before the storm and have recounted past episodes when such a trough was followed by a sharp rise in the US Dollar. Despite the 25-basis-point rate cut announced by the US Federal Reserve, the US Dollar rose sharply, probably anticipating more accommodating measures in the future. If anything, this underscores uncertainty.

The global economic scenario is not very encouraging, though there is no room for pessimism yet. The International Monetary Fund (IMF) continues to revise the global growth projections for 2019 downward though the outlook for 2020 is more positive. The growth in the developed countries remains sluggish and the emerging economies including China and India, the dominant contributors to global growth in recent years, appear to be facing a challenge. Another era of accommodative monetary policy regime seems to be round the corner as evident from synchronised rate cut by several Central Banks.

Global trade tensions between the two largest economies are a dominant theme of discourse today. As of now, there does not appear to be any possibility of quick resolution of the tension, nor does it seem to escalate and get out of hand rapidly in near future. Whatever may be the rational and economic logic behind the competitive protectionism through tariff barriers, it is certainly contributing to the global economic slowdown. The exit of Britain from the European Union, the so-called Brexit also is shrouded in uncertainty and it is recognised that a no-deal Brexit will surely be a disruptive factor. There are also risks emanating from geopolitical tensions in the Gulf and elsewhere that can adversely affect the sentiments.

Delicately poised as the global economy is at this juncture, much of which, as IMF Chief Economist Gita Gopinath says, is self-inflicted, it is entirely premature to think of deglobalisation. Globalisation is an irreversible process and has been progressing for millennia. It has progressed rapidly beyond expectation in recent times because of quantum

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advancements in communication and technology. All aspects of human existence including economies, markets, social interactions, education and so on have become intertwined. True, the process of globalisation has brought problems and discontent in its wake, but wisdom lies in addressing them rather than disbanding the process.

Free Trade has been one of the main planks of globalisation. It has been generally held that free trade amongst nations enhances welfare. The underpinning logic is the same as that in case of free market economics: specialisation, comparative advantage and productivity gains. Just as in case of free market economics, there are factors that affect the gains from trade. Besides, there has always been an asymmetric approach to free exports *versus* free imports. While every country favours exports (except when the terms of trades are deteriorating) because it contributes to domestic employment and growth, there is an abhorrence for imports because the country loses employment, growth and foreign exchange. This brings in deterrent measures like tariff and when one hears talk about optimum tariff, it simply means optimum for the welfare of the country concerned not for the global welfare as a whole. And if all the trading countries impose retaliatory tariffs, it becomes a negative-sum game affecting global welfare and welfare of individual nations to a varied extent.

Ordinarily, the exchange rate is supposed to play some kind of an equilibrating role in addressing the current account deficit, subject of course to several preconditions. A country with trade surplus should experience appreciation of its currency making its exports more expensive and imports cheaper and *vice versa* for a country with trade deficit. The success of this mechanism depends on to what extent the exchange rates are allowed to be determined by the market forces without intervention of national authorities. It is not surprising that allegations of currency manipulation were fairly common in the run up to the recent trade tension.

The increasing globalisation of trade, manufacturing, services, supply chain, capital movement, *etc.* has created a web of complex interdependence. Moreover, the externalities of national economic policies have also become substantially magnified. While the national governments and policy makers are supposed to act in interest of their respective constituencies, the collateral effect of their action on the rest of the world can be significant. The need for coordinated action amongst the leaders of the larger nations is urgent. It must be borne in mind that such coordinated action did contribute to contain the global financial crisis.

Speaking recently, Governor Das drew attention to the US Treasury's monitoring of countries as currency manipulators since 2015 in which India figured for some time till 2018. He further pointed out that the charter of the IMF has elaborate provisions to bind its member countries not to manipulate their currencies so as to gain unfair comparative advantage in trade and it is best that the issues relating to any alleged currency manipulation are best dealt with in a multilateral framework than bilateral attempts to correct a wrong. The same logic applies to trade in goods and services and other areas of discord as well. That was the purpose behind the erstwhile General Agreement on Tariffs and Trade (GATT), now WTO. The current trade tensions are best sorted out multilaterally through cooperation lest as Paul Krugman tweeted some time back, 'In the long run the world would be poorer and in the short run there would be immense disruption.'

The Indian forex markets have been fairly stable in recent months. As you know, the Reserve Bank is mandated to maintain orderly conditions in the foreign exchange market. Its intervention in the forex market is solely directed at curbing sudden turbulences not backed by the economic fundamentals. As has been said repeatedly, market operations are not intended to achieve any target exchange rate or band of rates. It must be pointed out that the exchange rate dynamics in India for more than a decade has been driven by capital flows rather than current account balances. As an aside, India has mostly run a current account deficit, notwithstanding a bilateral trade surplus with the US, marginally more than USD 20 billion during 2018. Though long-term flows related to Foreign Direct Investment (FDI) and long-term debt have been fairly stable keeping in tandem with the economic fundamentals, the portfolio flows have their own dynamics depending as much on attractiveness of returns of Indian assets as the global factors determining their risk appetite. Gyrations in the forex market in these circumstances leave no option other than market intervention to restore orderliness in the market. One also need to bear in mind that India's forex reserves are borrowed reserves and not built out of export surplus. Inasmuch as it provides a bulwark against sudden flow reversals, it enhances the country's ability to cope with the fall out and indeed, contributes to global stability as well.

The policy regime is also oriented to providing adequate instruments of hedging to all resident economic agents who have exposure to a foreign currency as well as all non-residents who have a Rupee exposure. The onshore markets are fairly deep and liquid but needs further strengthening. There is a wide menu of hedging instruments available and further expansion would be in keeping with understanding of their risk implication. In recent times, global institutions and investors have shown a healthy appetite for Rupee denominated assets, which while ensuring flow of foreign exchange protects the Indian issuers from exchange risk. This trend needs to be given further policy nudges.

In fine, I would like to say that though there are discouraging portents for the global economy and uncertainties arising from trade tensions and geopolitical developments, I am optimistic that coordinated policy response and dispute resolution within a multilateral framework will see us through the day.

I will also take this opportunity to highlight two other important issues. First, the issue of transparent and fair pricing of foreign exchange transactions which has been brought to our notice by various category of users. The problem of getting fair prices was especially acute for Micro, Small and Medium Enterprises (MSMEs) and small businesses who were not allowed to access the Foreign Exchange (FX) trading platforms of individual banks. In order to address this issue, the Reserve Bank decided to develop, through Clearing Corporation of India Limited (CCIL), a web-based platform wherein such participants could place their purchase/sale orders directly. The platform, is accessible to users from early August 2019 through an Internet-based application, allows bid/offers from retail clients and Authorised Dealer banks to be matched anonymously and automatically, thereby allowing complete transparency to the users about the levels of their trades. Banks will have to declare and recover their processing charges separately leading to competition amongst banks for customer business. I urge banks to make the platform popular among retail and small business houses/MSMEs.

Second, the Global Forex Code developed by the Bank for International Settlement (BIS) as a common set of guidance for the proper functioning of the FX market. It comprises a common set of principles (55 in total with 6 leading principles) aimed at restoring trust and allowing greater confidence in the forex market and its functioning after various scandals (like LIBOR fixing scandal, *etc.*) eroded confidence in the markets. The Code provides the corporate/intermediary with an opportunity to review/improve its internal FX operations and align them to global standards. It provides a positive signal to its clients, investors, counterparties and the wider market of the corporate's commitment to follow good practices while dealing in the FX market.

In India, all banks, barring one, and several non-bank participants have signed the Statement of Commitment (SoC) to the Code. Though the adoption of the code is voluntary, I urge all the non-bank participants present here to study the Code, examine their processes and, thereafter, sign the SoC to the Global Code.

I wish your deliberations all success.