Q61

Consider the following statements: 1. Tight monetary policy of US Federal Reserve could lead to capital flight. 2. Capital flight may increase the interest cost of firms with existing External Commercial Borrowings (ECBs). 3. Devaluation of domestic currency decreases the currency risk associated with ECBs. Which of the statements given above are correct? (a) 1 and 2 only (b) 2 and 3 only (c) 1 and 3 only (d) 1, 2 and 3 Official key: A.

UPSC Civil Services Prelims 2022 · General Studies · 2 marks · Economy

Indian economy, budget, schemes - Prelims GS Paper I.

Explanation

(a) Official key

1 and 2 only. Fed tightening can pull capital out; ECB interest costs can rise. Devaluation raises, not lowers, foreign-currency ECB risk.

(b)

2 and 3 only. Statement 3 reverses currency risk.

(c)

1 and 3 only. Statement 3 is the false limb.

(d)

All three. Devaluation increases the rupee burden of dollar ECBs.

Summary

The Commission later dropped this item, so there is no official key to mark. Still walk the options. A US Fed tightening can trigger capital flight from emerging markets. That reprices ECBs and can lift interest costs on floating or refinanced lines. A weaker rupee increases, not decreases, the currency risk on foreign-currency ECBs. WRAP does not stamp Official key on a withdrawn row.

Related possible facts

These can be asked in a future Prelims paper.

ECB
External Commercial Borrowing; RBI-regulated foreign-currency or INR debt.

Taper tantrum
2013 preview of Fed tightening and EM outflows.