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The increase in foreign investment inflows between 1997-98 compared to 1996-97, however, did not lead to a higher current account deficit. In fact, current account deficit increased but not as much as expected with increased capital inflows. The Reserve Bank's intervention in the foreign exchange market as a net buyer of foreign exchange to provide a hedge against the risk of a sudden reversal in capital inflows may have been a contributing factor.

Volatility in foreign exchange rates, particularly, volatility in the rupee, along with regional developments, may have led to the current account deficit. The volatility in the rupee may have led to the current account deficit. The volatility in the rupee may have led to the current account deficit. The volatility in the rupee may have led to the current account deficit.

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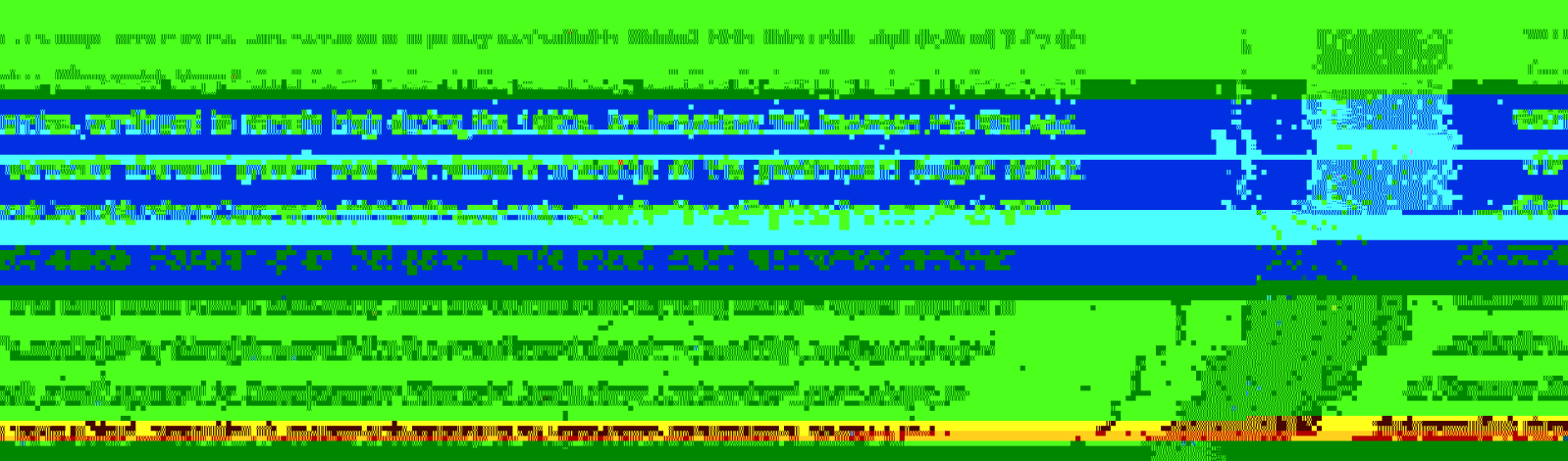


Figure 1: Long-run relationship between the variables. The graph shows that the long-run relationship between the variables is not significant.

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