



Fall of rupee: Causes and impact

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Abstract

The rate at which one currency can be exchanged for another is called the exchange rate. In 1947 the exchange rate of rupee against US \$ (US Dollar) was equal to Rs. 1 but thereafter the rupee started to lose its value. In 1948 to 1966 it was Rs. 4.79, in 1966 Rs. 7.50, in 1975 Rs. 8.39, in 1985 it was Rs. 12.38 and in the year 1990 it was Rs. 17.0. After 1991, Indian Rupee has been made freely convertible into or from foreign currencies. Now exchange rate of Indian rupee with foreign currency is not fixed by the government; rather it is fixed by the market forces of demand and supply of foreign currency. Since 1991 there has been depreciation which has lowered the exchange rate of rupee. On 28th August, 2013 the Indian Rupee (INR) has reached to its minimum level at 68.79469 against US \$ (US Dollar) whereas 4 months ago, it was just at 52. So a question always arises in mind that what has caused such depreciation and what have been the impacts of such depreciation on the Indian Economy.

Keywords: value of rupee, equity market, India stocks

Introduction

Objectives of the study

1. To find out the causes of fall in the value of rupee.
2. To study the impact of this depreciation on Indian Economy.
3. To explain the measures taken by Reserve Bank of India (RBI) to support the rupee.

Research methodology

The data analyzed are secondary in nature which is collected from various secondary sources like text books, reference books, journals, newspapers, magazines, and websites.

Causes of fall in the value of rupee

Although the Indian Rupee is depreciating since 1991 but in the month of August 2013 the rupee has reached to its all time minimum at 68.79469. It has happened due to various domestic and global reasons.

Domestic reasons

1. Policy flip-flops by RBI

On 20th August, 2013 the RBI announced that it would inject over \$ 1 billion into the market, just days after saying that it was working to tighten liquidity. In order to arrest the volatility in the forex market, the RBI started to tightening its Monetary Policy of July 15 and July 23, and on August 8, it followed-up with further tightening measures but on 20th August it signaled a reversal of tightening policy which send a confusing signals on monetary policy and rupee continue to depreciate.

2. Condition of import bill

India's import bill has been going-up and most of this can be attributed to gold. On 14th August the import duty on gold was hiked to record 10 percent, the third increase in eight months, while the duty on silver hiked from 6 percent to 10 percent. This was done with the expectation that the import of gold will reduce and this will also reduce the import bill but it did not work in the same manner rather it increased the

import bill because the import of gold went to 45 tons in first 25 days of July which was just 31 tons in the month of June.

3. Fire fighting of Indian authorities

The Indian Authorities firefighting did more damage to Indian rupee rather than salvaging it. While the government has opened up sectors for foreign direct investment, the RBI has resorted to interest rate defence of the currency. FDI measures are likely to be fruitful only for long-term, while RBI steps are seen largely as bandages that will be effective only for short-term.

4. Volatility in the equity market

The equity market in India has been volatile for a certain period of time. This has put the FII into a dilemma as to whether they should be investing in India or not. As per a report in Business Today the international investor in India have withdrawn to the tune of INR 44,162 crore during June 2013 and this a record amount.

5. Poor current account deficit

The high import of gold and crude oil in such a situation burdened the current account deficit and caused it to raise to unreasonably high level of 6.8% of the GDP. The govt. has been unable to come up with any new destination for exporting its products and this has also hampered the growth in the sector. There are other crucial reasons here like the lack of one window for clearance purposes and procedural delays.

6. Contraction of India economy

The various important sectors of Indian economy such as manufacturing, mining and agriculture have shown poor growth in 2013, and this has made them in India reduced by 2.2% and in July 2013 the RBI predicted that in the present fiscal there would be a growth of 5.5% which was lesser than its previous prediction of 5.7%.

7. Basic law of economics

As per the basic law of economics, if the demand for USD in India exceeds its supply then its worth will go up and that of the INR will come down in that respect. It may be that

importers are the major entities who are in need of the dollar for making their payment. Another possibility in the country and taking them elsewhere.

Global reasons

1. Tight monetary policy by federal reserve

The major event that triggered the rupee to depreciate by such a pace was the statement of the US Federal Bank's Chairmen Mr. Ben Bannanke wherein he expressed the unwinding of the bond purchase programme in the US. The US had been printing money to bolster its economy. Now with the revival of the economy the Chairmen plans to unwind the programme. This statement led to unrest in the US economy and the US investors started withdrawing money from the overseas market.

2. Performance of dollar with respect to other currencies

The Central banks across Japan and countries in the Eurozone have been bringing out a lot of money and this has meant that Both Yen and Euro have lost their value. According to Boolmerg Correlation-Weighted Index that tracks 10 developed national currencies, dollar has gain strength to the tune of 4.7%.

3. Withdrawal of investor

Recently ArcelorMittal and posco decided to pull out from their projects in India. Posco did not go ahead with a steel plant worth INR 30,000 crore that was supposed to built up in Karnataka and ArcelorMittal withdrew from setting up a steel plant in Orissa what was supposed to cost around 52,000 Crore. In fact in 2012-13 the Indian companies have spent more outside India compared to FII in India.

4. Downgrading of India stocks

Golden Sachs, one of the leading banks in the world, has rated India stocks as being underweight, it has also asked investors to be careful given the concerns surrounding the recovery of the growth of Indian economy.

5. Syrain crisis

Syrian crisis has also played a role in reducing the value of Rupee in the period. The crude oil prices rises due to the fear of US military attack on Syria and India being the larger importer of oil has to pay extra due to this rises, which has made the situation worse.

Impact of depreciation of rupee

The depreciation has not only impacted the govt., but also the industry and the individuals of the nation. The depreciation has the following impact on the Indian Economy

1. High rate of inflation

Buying imported materials become very costly. A weak rupee has created extra stress on Oil Marketing Companies (OMC) and they have passed it on to the consumers as the companies are allowed to do so after the deregulation of Petrol and partial deregulation of diesel. This has result in the form of high rate of inflation, as the OMCs increase fuel prices; there is a substantial increase in overall cost of transportation which will trigger inflation.

Country's fiscal health

A frail rupee add fuel to the rising import bill of the country and thereby increasing its Current Account Deficit (CAD). With every single value fall a burden of Rs. 9000 crores is created on the govt. in the form of subsidy. This has caused the fiscal deficit of the govt. to increase. A winding CAD is bound to pose a threat to the growth of overall economy.

2. High cost of students

Students who are studying abroad has to bear the burnt most owing to depreciating rupee. Expenses incurred towards the University/College fee as well of living has shoot up, thereby spelling a huge burden on students.

3. High cost of tourism

The depreciating rupee had surely affected the one is celebrating the holiday abroad. His travel charges as well as hotel charges escalate drastically; His shopping and other miscellaneous spending activities are also affected by the same.

4. Position of India in international arena

This weakened the Indian Position in International Arena. Foreign Institutional Investors (FII'S) lost faith in Indian economy and started withdrawing money from the Indian market. He Foreign entrepreneurs reduced (FDI's) in the Indian industry.

5. Hits investor sentiment

The investor's sentiments were hit badly due to the depreciation of rupee. With the high rate of fluctuation in the exchange market the investor do not want to invest.

6. Loosing confidence in Indian currency

As the rupee was depreciating the currency was loosing the confidence of the local as well the foreign residents.

Measures taken by Reserve Bank to support the currency

As the rupee was closer to 69 marks against US \$, the RBI announced fresh measures to shore-up the currency. Here are the steps taken to support the currency:

1. The Reserve Bank of India (RBI) will provide dollars directly to state oil companies in attempt to support the rupee. State-run companies are the biggest source of dollar demand in market-worth \$ 400 million to \$ 500 million daily-and directing them to a special window, meant to reduce pressure on the rupee.
2. The government will soon issue quasi-sovereign bonds to help bring more dollar inflows into the country. Under the scheme, state finance companies will sell these bonds to fund infrastructure development.
3. The RBI will sell Rs. 22,000 crore bonds every week to check the volatility in forex market.
4. The government has hiked the import duty on gold and silver to 10 percent to rein in the imports. The RBI has tightened the norms for gold imports by linking them to exports. Also, credit availability for gold imports has also tightened.
5. The RBI has reduced the amount of dollar that a resident Indians can take out of the country from \$ 2,00,000 to \$ 75,000 in a financial year. Indian companies have to seek RBI's permission if they want to invest any amount beyond their net worth abroad. Earlier, a company could invest as much as four times of its net worth in an overseas venture.

6. In a bid to attract NRI deposits, the RBI liberalized bank deposit schemes and some banks raised rates for overseas Indians this month.
7. PSU oil companies would be allowed to raise additional funds -\$4 billion- through external commercial borrowings (ECBs).
8. To spur banks to attract more dollar deposits from NRIs, the RBI has exempted these deposits from cash reserve ratio and statutory liquidity ratio requirements.
9. The RBI has tightened liquidity to reduce the availability of rupee in the banking system to reduce rupee volatility.

Conclusion

Although due to these causes, the value of INR is reducing but it does mean that the INR is completely losing its value and it cannot be recovered. This was alarming stage for the government and the government has taken some important above mentioned measures and due to these measures the value of rupees increased from 68.79469 to 61.73469 in the month of August/September 2013. As a whole we can say that though weakening rupee is the reason for someone's smile but it is a real threat for the country's overall fiscal health. Hence apart from the measures already taken the government should now concentrate on increasing exports. SEZ's and export houses should be given liberations so that they can sell their product in the market. Loans should be made cheaper for these organizations so that cost of borrowing reduces. Power and fuel costs should be reduced for them so that their overall cost of production falls. Further special tax rebates should be given to them. Adopting these measures we can increase the value of the INR.

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