Depreciation of Indian Rupee: Causes and Impact

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Abstract

India is facing a huge problem of currency depreciation and this has led to a volatile, uncertain and risky economy. This study focuses on the studying the impact of depreciation of Indian rupee against US dollars and also tries to learn the downfall of Indian rupee. Indian rupee once which was equal to the USD, over the course of few years showed a steady depreciation which has turned all the plans and strategies upside down. Stock markets have become uncertain and flexible, current account deficit is affected which leads to balance of payment and inflation is rising up. RBI tries it difficult to come up with a strategy to encounter this massive fall of Indian rupee.

Keywords: Depreciation of Indian rupee, Current account deficit, Indian economy, Inflation

1. Introduction

With the recent depreciation of Rupee, it has hit a life time low against the US Dollar. The Rupee has weakened nearly 8per cent since May 2013 and 15per cent since March 2012. Since the launch of economic reforms in 1991, the Indian rupee has undergone a series of devaluations and is getting weaker in recent times. Inside the Keynesian theory, money depreciating helps monetary development by advancing net exports, aggregate demand, and yield through the multiplier impact. Notwithstanding, this is just an important condition for degrading to be expansionary, not an adequate one.For example, by making imported inputs more expensive, devaluation can contract the aggregate supply curve, and cause inflation. For a similar reason, it can likewise bring down venture, a key part of total demand. Moreover, if it is a crisis-driven devaluation, it could damage the country's reputation and lead to a flight of capital and destabilize the economy.

` Depreciation of rupee has become a big worry for the Indian government because it has depreciated to an all-time low with respect to the US Dollar. Trade rates assume an indispensable job in a nation's level of exchange or, in other words relatively every free market economy on the planet. Therefore, exchange rates are among the most monitored analysed and manipulated economic measures by the government. This study aims at exploring the dynamics of exchange rate mechanism, rupee journey against dollar since independence, factors influencing the fluctuation of Indian Rupee and finally modelling the exchange rate through multivariate analysis (OLS).

India isn't the main rising country encountering a lofty decrease in its money's esteem. A few developing business sector countries are additionally encountering sharp deterioration over the possibility of inevitable decreasing of the US Federal Reserve's arrangement of quantitative facilitating (QE) program. The South African Rand and the Brazilian Real contacted four-year lows against the US $ in June 2013. But the Chinese Yuan and Bangladeshi Taka, most Asian monetary standards have seen sharp deterioration since the start of 2013. In any case, the Indian rupee has fared more poor than other rising country monetary standards in light of its twin deficiencies – current record and financial shortfalls.

2. Objectives of the study

1. To know the reasons of continues downtrend of Indian rupee value against US Dollar.
2. To study the effects of depreciated Indian rupee on economy.

3. Review of literature

Harberger (2003) in his study in explained the impact of economic growth on real exchange rate and also stressed upon that there is no relation between economic growth and exchange rate.

Due and Sen (2006) found out that the relation between exchange rate , capital and volume of flow of capital, fiscal and monetary policies have been conducive.

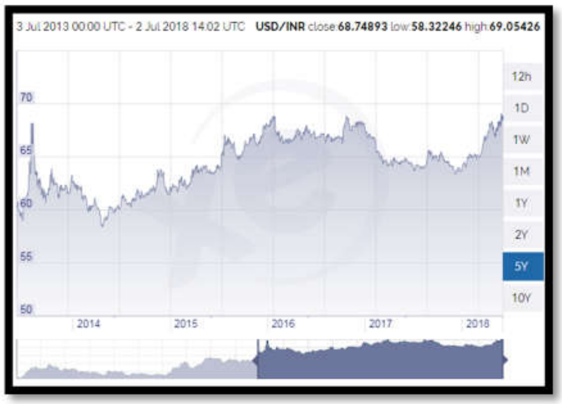
Kim and Ying (2007) comment that with financial liberalization and improvement in information technology, devaluation may be more contractionary than before as it worsens the balance of payments of countries with heavy foreign currency liabilities.

4. Discussion

A. Downtrend of Indian Rupee

The rupee has dove to an unsurpassed low against the dollar and its fall has turned into a subject for discussion. The typical talks on the fall of the rupee raise large scale financial matters, for example, moderate monetary development, enormous current record shortage, rising imports and so on.

At the time of independence when India had no foreign borrowings the rupee was at standard with the dollar. With the presentation of the 5 years plan and the subsequent necessities for outside ventures the dollar gradually climbed. In 1985, as soon as the Rajiv Gandhi government was pulled out due to Bofors scam, the US dollar equalled to Rs. 12.35. And later since economic liberalisation and privatisation, the dollar rate steadily increased to a rate of Rs. 26.40. In early 2000 the rupee lost its value much as it hit a low of Rs. 45 per dollar. In 2013 it hit a historical low till then of Rs. 65.42agaist USD and never the less this steady depreciation continues even in 2018 where USD has hit a low of Rs. 70 per USD. Central bank and economists are trying to figure out what strategy could be implemented to put a halt to the depreciation of Indian rupee.



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This circumstance is to a great degree unsafe for the economy and a nation all in all. Swapping scale influences exchanging connections between countries. The swapping scale is a vital fiscal strategy apparatus for rising economies like India. India has received expansion focusing on and has less adaptable swapping scale game plans. The devaluation of rupee influences purchasing power of income, interest rates, inflation and current deficits. The swapping scale of the cash decides the genuine return of the portfolio that holds the main part of its speculation. It influences purchasing power of income and capital gains derived from returns, income factors such as interest rates, inflation and even capital gains from domestic securities.

Since 2008 after the global financial meltdown, rupee has been devaluating constantly against dollars. The Indian markets opened up during 1990 which helped India to grow economically and also in terms of opportunities for being one of the super powers in the world. However, the devaluation of rupee against dollar in recent years has ripped apart the economy causing heavy destruction. The after effects of the downtrend of rupee value against the dollar have caused our nation a huge loss.

B. Depreciation and Economy

- **Increases in the CAD:** Due to the depreciation of Indian rupee, the gap between a nation's foreign earnings and its payments would be more. Imports become more costly which will increase the outflow of foreign reserves. Since India faces current account deficit, it is predicted that with the largest import of oil, this deficit can widen the gap. Withdrawal of funds by investors also leads to outflow of foreign reserves and this also leads to deficit widening. The central bank will have very less control on the policy cut which may be a burden for the borrowers and thereby increasing its current account deficit (CAD). A widening gap in the current account deficit can be a challenge for the growth of an economy.

- **Inflation:**

  Depreciation of rupee can boost the inflation adversely as the inflation rate in the economy is already close to two digits. As the imports go expensive the fuel price would be inflated considerably. Rise in fuel prices will impact the prices of raw materials and other products which will lead to a steady inflation in the economy. This will create a huge pressure on the developing economy in terms of growth. Curbing inflation will become a tedious task for the central bank and government.

- **Costlier Imports:**

  Cost of imports will be relatively high as the depreciation of rupee is considered. India imports more than 70% of its crude requirement from various nations. Oil prices relatively will be inflated as the cost of importing fuel rises. Per barrel crude will rise as Indian rupee continues to depreciate. However it needs to be noted that the exporters will be in profits as they will generate more revenue considering the exchange rate fluctuations. Hence this will boost exports in India. DK Joshi, chief economist, Crisil, told *Business Standard* that the benefits of the depreciating rupee would be neutralized by the hit to exports. Still, sector wise, experts believe information technology exporters will be among the biggest beneficiaries.

- **Corporate Competition**

  As an impact of costlier raw materials, Indian companies may face challeges in the global market as the cost of production of such companies will be relatively higher than that of other foreign competitors. This will affect the revenue generation of Indian companies compared to their foreign competitors. As per a study conducted by Morgan Stanley, gross revenue margins of companies are at decade lows, mainly due to higher raw material costs and tougher competition. This will encourage companies to shrink the remuneration packages or human labour.

- **Affects foreign investments**

  Falling rupee will also create panic among the Foreign Institutional Investors as they have a huge uncertainty amount the performance of the economy with the continuous downfall of the currency. This may lead to FIIs withdrawing their investments from Indian markets or booking their profits early. The recent plunge in the rupee rate has let the FIIs pull out their investments from the Indian markets which lead to an economic correction. The markets collapsed and it will affect those investors who have invested their money in the market as the market is highly volatile. On the contrary NRIs and other Indian nationals who earn abroad will be interested to invest in India as they will be able to make an advantageous deal with the fall in the Indian rupee.

- **Education and tourism**

  Education and tourism part has additionally been influenced with the dip in the value of Indian rupee. Students, who are studying abroad, will be burdened with the effect of devaluing rupee. Costs towards the college/university expense and additionally that of living will build, which will expand the weight of education. Indian rupee depreciation will likewise influence the tourism. The charges of travel and accommodation will be more costly and this will pull down the interest impressively which will again cause a negative effect.

5. Conclusion

A nation focuses on selling goods and services to other nations in surplus than that of purchasing from other nations. Hence, maintaining the required amount of foreign exchange in the economy for the growth and development of the country. However in case of India, the deficit has been increasing and this was due to major setback on the depreciation of Indian rupee. It is assumed that the fallen in rupee to a certain extent is good as it helps the market to correct itself in the course of time. The movement of the value of a currency will not cause much effect on the economy if it is for a short run. The regulatory bodies in India have taken various corrective measures to curb the volatility of the currency fluctuation. However one needs to wait and see how much it can bring some kind of relief to the economy. It is inferred that the fall in the estimation of Indian rupee has a few outcomes which could considerably affect Indian economy.

6. References

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