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Fluctuating Rupee: Impact on Indian Economy

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Abstract: In present scenario currency fluctuation is the main problem which is facing by the Indian economy. In January 2014 rupee was at 61.90 levels and in February 2016 it was on its peak i.e. 68.8 which was not good for the developing countries like India. India has always been major country when it comes to being trading partner of U.S which has always given economic and strategic support to country like India. The present paper conceptually based on study of Indian rupee fluctuation vs. dollar and relationship in terms of rupee appreciation i.e. dollar depreciation and rupee depreciation i.e. dollar appreciation. It provides valuable insights into impact of changes in currency keeping focus on the Indian economy.

Keywords: ***Appreciation, Depreciation, Rupee fluctuation, Rupee-Dollar*.**

I. Introduction

The term exchange rate means how much one currency is worth in terms of another currency. There are two types of exchange rate fixed and Floating. Fixed exchange rate is fixing by government where as floating exchange rate is set according to market forces. Presently rupee is under volatile trend, caused by sudden changes in demand and supply forces in foreign exchange markets. In January 1, 2014 rupee was at 61.9 per dollar and it was appreciating up to 58.8 when Narendra Modi became Prime Minister. Again, after that rupee was depreciating up to its all time high i.e. 68.8 per dollar in February 2016. But due to strong capital inflows and increasing forex reserves it again appreciates around 5.6%. The rupee depreciation will particularly hit the industrial sector and put higher pressure on their costs as items like oil, imported coal, metals and minerals are getting affected. On the flip side rupee appreciation affect Indian software, automobile and pharmaceutical companies but appreciating rupee is not good for corporate earnings. In 2017 rupee has gained 6.11% against the US dollar joining the best performing emerging market currencies. The main reasons for fluctuation in Rupee are:

(1) Interest rate – The interest rate between two countries create demand for capital. In developing countries like India interest rate prevails around 6-8% which encourages capital inflow.

(2) Inflation rate- The demand for a India's goods and services by the foreign buyers would be more when the inflation rate is lower in India compared to other countries. But sometimes it may increase which result fluctuation in the value of rupee.

(3) Foreign exchange reserve- the levels of forex reserves of India is not satisfactory position which also cause fluctuation in currency.

II. Rupee Depreciation and Appreciation

Depreciation of Rupee means we will get less foreign currency/Dollar by paying more home currency or say more Indian Rupee. On the other hand appreciation means we will get more foreign currency/Dollar by paying less home currency/Rupee. For example: few years back one Dollar was valued at Rs. 62 which means for every Dollar we had to pay Rs.62 and now for every Dollar we will have to pay Rs. 65 that means Rupee is depreciate and Dollar become appreciate.

III. Literature Review

In India some work has been done on the Rupee-Dollar exchange movements (Krishna & Rajesh, 2013). Their paper attempts to understand the dynamics of Indian Rupee fluctuations against US Dollar using yearly observations over the period of 13 years from 2001 to 2013. It identifies six independent variables affecting the exchange rate movements. Golaknath (2002) does an empirical study on the long memory in the case of Dollar-Rupee exchange rates.

IV. Objective of the Study

This study is based on rupee-dollar relationship in terms of rupee appreciation i.e. dollar depreciation and rupee depreciation i.e. dollar appreciation. It shows impact of changes in currency value on Indian economy.

V. Research Methodology

Research methodology is the exact way to solve the research problem in a systematic manner. This paper is based on conceptual study therefore secondary data has been compiled from newspapers, reports, research papers and websites as well. As this is a conceptual study so no statistical tools/ techniques has been used.

VI. History of Rupee-Dollar

At the time of independence, India's currency was pegged to pound –sterling, and the exchange rate was a shilling and six pence for a rupee which worked out to Rs. 13.33 to the pound. The dollar-pound exchange rates then was $4.03 to the pound, which in effect gave a rupee-dollar rate in 1947 of around Rs. 3.30. From 1950 to 1973 Indian rupee was linked to British pound. In 1966 and 1973 devaluation adopted. In 1975 the connection between Indian rupee and pound was broken. In 1991 rupee was devalued in two stages. India was in high inflation position, low growth and insufficient foreign reserves. There was great political and economical instability. The government opened the economy. This was followed by several other reforms liberalising the economy and exchange rate regime. In 1993 India moves to a market determined exchange rate system after merging the dual rates of Liberalised Exchange Rate System (LERMS) introduced by RBI and the system of market exchange rate was adopted. At that time one US dollar was equal to 31.44 Rs. In 2000 when FEMA, 1999 replace FERA 1 US dollar is worth Rs. 44.7. After that in 2004 when Congress led UPA government came the value of 1 dollar equals to 45.32 but when BJP led NDA came in to existence on 26th May 2014 the value of rupee were 58.43 Rs. per dollar. The main causes were increase in imports of oil and gold and depletion of forex reserves. In India due to high demand of Dollar Rupee was always weaken. The below table shows the value of Rupee was changes over the period of time. In 1976-77 the average value of Rupee was 8.97 which mean for every one Dollar Rs. 8.97 was to be paid. It was the time when India's Balance of Payments in surplus position. After that due to heavy import of crude oil and gold the demand of Dollar were increasing which results depreciate Rupee.

Values of Indian Rupee against Dollar since 1976-2015
(Approximate average for the year)

Year	US Dollar Average	Year	US Dollar Average
1976-77	8.9775	1996-97	35.4999
1977-78	8.5858	1997-98	37.1648
1978-79	8.2267	1998-99	42.0706
1979-80	8.0975	1999-20	43.3327
1980-81	7.9092	2000-01	45.6843
1981-82	8.9683	2001-02	47.6919
1982-83	9.6660	2002-03	48.3954
1983-84	10.3400	2003-04	45.9515
1984-85	11.8886	2004-05	44.9315
1985-86	12.2349	2005-06	44.2735
1986-87	12.7782	2006-07	45.2495
1987-88	12.9658	2007-08	40.2607
1988-89	14.4817	2008-09	45.9933
1989-90	16.6492	2009-10	47.4433
1990-91	17.9428	2010-11	45.5626
1991-92	24.4737	2011-12	47.9229
1992-93	30.6488	2012-13	54.4099
1993-94	31.3655	2013-14	60.5019
1994-95	31.3986	2014-15	61.1436
1995-96	33.4498		

Sources: RBI Bulletins

Factors Affecting Fluctuations in Rupee-Dollar

There are number of factor influencing currency depreciation and appreciation. The currency value of an economy, influence the growth rate of Gross Domestic Product (GDP). Several other factors that have a direct influence on the over or the undervaluation of a currency are listed below.

1. Inflation rate
2. Interest rate
3. Foreign Direct Investment(FDI)
4. Foreign Institutional Investment(FII)
5. Global currency trends
6. Foreign exchange reserve
7. Crude oil prices

VII. Impact on Indian Economy

Volatility in Rupee has adverse effect on profitability, revenue, expenses, and imports. Rupee appreciation makes imports cheaper and exports more expensive. Indian software, automobile and pharmaceutical companies will be affected the most by stronger Rupee. But from Indian companies point of view it is not good sign. On the other side Rupee depreciation makes imports expensive and exports cheaper. A sharp decline Rupee triggers inflation, broaden current account deficit. A weak rupee will create extra stress on oil marketing companies and the partial deregulation of diesel. Travelling abroad will be costlier as Indians will have to pay more Rupees to buy Dollars for overseas trips. Following points showed impacts on Indian economy with fluctuating Rupee value.

1. **Gross Domestic Product (GDP)**- There are some relationships between GDP and exchange rates, but it depends on time period we observed. Sometimes it could be very strong relationship and sometimes it could be soft. In 1975-76 when GDP rate was 9% (*www.Statisticstimes.com*) at that time exchange rate were at 8.80 Rs per Dollar. But when economic reforms were introduced in India in 1991 the GDP rate was 1.43% and the value of rupee at higher level i.e. 31.22 per dollar. In 2004-05 when UPA government came then the GDP rate was 7.05% where as the value of Rupee 43.75 per dollar. After 10 years regime of UPA government when NDA government came than the GDP rate was 7.2% and the value of rupee 60.09 per dollar.

2. **Inflation:** Inflation is closely related to interest rates, which can influence exchange rates. Countries attempt to balance interest rates and inflation, but the interrelationship between the two is complex and often difficult to manage. As the rupee strengthens, import prices fall and drive down inflation but when rupee depreciates inflation will go up. Inflation rate in India averaged 6.68%from 2012 until 2018, reaching an all time high of 12.17% in November 2013 and a record low of 154%in June 2017. In 2012 inflation rate in India was at highest level i.e. 11.17% but same time value of rupee was around 54 Rs. per dollar. In 2015 when the inflation rate was 5.88% and rupee value was around 63Rs. per dollar. So this shows that rupee-dollar value can be fluctuate in any direction.

3. **Foreign exchange reserves:** Right now forex reserve of India is in its peak position i.e. 421.7 million dollar and the value of Rupee is appreciating. The reason for increasing forex reserve is due to increasing Foreign Direct Investment and Foreign Portfolio Investment. In December 2014 when the value of Rupee was around 61.9 per dollar and same time the forex reserve were 319.7 Million Dollar. Where as in December 2016 the value of Rupee was 67.92 per Dollar and at the same time the forex reserve was 359.67 Million Dollar. Which shows that as the value of Rupee is depreciating the forex reserve increases.

4. **Current Account Deficit (CAD):** Current account deficit indicates the status on trade between a country and the rest of the world. Any deficit in current account shows that a country's total imports of goods and services are greater than the country's total export of goods and services. This situation makes a country a net debtor to the rest of the world. In such situation, a country has to buy more foreign currency to meet its need with in the country. India's CAD is 204% of GDP in Q1 of 2017-18 increased sharply from .1% of GDP in Q1 of 2016-17 and .6% of GDP in Q4 of 2016-17. The widening of the CAD on year-on-year basis was primarily on account of a higher trade deficit cause of higher imports.

5. **Foreign Institutional Investment(FII):** Economies like India, Which offer relatively higher growth than the developed economies, have gained favour among investors as attractive investment destinations for foreign institutional investors (FII).India is the largest start-up base in the world with more than 4,750 technology start-ups and about 1,400 new start-ups being founded in 2016, according to a report by NASSCOM. On 1st April 2005 FII investment was Rs.45765 crore and at the same time value of rupee were 43.705 per dollar. In January 2009 the rupee value were 48.26 per dollar and the FII investment was Rs. -45811 crore which shows that as rupee value depreciate the flow of foreign investment also decrease. In the last month of 2017 the value of rupee was Rs.143878 crore which means as value of Rupee fluctuate FII investment also changes. Presently the FII investment on its peak because of appreciation of Rupee value.

VIII. Conclusion

This study provides the basic understanding of the term fluctuation of rupee and impact of fluctuating rupee on Indian economy. Since there are various internal as well as external reasons behind rupee appreciation and depreciation to a large extent, It takes time to bring back the situation to the normal state. RBI and other Government agencies have to play their role to tackle this situation. It is desirable to impose curbs on imports of non essential items. In addition to higher custom duties, strict quantitative restrictions on the import of gold and non-essential items should be imposed so that the demand of dollar will be decline. Presently 'Make in India' scheme will focus on more FDI inflow in India which boost Indian manufacturing sector and also increase forex reserve. Issue of 'Masala Bonds' by Indian corporate houses will also control on the Rupee fluctuation. More export incentive should be provided to boost export trade in the country. RBI should sell forex reserves and buy rupees in an immediate action in order to control currency depreciation.

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