ABSTRACT

India being a fast developing economy of the world is witnessing a continuous fall of its currency Rupee against US Dollar in recent times. The devaluation of the Rupee is the latest point of debate in many news broadcasts on television today. No common man would have ever expected that rupee could fall to such a low level against Dollar that what it has nowadays. In the year 1947, when India got Independence 1 Rupee was equal to 1 Dollar. But in August, 2013 it reached to the lowest of all time to Rs.69 per Dollar.

Highlighting some important points on continuous fall of rupee, its causes and impact on the common man, corporate sector and country as a whole.

I. REASONS FOR DEPRECIATION OF RUPEE

As we all know, Money is not an organic creature but its value keeps changing with the society and its economic conditions. One rupee in 1947 is not the same as one rupee today, both in terms of appearance and purchasing power.

The value of a country's currency is linked with its economic conditions and policies. The value of a currency depends on various factors that affect the economy such as imports and exports, inflation, employment, interest rates, growth rate, trade deficit, performance of equity markets, foreign exchange reserves, foreign investment inflows, and geopolitical conditions etc”. Let’s understand the some major reasons in devaluation of rupee:

1. Unfavorable Balance of Payments:
   International monetary transactions of a nation is recorded in two accounts.
   a). Current Account: This account records all the trades (export-import), remittances, interests and earnings on investments made into outside countries and other flows which is current in nature. If total inflow of foreign currency in the country through its export, remittances and earning from its investments abroad, is more than its outflow through its import, remittances out of the country, payments of interests etc. then the country is said to have current account surplus. Similarly, if outflow exceeds inflow, the country is said to be in Current Account Deficit (CAD). India has huge current account deficit (about 120 billion USD in FY 2012). And due to various reasons like heavy import bills etc., the problem of CAD continues to persist.

b). Capital Account: This records all the flow (into or out of the country) made for future return – investment in stocks, bond or companies, in real estate or FDI (investment made for setting up of business or industry). It also includes loans taken from abroad (which actually is investment by foreign lender into the nation). Foreign Currency Reserves are also part of Capital account but are generally not reported. A country is said to be in Capital Reserves when the inflow is more than outflow through its foreign investment inflow, payment of interests etc.
account surplus if total inflow into the country (FII, FDI and borrowing from foreign companies/banks) exceeds total outflow (investments into foreign countries and lending to foreign countries or companies). In case situation is reversed, country has capital account deficit.

2. **Foreign Exchange Rate Mechanism – Increased Forex Demand**

   All economies that interact with international economy can be broadly classified into three categories on the basis of exchange rate policy of the country.

   a. **Fixed Exchange Rate**: The countries which have adopted fixed exchange rate are the economies which have fixed the value of their currency with some other prominent currency like US dollar. This system is simple and provides stability to the economy (of course, if the economy of the country to whose currency its currency is fixed/pegged is stable). This type of exchange rate regime is maintained by generally smaller economies like Nepal and Bhutan which have fixed/pegged to Indian Rupee. Rational behind such regime is that in case of small economy – if the exchange rate is market determined – the sudden influx or outflux of even relatively small amount of foreign capital will have large impact on exchange rate and cause instability to its economy.

   b. **Free Exchange Rate**: The countries which have adopted free floating exchange rate policy are the economies where foreign exchange rate for conversion of currencies entirely depends on the market scenario. The example of such countries are like USA, UK, countries of European Union etc.

   c. **Hybrid system**: Most mid sized economy like India practices a mix of both these regimes. It allows for the exchange rate to float in a range which it deems comfortable. Once the market determined rate tries to breach this range, central bank (government) intervenes in the currency market and controls the exchange rate.

   In India due to increased demand of oil and gold, the imports are higher and for such imports foreign currency is needed and thereby generates demand for foreign exchange. Though it is the market forces that determine the rates of rupee per dollar and market being unfavourable for India has resulted increase in demand of Dollar and depreciation of Rupee.

3. **Inflation**

   Only two kind of person always complain about price rise i.e. male and female. Nobody is spared from heat of inflation. Every generation complains about price rise or inflation. Inflation is a necessary evil which automatically devalues the currency of any country where it exists. Prices shoot up when goods and services are scarce or money is in excess supply. If prices increase, it means the value of the currency has eroded and its purchasing power has fallen.

   A fall in purchasing power due to inflation reduces consumption, hurting industries. Imports also become costlier. Exporters, of course, earn more in terms of local currency. However, if the increase in money supply lags economic growth, the economy will face deflation, or negative inflation. The purchasing power of money will increase when the economy enters the deflationary state. If one think deflation will help him consume more and enjoy life more, he is wrong.

4. **Income levels** also influence currencies through consumer spending to some extent. When incomes increase, people spend more. Higher demand for imported goods increases demand for foreign currencies and, thus, weakens the local currency.

5. **Political Factor**: In India Political Factor has a huge impact on country's economy and functioning. Within past few years, the country has witnessed record no. of scams involving huge public money which is a direct loss to the growth and sustainability of a nation. Increasing corruption, ineffective and poor implementation of the policies, delay in execution of works approved for public welfare and growth, have lead to the situation of policy paralysis in the country which has reduced the trust of investors into the country’s economy and thereby has created a Trust Deficit among the investors whether Indian or Foreign.

II. **DEVALUATION OF RUPEE GOOD OR BAD …?**

   From a country’s perspective, it creates an imbalance on the Balance of Payments especially for import driven economies. A country like India which imports majority of essential commodities like oil, pays much more in terms of the value in INR than opposed to what it previously would have paid. The imports get expensive thereby increasing the Current Account Deficit. This will further devaluate the currency which becomes a vicious cycle until the imports are reduced.
On the other hand, the Devaluation in currency is a welcome change for a company which is into the export of goods or services. For example, let us consider the IT or Export Oriented Units (EOUs) companies in India, the currency devaluation has come as a blessing in disguise as these industries were battered with slow growth due to global economic slowdown. From a healthy growth of 18% in the past, the NASSCOM has estimated that this year the industry would grow around 10-14% most likely on the lower side of the range. The currency devaluation at this point of time is more than welcome for these companies as they contribute directly to the bottom line. For example, a contract worth $100 was worth INR 5,000 a while back when the exchange rate of $ to INR was 50. Now at the current exchange rates, the same project is worth more than INR 6,000.

The depreciation of rupee has impacted the automobile sector in three ways. First, input costs have risen as these companies use imported components. Second, some companies will have to pay higher royalty to foreign parent firms. Third, many have foreign currency loans in the form of external commercial borrowings and foreign currency convertible bonds. Therefore, more or less all auto companies will have to increase prices. “We expect at least a further 2% increase in prices. Few automobile and tyre manufactures have already revised prices recently and it is expected that others that have large import content will have to soon increase prices to protect margins.

Electronic consumer goods such as computers, televisions, mobile phones, etc, with imported components will also become costlier. International food chains which run outlets in India are not denying the impact on profitability. The impact of rupee devaluation on the FMCG sector will be due to higher cost of imported raw materials. The companies are already facing cost pressures but the rupee depreciation has added to their woes. Students who have taken loans to fund their foreign degree are also bearing the brunt as the cost is in a foreign currency while the borrowing is in the rupees.

III. IMPACT

Why oil price is increasing is quite obvious. But there is continous increase in petrol and diesel prices in the country which directly hits the common man. The daily needs goods are getting costlier day by day without any increase in salary. Further, for reducing burden of increased inflation and economic slowdown corporates are cutting jobs of employees resulting in huge unemployment which is serious concern for the country. In the last two years, the rupee has plunged more than 30% against the dollar which means we have to shell out 30 percent more to purchase things that can be had for a dollar. Evidently, the downfall of rupee against dollar is making Indians poor as rupee is loosing purchasing power.

What has made the devaluation of rupee more problematic is global slowdown. Alternatively, it might well be that this downfall was brought about by the global slowdown. But in either cases, the demand for goods and services in developed economy is dwindling. But demand in certain goods like textile will not be impacted that much. Main competitor of India in such sector is China. During the same period when Indian rupee has been falling, salaries of labors in China has been on the rise. This had made Indian export more favorable.

Another impact, which may seem like silver lining in the dark cloud is that it has forced government to bring certain economic reforms (FDI in retail and other sectors) and has brought a near crisis like situation which can force unwilling government to bring reforms.

Government has tried several things to control downward spiraling rupee but those steps are too little, too late and many are pointed in wrong direction; like curbing import of gold. Demand of gold in India is culture induced. Also, demand of gold increases when economic uncertainty increases. Trying to micromanage people’s behavior will have undesirable impact in long term.

This is a time when we should be investing in technology and innovation, and boost our GDP through better & higher productivity and superior products. This will not only help to get more revenues through taxes but will also help in reducing the fiscal pressures and strengthen our economy and in turn our Rupee. Rupee must appreciate to the extent to stop the losses. As excess appreciation is also not so good for country’s exports and foreign trade. There are not many options in short term, but in long term government needs to bring reforms pending for many decades. Those reforms need strong political will and good monitoring.