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Fall of Indian rupees: causes and impact on Indian economy

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ABSTRACT
Over the years, the Indian Rupee (INR) has emerged as a strong currency having a strong base with good fundamentals it is generally believed that Europe's economic crisis, growing import bill, external debt amounting to nearly 20 billion US dollars maturing in 2012 are all putting pressure on already stressed rupee. Historically, from 1973 until 2014 the USD/ INR exchange flucatutate30.32 to 68.85. And a record low of 7.19 in March of 1973.India may face its worst financial crisis in decades if it fails to stem a slide in the rupee, leaving the central bank with a difficult choice over how to make the best use of its limited reserves to maintain the confidence of foreign investors. The fall in the value of Indian rupee has several consequences which could have mixed effects on Indian economy. This paper tries to study the reasons for devaluation of Indian rupees. It also attempts to study the real implications of the depreciation of the rupee on the Indian economy and shows that in the long run, the Indian economy has more to lose and less to gain with weaker rupee. In this paper effort has been made to highlight on the importance of central bank intervention to control this situation

I. OBJECTIVES OF THE STUDY

1) To know about the history of Indian Rupee.
2) To understand the concept of Indian rupees depreciating
3) To understand the causes and the steps taken by RBI and government on the major devaluations that took place in India.
4) To study the real implications of the depreciation of the rupee on the Indian economy

History of Indian rupees

The currency of India is the rupee. Rupee is derived from the Sanskrit rupyakam which means coin of silver ("Indian Rupee"). The rupee has transitioned through several governing bodies over its recorded history. Each transitional phase can be traced by the examples of the rupee notes as follows: early private and semi-governmental banks, Government of India, King George V, King George VI, Indo-French Territories, Indo-Portuguese Territories, Prisoner-of-War Coupons, Princely States, cash coupons of Princely States, and post Independent India (Indian Currency Collector Online).

Early Private and Semi-Governmental Banks (1770-1861 A.D.)

The European traders, especially those with the East India Company, were familiar with using paper currency to further paying for their trades. Previously in India, banking existed dating all the way back 500 B.C. as a commercial activity among the tradesmen of the time (Reserve Bank of India). Yet as the European traders began their commerce in India no form of paper currency existed. Private Banks were created, initially in the province of Bengal. The first such bank to implement paper money was established by Governor Warren Hastings in Calcutta around 1770 A.D. (Jhunjhunwalla Online). Following the first Private Bank, the Bank of Bengal was formed. The paper money printed by the Bank of

Bengal was circulated on a much wider basis, as well as being accepted as payment for certain government dues. The Bank of Bengal was the first bank in India to have a government share in its working capital. The paper money the Bank of Bengal issued ranged in denominations from rupee (Rs.) 10 to rupee (Rs.) 1000 (Jhunjhunwalla Online).
Bombay had a large commercial boom in the 19th century. This boom led to the Bank of Bombay being established, which was chartered in 1840. Bank of Bombay's charter meant the bank had the authority to issue and print its own paper money or notes. Bank of Bombay also enjoyed a government share..

I. INTRODUCTION

A persistent depreciation/fall in the value of the currency would have important consequences on the Nation's continued reliance on deficit financing. decrease in the value of a currency with respect to other currencies. This means that the depreciated currency is worth fewer units of some other currency. While depreciation
means a reduction in value, it can be advantageous as it makes exports in the depreciated currency less expensive. To put it differently, if one US dollar can buy 45 INRs today, and can buy 60 INRs tomorrow; INR would have depreciated by 33 percent. The opposite logic holds true for a currency appreciation. But what exactly determines the value of a currency? It is the demand and supply. If more people demand say, US dollar, the value of it goes up relative to the INR, and vice-versa.

As the S&P BSE Sensex is plunging every other day coupled with the free fall of rupee, there is little any one can do. If the depreciation in rupee continues, it will further increase inflation, because of this extreme fear people across all age groups have started saving more which is good news for banks as banks are grappling with the tight liquidity. The volatility in the stock market, the continuing decline of the rupee, and rising
yields in government bonds reveal investors' lack of faith that the Indian government is in control of the situation due to which investment cycle is in its bottom stage which is putting pressure on Indian currency.

Why is the Indian rupees depreciating

The Indian rupee touched a lifetime low of 68.85 against the US dollar on August 28, 2013. The rupee plunged by 3.7 percent on the day in its biggest single-day percentage fall in more than two decades. Since January 2013, the rupee has lost more than 20 percent of its value, the biggest loser among the Asian currencies. There is no denying that India is not the only emerging market experiencing a rapid decline in its
currency's value. Several emerging market currencies are also experiencing sharp depreciation over the prospect of imminent tapering of the US Federal Reserve's policy of quantitative easing (QE) program. The South African rand and the Brazilian real touched four-year lows against the US dollar in June 2013. Except the Chinese Yuan and Bangladeshi Taka, most Asian currencies have witnessed sharp depreciation since the beginning of 2013. Nevertheless, the Indian rupee has fared much worse than other emerging market currencies because of its twin deficits – current account and fiscal deficits. The foreign investors are particularly concerned over India's bloated
current account deficit (CAD) which surged to a record high of US$88.2 billion (4.8 percent of GDP)in 2012-13. Despite a modest recovery in the rupee's value between September 4 and 12, the investors remain wary of India's excessive dependence on volatile "hot money" flows to finance its current account deficit. Over the past several months, India's exports have considerably slowed down due to weak demand

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from traditional markets such as the US and Europe. While high imports of gold and crude oil have

Causes of devaluation of Indian rupees

1. The gold and silver imports were nearly $33 billion (bn) during January-May 2013.
From Capital Glut to Capital Flight There is ample reason for concern that capital outflows from India and other emerging markets will rapidly accelerate if the Federal Reserve decides to curtail its bond-buying program on September 17. This move
would lead to higher interest rates in the US and investors may dump risky emerging markets assets in favor of safe havens.
2. Since the beginning of QE program, much of the money has leaked into emerging markets offering higher yields and better growth prospects. The emerging markets have been the biggest beneficiaries of Fed's loose monetary policy, which has pumped extra liquidity since the global financial crisis of 2008. According to the IMF, emerging markets received nearly $4 trillion in capital flows from 2009 to early this year.
The investors borrowed cheap short-term money in the US and invested in higher yielding assets in India, Indonesia, South Africa and other emerging markets. This resulted in more money flowing into debt, equity and commodity markets in these countries. In India, many companies resorted to heavy borrowings overseas. The massive capital inflows also enabled India to comfortably finance its trade and current account
deficits rather than addressing the structural aspects of CAD. However, this money will quickly leave India and other emerging markets when the tapering of QE program begins. Already, emerging markets are witnessing a huge outflow of dollars as investors have started pulling money out of bond and equity markets. The foreign investors pulled
out a record Rs.620 bn ($10 bn) from the Indian debt and equity markets during June-July 2013. If the Federal Reserve decides to taper the QE program, the liquidity withdrawal would continue to put pressure on the rupee over the next 12 to 18 months.
3. Other Developments There are a host of other factors which have added to the bearish
sentiments on the rupee. Economic growth in India in the first quarter(April-June 2013)slipped to 4.4% due to a contraction in manufacturing and mining. A sharp rise in domestic food prices has also put a grinding pressure on the rupee.
4. Apart from economic factors, the rupee remains vulnerable to rising global oil prices and geo-political tensions in the Middle East and North Africa. As the threat of US-led war against Syria rises, oil prices are expected to rise which will further make it difficult for the Indian government to reduce CAD since India imports over 80 percent of its oil.
The foreign investors pulled out a record Rs.620 billion ($10 bn) from the Indian debt and equity markets during June-July 2013.
5. High Current Account Deficit:
CAD occurs when a country's total imports of goods, services and transfers is greater than the country's total export of goods, services and transfers. This situation makes a country a net debtor to the rest of the world. The High current account

deficit is putting a lot of pressure on rupee. The CAD reached to 4.8% of GDP which has breached the comfort level of 2.5% of GDP as mentioned by RBI in 2012-13. The Primary reason for ballooning CAD is high imports as compared with Exports.

India is Importing crude oil as our country can only produce 20% of the demand , rest 80% is being imported from different oil Producing countries first being Saudi Arabia followed by Iraq. The steadily worsening balance of payments (BoP) outlook
has been a central point of concern to not only RBI, but to the finance ministry as well. According to the minister of commerce Mr. Anand Sharma Total import of crude oil is $150 Billion and the import of Gold is $60 billion. The total current account deficit is $150 in 2012-13. The facts show that fertilizer imports surged by 30% in the last two years and coal imports have doubled. Therefore, the problem of CAD continues to persist. With the reduction in exports and an increase in imports, on one hand the current account deficit has swelled while on the other, the fiscal deficit is also expected to be above the comfort levels due to increased subsidy by government. A slowdown in
the global economy has drastically reduced the demand for Indian goods and services.
The fall in commodity prices on the other hand have increased imports which resulted in an imbalance between payments and receipts. S R Rao, India's trade secretary said that India is unlikely to achieve the export target of $ 350bn which could result in higher current account deficit due to which there will be fall in rupee value. A large fiscal deficit forces central bank (RBI) to print more money and encourage inflation. This further hurts the rupee value.

6. Less FDI coming to India:

The United Nations Conference on Trade and Development (UNCTAD) june 2013 pointed out that the foreign direct investment in India gone down by 29% to $26 billion in 2012. When dollars come into India through the foreign direct investment (FDI) route they need to be exchanged for INR. Hence, dollars are being sold and rupees are bought. This pushes up the demand for INR, when we increase the supply of dollars, it helps rupee gain value against the dollar or at least hold stable. In 2012, the FDI coming into India has fallen dramatically. The situation is likely to continue in the near short term.

The corruption scandals revealed in the 2G and the coalgate scam hasn't improved India's image abroad. In fact in the 2G scam telecom licenses have been cancelled and the message that was sent to the foreign investors was that India as a country can go back on policy decisions. This is something that no big investor who is willing to put a lot of money at stake, likes to hear. Opening up multi-brand retail sector was government's other big plan for getting FDI into the country. In September 2012, the government had allowed foreign investors to invest upto 51% in multi-brand retail sector. But between then and now not even a single global retail company has filed an application with the Foreign Investment Promotion Board (FIPB), which scrutinizes FDI proposals. This scenario doesn't look like it is changing as still foreign
investors struggle to make sense of the regulations as they stand today. Dollars that come in through the FDI route come in for the long run as they are used to set up new industries and factories or to have joint venture in existing companies. This money cannot be withdrawn overnight like the money invested in the stock market and the bond market by FIIs.

7. Unreasonably High Imports:

Love for gold by Indians has been prime reason behind significant demand for the dollar. Gold is bought and sold internationally in dollars. India extracts very little gold on its own and hence has to import almost all the gold that is required in the country. When gold is imported into the country, the payment has to be done in

dollars, thus pushing up the demand for dollars. As many have argued in the past that there is some logic for the love that Indians have had for gold. A major reason behind Indians buy gold is high inflation. Consumer price inflation is still very high. Also, with the marriage season around the corner for the next few months, the demand for gold is likely to go increase. India imported record 162 Tonnes of Gold in May'13, what can also add to the demand is the recent fall in price of gold, which will get those buyers who preferred to stay
away from gold because of the rising price, back to the market. All this means a higher demand for dollars. Gold is the 2nd largest commodity after crude being imported by the Govt. Also India has been importing a huge amount of coal lately to run its thermal power plants. India's coal imports drastically grew by 43% to 16.77 MT in May'13, as compared to the same period in 2012. Importing coal again shows increased demand for
dollars.

The irony is that India got huge coal reserves which are still not being extracted. The common logic here is to blame Coal India Ltd, which more or less has had a monopoly to produce coal in country. The government has tried to bring private sector
investment in the coal sector but that has been done in a haphazard manner which resulted in the Coalgate scam. This has delayed the process of bigger role that the private sector could have played in the mining of coal and thus led to lower coal imports. The situation cannot be improved overnight. The major reason for this is that the expertise to get a coal mine up and running in India has been limited to Coal India till now. To develop the similar expertise in the private sector will take time and till then India should continue to import coal, which will need dollars

8. Rupee Sinks due to huge FII outflows:

FIIs had resulted sellers in June due to the sharp decline seen in the rupee. With US economy showing signs of improvement, the dollar strengthened, causing currencies across the emerging markets to decline in June-July. The rupee fell by a little more than 10% since June 11. Improving employment data and lower inflation in the USA were conceived as indicators of a recovering economy, leading investors believed that the Quantitative Easing-3 (stimulus) would be phased out sooner than expected; causing funds to flow away from emerging markets like India, back into developed markets. Emerging economies had been the biggest beneficiary of the QE3 bond-buying programe, worth $85 billion per month.

9. Time to Repay ECB:

While the supply of dollars will remain a problem, the need for them will continue to remain high. A major demand for dollars will come from firms which have raised loans in dollars over the last few years and now have to repay them. In Beginning 2004, the RBI has approved nearly $220 billion worth of external commercial borrowings and foreign currency convertible bonds (FCCB), at the rate of a slightly over $2 billion
a month. About two-thirds of this amount was approved in the past 5 years. Much of this ECB will have to be repaid this financial year, putting further pressure on the Indian currency.

A lot of companies have raised foreign loans over the last few years simply because the interest rates in India are very high as compared to outside world. These firms will need dollars to repay their foreign loans as they are nearing maturity. The other thing that may happen is that firms which have cash, might look to repay their foreign loans earlier rather than later. This is simply because as the dollar is appreciating against rupee, it takes a greater amount of Indian currency to buy dollars. So if companies have idle cash lying around, it makes greater sense for them to pre-pay dollar loans. The trouble is that if a lot of companies decide to prepay loans then it will add to the rise in Demand for the dollar and thus put further pressure on the INR.

10. Historical Value of Exchange Rate

Indian currency i.e. rupee has been in news because of recent fall against the dollar. Rupee has fallen more than 15% in just 3 months' time against dollar. India rupee has been depreciating against dollar for long time now. Post liberalization, the fall in the rupee against dollar has been rather steep. It is important to note that rupee has started falling against dollar more frequently after partial convertibility of rupee was introduced. The partial convertibility gave it more elbow room to automatically adjust against the dollar.

Impact on Indian economy

Country's currency weakness could be a boon to exporters, because they benefit from weak rupee. However, falling rupee is making life difficult for the commoners, as falling rupee is making imports dearer, especially the petro products, fuelling inflation. Weakening of rupee means more rupees to be paid per dollar of imports.

Fiscal deficit of a country is an important factor that drives the currency of that nation. Higher deficit means the government will have to pay more and also print more rupee notes. This would result in excess supply of rupee in the market, leading to inflation and reduction in its value. Similarly, current account deficit (CAD), which represents the net of import and export, results in more obligations for the country to make its payments in foreign currency.
As far as impact of weak rupee is concerned, first, a weak rupee would push up the fiscal deficit further. India imports around 80% of its requirement of crude oil and the government will have to pay more for it in rupee terms. Due to the control on oil prices, the government may not be able to pass on the high prices to the consumers. This strains its finances and leads to an increase in fiscal deficit. Also, higher oil prices would also push up inflation, which is perilously close to the double-digit mark. Companies will also have to pay more in rupee terms for their raw materials, despite the fall in global commodity prices, due to a depreciating rupee. More importantly, a weak rupee could negatively impact FII flows into the Indian markets.

Companies which export goods and services to the US are the main beneficiaries of depreciation of the Indian rupee. They receive their revenue in US dollars whereas their major expense is in the Indian rupee. With rupee depreciation, their rupee-denominated revenue will continue to grow even though there is no change in expense. Information Technology (IT) is one such sector, which receives more than half of its revenue from the US.

The sectors that use heavy machineries usually import them from outside India. These items are very expensive and require a huge amount of initial cash outflow. Typically, companies borrow in foreign currency, also known as ECB (external commercial borrowing) to finance their investments. The interest and principal repayment is spread over several years. When the rupee depreciates, these companies have to shell out more rupees to meet their payment obligations. Those which are planning to set-up a new machinery at this point of time would be the worst hit. Companies in telecom, power and infrastructure are the likely target of this category.

Thus weak Rupee is affecting almost all the sectors of the economy. Gradually with more global linkages, effect of exchange rate movements will be more acute on different sectors. Therefore stability in exchange rate is

essential for stability in economy and this stability will not be assured by buying and selling of dollars by RBI but by stable growth of both export and import based industries of the country,

Role of RBI and Indian govt to control devaluation

The RBI has been able to curtail the Money Supply (M3) growth to 13 percent as against 17-22 percent (between 2005-2008). In the last one year the M3 has again gone up by 17 percent and hopefully given the new policy framework adopted by Governor Prof. Raghuram Rajan of having a multi-facet monetary targeting policy with special focus on an inflation target, would help the RBI bring the M3 back to a 13 percent level. The multi-objective and multi-instruments approach followed by the RBI in formulating the monetary policy has helped in interpreting developments in the financial system and taking prompt corrective action. Also the measures such as putting in place robust systems for reducing counterparty risk in OTC transactions through CCP arrangements and regulation of shadow banking institutions to address the interconnectedness issues have helped in containing the impact of the crisis.

The high savings rate of 33 percent has also been a positive anchor to the economic downturn and the threats of rising unemployment and large number of Indian workforce retrenched and returning back home between 1995 (from the U.S.); 1997-99 (from South East Asia), 2001-03 (from the U.S.), 2008-12 (from Europe and the U.S.). It should be kept in mind that India has a shadow economy as strong as the normal economy, which provides for a buffer for any kind of recession with actual savings rate and GDP growth being substantially higher than the official figures. The FDI flows in 2011-12 and 2012-13 have seen a big jolt due to the bleak economic scenario globally, however, given the trends observed in the increase in FX reserves it is expected to improve in 2013-14.

The Government of India needs to re-consider its FX reserve policy both from the perspective of putting the excessive reserve to productive use and by allowing the exchange rate to float freely and to appreciate – given strong currents of depreciation of the US dollar, the Euro and the GBP, which are the major currencies in the basket of currencies in accordance with trade balances.

Governor Rajan having served as Advisor to the Prime Minister and as a Chief Economic Advisor to the government would entail smooth functioning. I strongly feel that the symbiotic relationship which Rajan has with President Shri Pranab Mukherjee, Prime Minister Manmohan Singh and Finance Minister Shri P Chadambaram is unique and would serve to be of advantage for the Indian Economy and international confidence in India.

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. RESEARCH METHODOLOGY

The present study is exploratory as well as descriptive in context of currency depreciation. The primary data for the study was collected from different background of people like students, working employees, housewives. These people were approached
with a structured questionnaire and they requested to participate in the study. The secondary data was collected from reliable database of Reserve bank of India, SEBI and besides this data was also extracted from websites of different leading newspapers
and magazines.

As the population covered was large, sample size of 126 individuals belonging to different fields, classes, age groups were taken. Though respondents name and contact details are recorded for research verification purpose, but each of them was assured
Of his/her anonymity.

CONCLUSION

Thus we can see that since 1950 besides few appreciation rupee is depreciating against US dollar and the causes of depreciation are invariable different. Even after taking few measures by government if we see the recent depreciation, Rupee depreciation has abated but it still remains under pressure. Both domestic and global conditions are indicating that the downward pressure on Rupee to remain in future. Thus, RBI should likely to continue its policy mix of controlled intervention in forex markets and administrative measures to curb volatility in Rupee. Apart from RBI, government should take some measures to bring FDI and create a healthy environment for economic growth. Some analysts have even suggested that Government should float overseas bonds to raise capital inflows.

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