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Devaluation of Indian Economy with special reference to RBI- Its Causes and Impact

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Abstract
The fall of the rupee has been a regular event since last three months and recently the rupee hit an exchange rate of 61.80 against the USD which is its lowest value ever. The fall started last year with fluctuation between INR 45 to 55 per dollar and in the first quarter of FY2014, the rupee has fallen by more than 12%. Through this report, we have attempted to examine the various reasons that experience contributed to this unfavorable situation and the impingement of a depreciating rupee and future path of actions that could come to the foreign reserves. An attempt has been established to present reasons and analyze the complete issue in depth. The topic assigned to me for undergoing Research Work and making a Research Report was entirely about the Devaluation of the Indian currency. The Research Report conducted, assisted me to know the several reasons behind the occurrence of the Indian Currency`s Devaluation. It also helped me to experience the various effects of it on the Indian Economic Structure. Also the Remedial Actions taken by the Reserve Bank of India in order to undertake this trouble came into notice during the conduction of this Research Report. **To bring into the insight and prepare a thorough survey of the pros and cons of the devaluation occurring in an economic organization.** The focal point of this Research Report is to state and examine the various facial expressions related to the Devaluation of the Indian currency like the trends behind it and the various shocks of it on the Indian economic Structure as well as digging into the various steps taken by RBI to bring off this vital situation. This required a depth study of that particular situation as it is a macro aspect and a nation`s economic structure is very much affected by it. While some of the people suggest it to be dependable for an economy while the others argue to be a threat to the economic organization. Descriptive and conclusive types of research are carried. The study is taken away at the base of analysis of information and data collected that is the, the type of research used here is Descriptive Research. This kind of research is needed to supply a theoretical framework and background on which, total knowledge and operational practices can be practiced and valued.

Keywords: Currency, Economy, Devaluation, Indian Ruppee

1. Introduction to topic

The Foreign Exchange Market in India has undergone many alterations over the last few months. This question has been carried out in society to see into several components (variables) leading to the depreciation of the Indian currency. An attempt has been made to review the potential reasons for the depreciation of the Rupee and analyze different determinants that have a depreciating impact on the exchange rate and their extent.

India has experienced a late episode of excessive volatility leading to sudden and sharp depreciation of the Indian Rupee against the US Dollar. In June 2012, the Indian Rupee dropped to 57 per Dollar mark & reached until 57.25- its all-time low against the Dollar. International trade and investment decisions become more difficult due to volatile exchange rate because volatility increases exchange rate risk. If the participants in international trade are aware about exchange rate risks, they may choose to switch to domestic activities where profits are relatively less uncertain rather than continuing trading in foreign marketplaces. Alternatively, international traders may attempt to use forward foreign exchange markets in order to hedge against any possible losses. One of the important reforms was to step downward adjustment of the Indian Rupee in order to install investors' confidence & boost domestic competitiveness. The beginning course is linked up to the competitive position of a state in the international securities industry. For e.g. if a price level in a country rises, it will make its products & services uncompetitive in international markets and the balance of payments will hold from a deficit. In parliamentary law to preserve equilibrium in the balance of payments, the land may use various macroeconomic policies to slim down the price level, and because prices are sticky-downwards this may lead to painful adjustment and may result in welfare losses. Consequently, it is better, to leave the exchange rate to depreciate to compensate for the rise in price level and to prevent the competitive position of the country without a need to undergo such long adjustment. The second parameter of the proponents of flexible exchange rates is based upon the assumption that the stabilizing behavior of speculators will make exchange rates relatively stable compared to determine rates.

The study has been divided into two parts. The first section describes major economic variables that have direct or indirect impact of exchange rate volatility while the second section analyses the correlation of various macroeconomic variables with the exchange rate of a country.

Devaluation in modern monetary policy is a diminution in the value of a currency with regard to those commodities, services or other monetary units with which that currency can be subbed.

Devaluation means official lowering of the value of a country`s currency within a set exchange rate system, by which the monetary authority formally sets a new fixed rate with respect to a foreign reference currency.

The rupee has plunged to an all-time low against the dollar and its fall has become a matter for debate. The usual discussions on the ruin of the rupee bring up topics such as-

- Economic growth is also slowing overseas
- Huge current account deficit
- Rising imports, and so on

At the time of independence when India conducted in no foreign borrowings the rupee was at par with the dollar bill. With the launching of the 5 year plan and the subsequent needs for foreign investments the dollar slowly rose. In 1985, after the Bofors scam, which toppled Rajiv Gandhi`s government, the dollar was equal to 12.35 rupees and since the economic liberalization in 1991, there was a sharp devaluation of the rupee and the rupee had dropped to Rs. 24.5 against a Dollar. The morning of the third millennium gave a further worsened the condition rupee against the dollar and the rupee has hit an all-time low of Rs. 65.42 against a dollar on the 22nd of August 2013. And so the Indian economists are attempting hard to chalk out a strategy to counteract the falling value of rupee but it seems the attempts are fruitless. As at present the value of rupee against dollar is Rs.62.13. Hence the devaluation of the rupee or INR is the latest stage of argument in many news broadcasts on TV today. Some charge it on the Current Account Deficit (CAD) and some blame it on the strengthening US dollars (USD) as the field from the US hinted of the gradual withdrawal of the Quant Easing.

Nonetheless, the INR has lost more than 15% in value against the USD in the recent past.

Rupee in News-

- Rupee closes in on 69 views Dollar its biggest day fall in 18 years.
- Outgoing R.B.I Governor blames Government for sinking Rupee.
- Gold shines at record highs
- Rupee opens at record lows.
- Rupee posts single decay rise in 15 years.
- The country faced with the difficult Economic Situation: PM

Hence above mentioned are some news headlines which were very familiar to us nowadays, which reflected the various threats of the devaluing currency.

Though the initial slide in the Indian Rupee`s value in the third quarter of Financial Year [2011-2012] was debated to be temporary, the continued decline in the final section of the quarter had caused enough stress in the circuits of the Indian Economy.

With a lot of experts` forecasts pouring into the media accounts and the Economic Commentators giving their views on T.V. Channels all across the nation, it is important to realize the dynamics associated with the INR movement. While most of the reports and commentaries are trying to question on where the rope is heading, some of them are even rising due concern about what the impact would be the Indian Economy and for the Indian Industry.

This story talks about the grounds behind the latest depreciation spree of the INR. Though any economics textbook would give a number of grounds on why a domestic currency`s value falls with regard to other currencies, this story focuses largely on the late evolutions of the economic state of affairs, both across the country and internationally, and connects them to the INR depreciation or devaluation story. This story also talks about the effects that the INR devaluation produces, both in the short and longer term perspectives.

The value of the rupee is expected to go with the same pace with the value depreciating in the times to come. All the exertions established by US government to strengthen their economy will further lead to the depreciation of Indian currency. Yet the current currency problem is not confined to India as majority of emerging market is also facing similar troubles. Thus, many experts believe that its' not depreciation of rupee that we are currently observing, it is more about appreciation of the dollar. But the styles presented in Exhibit 1 clearly shows that the rupee is depreciating against all the major currency and the trend of depreciation against these major currencies is almost like.

Exhibit 2 indicates the trading of various currencies in the OTC market, which clearly captures the perception of people about further fall of the rupee. (Staff, 2013).

The depreciation is governed principally by the principle of demand and supply of money across different states and with India's current account deficit of the range of 4.8% of GDP, the state of affairs is not right and if major actions are not required to revamp exports and attract Foreign investors, the situation is not proceeding to turn for Indian rupees. The demand of oil and gold is the premier cause for structural weakness of current account deficit.

The shock of this depreciation is many fold and leads to a vicious circle, wherein the effects of the depreciation acts as a movement to further weakening of the currency. For example, the import of crude oil is a necessity and the more rupee depreciates, the more India has to induct in the petroleum petroleum which will further deplete the foreign reserve leading to more weakening of the Indian currency. Despite the fact that RBI has been trying hard to increase the liquidity, things have not improved much. With just $ 280 billion reserves, which could only support import for the next seven months, India is in deep crisis in dollar supply. With the Fed's program to inject dollar in US economy at the rate of $ 85 billion a month through bonds purchase, the rope is going to be run into further more in coming months. (Reuters, 2013)

Causes of Rupee's Depreciation

The rupee depreciation can be attributed to both external and internal reasons that are happening now. The external reasons are because of the policy changes by the US government and also the state of the worldwide economic system.

Tapering of Quantitative Easing by US Fed

Quantitative easing was undertaken by the US Federal Bank in order to stabilize the US economy and kick start the growth of the US economic system. In parliamentary law to answer that, the US federal bank lowered the interest rates in the US system and cut the interest rate to historic low of.25%. After this, as they could not bring down the interest rates further, in parliamentary procedure to inject further liquidity in the system, the US started buying bonds from the clear market and injecting around USD 85 billion each month and increased the liquidity in the US system.

Because of this reason, returns on the US bonds were very less and the institutional investors tried to invest the funds with them in places where they could produce more productions than they would be drawing while being invested in US. They invested huge sums in the emerging markets like India, Brazil and other Asian nations.

It is anticipated that the quantitative easing by the US federal bank would be discontinued in one case the unemployment reaches below 6.5% with the inflation rates anchored at 2%. It's anticipated that this position could be attained in April 2014, and there is a signal of tapering of bond purchases by the US federal government by the conclusion of this yr. With the resurgence of the US economy shown by the unemployment rates and housing price stats, it is anticipated that the quantitative easing would be sharpened and finally taken out in the close future.

If the quantitative easing is withdrawn, the issues in the US treasury bonds would go up. If the yields in the Treasury bonds rise, then the paste between the G-sac's and treasury bonds would be very less and India will lose its attractiveness as an investment destination for FII's. India's stock market and debt market have experienced a huge sum of investments from the FII's in 2012. FII's have started plucking out their investment in the land and they have taken out a staggering 10.5 billion USD in the months of June and July alone leading to the selling of rupees and buying of Dollars which has given to the disparagement of the Indian Rupee to a major extent.

Global Economy and Recession

The USA (11.9% of exports) and Europe (19% of exports) have always been major markets of Indian exports. Anything which affects this growth of the economy, will impress the Indian economic system as well as the Indian currency. With the slowdown in this economy, the demand for Indian exports has come down leading to the broadening of the CAD (Current Account Deficit) of India. A widened CAD always is accompanied by the derogation in the Indian Rupee.

Strengthening of the USD in regards to other Currency

The probable exit of Greece from euro zone is looming large, and adding to that the other countries like Ireland, Portugal, Spain and Italy are in recession and they have vast debts in the European central banks, and so the exit of Greece may cause the Euro central bank to suffer huge losses. In parliamentary law to pull through the banks, huge amount of Euro is needed and the two biggest economies, Germany and France are also in trouble, these two countries bear most of the attachments of the Euro banks and the collapse of these banks would greatly affect the economic systems of Germany, France and Italy. This crisis has contributed to the instability in the Euro's and the USD dollar is getting the most stable currency. All the investors would attempt to make the investments in USD increasing the demand for USD which has further contributed to the appreciation of USD in terms of Indian Rupee.

High Volatility of Indian Currency

The high volatility of the Indian currency has led to the increase in costs of hedging the Indian rupee. This increase in the cost of hedging has further lowered the returns got by the FII's in India. Since the returns are turned down, the FII's have started to pluck out their investment in India and as explained in the beginning they have pulled around 10.5 billion USD in the past two months itself, leading to the redundant provision of Indian rupee's and also the demand of the USD has increased leading to the disparagement of the Indian rupee.

Current Account Deficit and Trade Deficit

The depreciation of Indian rupee has had a vast impact on the Imports of India. India is more of an importer rather than an exporter. India Imports 80% of the total oil needs and with the growth in global crude oil prices, there is a huge impact on the consequences. If we talk in absolute terms, every 10 dollar increase in the cost of an oil barrel increases the Indian current account deficit of around $6.5 billion bucks. The current account deficit has widened to a range of 4.8 percent of the GDP, even though in the fourth quarter it moderated to 3.6% of GDP, still the current account deficit is high while the trade deficit is even bigger at about 7 per cent of GDP.

Further, recent trends indicate a substantial worsening of both craft and current bills. Both exports and imports actually declined in 2012-13 compared with the previous year, but even so the trade deficit still increased by nearly 4 per cent, or more than $7 billion. In April 2013, exports were 2 per cent higher than in April 2012—but imports were 11 per cent higher and non-oil imports were 15 percent more. Hence the trade deficit increased by more than 26 per cent in April 2013 compared with the previous year (Finance Ministry, Monthly Economic Report for April 2013).

Crude oil represents 30.1% of the total Indian imports in dollar value. All the same, an interesting point to observe is that Gold & Silver represent 10.1% of the import basket. This fetish for Gold & Silver is unique to India and has created a dangerous problem for the RBI governor on the current account deficit front. Economists talk about the J curve coming into play when imports will eventually become expensive and hence their demand of the commodities will come down. Only in case of India, the oil goods are highly subsidized. This has contributed to the inelastic demand of the oil products in India, and so even with the increase in petroleum petroleum prices in the world market, the Indian demand for the oil has not come down thus increasing our CAD, In the case of Gold and silver imports, the recent decrease in the Gold prices in the world market has increased the demand for gold in Indian market further widening the current account deficit in our nation. This has become a vicious circle with higher CAD leading to the depreciation of rupees and a weaker rupee further widening our CAD. The weaker rupee can be presumed to be beneficial to the exporters as they would be more price competitive in the worldwide marketplace. Simply due to imports, the price of crude materials for most of the exporters have gone up thus stripping them of their advantage got with the depreciation of the rupee. So the advantage is lost and they are not able to sell their commodities at lower costs. In the current scenario of high recession, it's real hard for the exporters to increase their exports, thus the depreciation of the Indian rupee has not served us lots.

Government Policies

Policy paralysis and non-execution of the proposed policies has been adduced as one of the major causes for the depreciation of the rupee. Even though the card regarding the multi brand retail has been exceeded, it has neglected to make any meaningful investment in the multi brand retail has occurred because of many of the articles in the invoice and the uncertainty regarding the carrying out of the bill in different provinces of the nation. The GAAR, which are targeted at reducing tax avoidance by introducing regulations and also the implementation of GAAR retrospectively has created enough furor and has also dissuaded foreign investors from investing in India, which has dried up the investments in our country reducing the demand for the rupee. Some of the policies like Direct tax code, Goods and service tax has been in the pipeline for implementation for a long time, but haven't been implemented still which has created negative sentiment around the job environment of India and thus dissuading the foreign investors from investing in India. Implementation of GST is expected to promote the business environment in India and will help increase the tier of foreign investments which in turn will support the rupee. Till today, the government has only managed to remove a few little steps like increasing the terminal point for foreign institutional investments in government securities and increasing import duty on Gold to support the plummeting rupee. On the other hand, RBI has taken steps such as tightening the norms for rupee forward contracts, raising interest rates on non-resident deposits and announcing relaxations in external commercial borrowings to support the rupee.

Fiscal Deficit

India's fiscal deficit stands at 5.6% of the GDP or 2.63 trillion rupee's and in order to finance this expense, the government has to issue bonds from the public and this causes the decreases in the money available in the market which can be used for the purpose of investment thus slowing down the economy. This also increases the monetary value of borrowing for the corporation since the government requirement for money is inelastic to the boost in interest rates and so naturally the interest rates would go up. With the increased cost of capital, the corporation would be loath to borrow and invest in new projects leading to stalling of the economy and stalling of employment generation in the state. The increased fiscal deficit may also lead to downgrading of the Indian business environment, reducing the inflow of the money and also increasing the cost of capital for the fellowships. Hence in order to overcome this, the regime has to cut back the subsidies or increase the taxes and both will affect the economic system. Increasing the revenue enhancement will reduce the disposable income in the manpower of the common man thus slowing down the economic system. The increased fiscal deficit has set a huge pressure on the regime to cut its expenditure on items such as gas and fertilizer subsidies. Simply due to the populist measures taken by the government and the pressures of coalition politics, it has been unable to cut down this expenditure. In fact, the regime has increased the outlay for public expenditure in some countries. The implementation of the food security bill will also increase our financial deficit. With the elections approaching, the regime would not be willing to bring down the subsidies in the close future.

Persistent Inflation

In the past 2 years, India has had huge inflation and has remained above 8%. The prolonged inflation will lead to overall worsening of the economic system and causes the currency outflows to happen thus depreciating the currency. The REER index measure includes the degree of inflation differences across countries; it thinks over a country's competitiveness in international craft. The Real Effective Exchange Rate (REER) index has come down by 13.84% during the last year, while the nominal rate has depreciated by 24%. The course indicates that the country's competitiveness has not improved as much as the declivity in the nominal exchange rate. This mainly points out to the fact that there is an increase in domestic prices. Generally the increased inflation can be overcome by advancing the interest rates, but in India, since the involvement rates were already high, it couldn't be raised further thus leading to higher inflation in the land. Because of this, the countries, companies have become less competitive and even the gains realized by the depreciation of rupee for the exporters doesn't impact a great deal by means of increasing the exports.

Impact of depreciation on the Indian Economy

The undermining of the Indian Rupee has had a variety of influences along the Indian Economy. The most famous among them are fat burners:

A sharp rise in inflation

India is a nett importer of goods and serves. Agreeing to a recent press release by the Economic division of the Department of Commerce (Ministry of Commerce and Industry, 2013), India's net imports were $ 11244.45 million in June, 2013 only. Refer **Exhibit 3** for exports and imports data in the month of June. As the currency depreciates more INR would be required to purchase 1 USD and this will increase the input prices of sensitive materials in several sectors of the economic system and the high wattage of close to 35% that global commodities have been sacrificed in the wholesale inflation basket will put an upward pressure on the Wholesale price index (WPI). In sectors such as oil and natural gasoline, electronic appliances, fertilizers and organic chemicals where India is heavily dependent on imports, increased costs for the fellowships will be extended on to the customers in the configuration of an increment in the prices of wares. The prices of gasoline and diesel have already been increased as crude oil is the largest item in the list of India's imports and due to depreciation, the price of importing oil has increased. Very recently, Panasonic India declared that they had factored a level of 62 for USD/INR and would increase prices of their merchandise if the rupee depreciated further. (Das, 2013)

Investment Climate

With the decline of the Indian rupee, the return that foreign investors receive from their investments in India will cut. Due to this, Foreign Institutional investors (FII's) will get away their money from India and invest it elsewhere due to fears of a falling rupee. In the month of June alone, FII's pulled out more than $7 billion of the equity and debt markets in India which led to increase in proceeds of government protections. This is because their returns in dollar terms would reduce as they would need more rupees to make the same sum of dollars as the rupee continues to decrease. Reduction in capital inflows has occurred due to the rupee depreciation and the RBI's tightening of the monetary policy has encouraged companies to delay investment and expansion programs. For fellowships that have got debt in foreign currency, i.e. External Commercial borrowings (ECB's), depreciation of the rupee would have an adverse impact on their Income statements. To return this debt in foreign currency, the company would immediately need more rupees than before to repay debt if we consider that repayment is in monthly installments. Recently, Adani Enterprises posted a huge loss in the first quarter of 2013 due to the rupee's volatility. The fact that they had to import coal due to shortage of coal supply in India also contributed to increased price of cutting fabric. (Press Trust of India, 2013).

Maybe of Interest rate rise

In parliamentary law to check the descent of the rupee, the RBI has tried to tighten the monetary policy and reduce liquidity in the Indian fiscal system. By doing this, the RBI hoped that demand for INR would go up this-à-vis the USD and rupee would appreciate. Only the sale of government bonds, increase in Cash Reserve Ratio (CRR) did not accomplish the aim. The next possible move is to increase the Repo Rate. If this passes, the bank would have to ante up a higher interest on their borrowings from RBI and this higher interest will also be passed along to clients in the form of increased interest rates. This position is in utter contrast to the kickoff of the first quarter of FY2014 when interest rates were expected to diminish and this change can be imputed to the disparagement of the Indian rupee. The interest rate hike would enable inflow of capital from foreign countries and strengthen the rupee. But it would likewise mean that borrowers would have to pay higher interest on their loans and this would discourage new investments in projects.

Foreign education and foreign travel

Depreciation has also caused an impact on those who desire to pursue foreign education or go overseas. They would today need more rupees to buy foreign currency to meet their needs abroad.

Current Account Deficit (CAD)

Derogation of the Indian rupee will favor exporters in India. Still, considering the imbalance of imports and exports in India, this advantage is nullified. Hence the Current Account Deficit (CAD) will go forward to broaden.

Benefits from rupee's depreciation

The major benefactor of the rupee depreciation has been the IT industry. Because the industry majorly earns revenues in dollars, the rupee value of the earnings has substantially increased and IT companies have put up big profits in the 1st quarter of FY2014. Some other industry that benefits is the tourism industry. Disparagement of the rupee means more INR per unit of foreign currency and tourists can gain more value for their currency in India. Also NRI's who remit earnings to India stand to attain due to pass in the rupee's value.

Closing remarks

RBI should take steps to curb the free descent of the rupee because of the shocks it has on the Indian economy. The RBI should concentrate along the monetary policies and the government should lay down policies such that the investment climate is improved in the nation. The major grounds of policy paralysis should overcome with a raft of measures helping in kick starting the economy and also bringing in investments. Some of the measures like increasing the FDI limit in different sectors should be increased. This would increase the investment in the country and help in overcoming the huge Current account deficit that India has today.

As a short term measure, RBI is trying to increase the interest rates which will also take the investments into the country so that the ranch between the investment in the USD and the Indian rupee remains the same. This will guarantee that the foreign investors will keep investing in the state. The other thing it can do is to sell the FOREX reserves it has with it so that the demand for rupee could increase. RBI can take steps to increase the provision of foreign currency by expanding market participation to support Rupee. RBI should increase the FII limit for investment in corporate debt bonds and government debt bonds. It can pay for long term FDI debt funds in infrastructure sector. The present ceiling on the ECB can also be increased.

Some other significant step taken by RBI is to temper the speculation led volatility by curbing the trade in rupee forwards and this will also lead to stabilizing the Indian rupee. These are short term measures. As a group, the depreciation of rupee is not dependable for the economy to arise and we feel that in long term, the rupee will stabilize against other currencies only if the investment climate is improved in the country and also the financial deficit and current account deficit is brought down, which will help a long manner in helping in the Indian economy to grow as strong currency is one of the major needs for development.

Literature Review

My research work got a tremendous help from some of the significant contributions from the theories, concepts, issues and research reports like:

Since INR depreciation is exposing weaker economic fundamentals of the economic system, it is high time for the Government to set up through a spate of bars that are expected out of it. In parliamentary law to maintain long term growth, the government at the Centre must clear the impending key policy defining bills in the Parliament. Vexed is the investors, thanks to the deficiency in the implementation of long standing bills on topics like the FDI in retail, Direct Tax Code, Capital Account Convertibility etc. Key policy measures should be implemented like increasing the FII limit on investment in Government & corporate debt instruments, putting up the ECB ceiling imposed on Indian corporate etc.

- Simon (1997) found that the exchange rate and the current account have direct and confident relationship with inflation, and both exchange rate and current account are the key factors that seriously affect the smaller economies.
- Edwards (2000) investigated the association between the substitution rate, capital flows and currency crises in emerging economic systems. He reasons out that under the appropriate conditions and policies, floating exchange rates can be effectual and efficient.
- Taylor (2001) discusses that the money supply within the country and the supply of credit to firms are drawn straight to international reserves. Hence if the country gets capital inflows, the provision of money and credit increases, contributing to a significant gain in domestic monetary values.
- Harberger (2003) examined the impact of economic growth on real exchange rate. He set up that there is no systematic association between economic growth and the actual exchange rate.
- Husain (2004) found in their field that little admission to international capital is available for the weaker and less developed nations, so low rate of inflation and higher degree of durability is associated with the fixed exchange rate regime in those states. Nevertheless, they found no robust relationship between economic performance and exchange rate regime in the developing economic systems. They too found that advanced economies may experience lasting and slightly higher level of growth rate without higher levels of inflation in flexible exchange rate regime.
- Due and Sen (2006) examine the interactions between the real exchange rate, level of capital flows, volatility of flows, fiscal and monetary policy indicators and the current account surplus for the Indian economy for the period 1993Q2 to 2004Q1.

Research Objective

The focal point of this Research Report is to state and examine the various facial expressions related to the Devaluation of the Indian currency like the movements behind it and the various shocks of it on the Indian economic Structure as well as probing the various steps required by RBI to manage this critical position.

This took a depth study of that peculiar spot as it is a macro aspect and a nation`s economic construction is very much impressed by it.

While some of the people suggest it to be safe for an economy while the others argue to be a menace to the economic system.

Research Methodology

Descriptive and conclusive types of research are carried.

The work is held away on the base of analysis of information and data collected that is the, the type of research used here is Descriptive Research. This sort of research is required to provide a theoretical framework and background on which, total knowledge and operational practices can be used and evaluated.

Research Design

The work is held away on the base of information and information collected from the various newspapers, articles and CRISIL Reports, etc. The Research Design includes:

Universe: Indian Economy

Select a data collection method that is appropriate

The research is compiled through the secondary data

Secondary Data

The Secondary Data includes:-

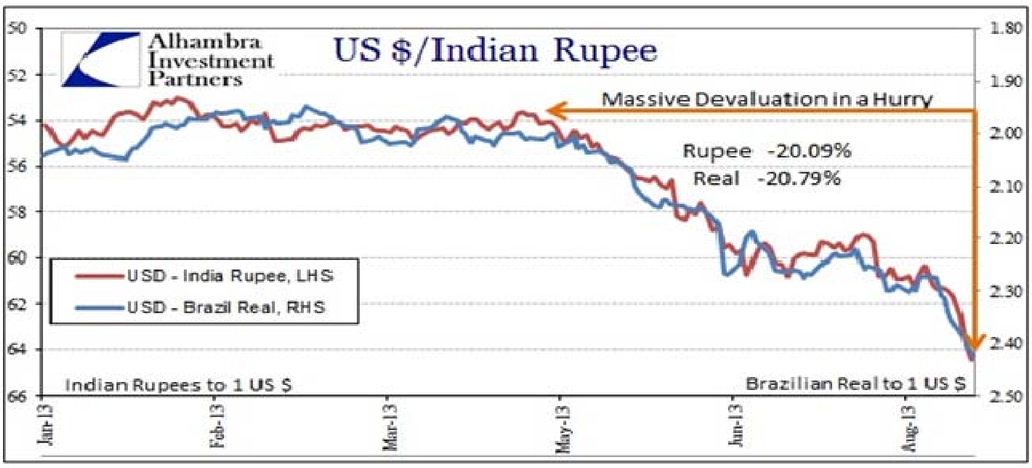
- Yearly report and other publication.
- Other published articles
- Several web sites, etc.

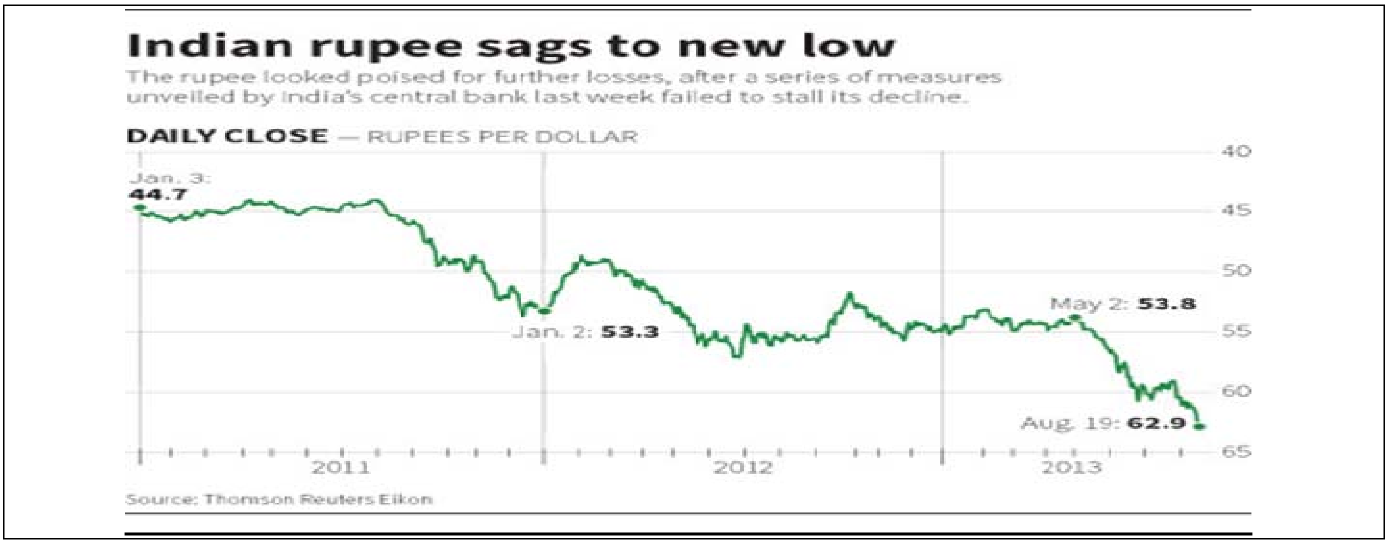
You must also highlight the significance of the research

The topic is a really significant aspect in itself therefore to do a research on this issue is a groovy and interesting task. By doing the study of this topic, I will come to recognize the various reasons behind the occurrence of the devaluation, its effects on the economy and the remedies required by the Reserve Bank of India.

Research Methodology

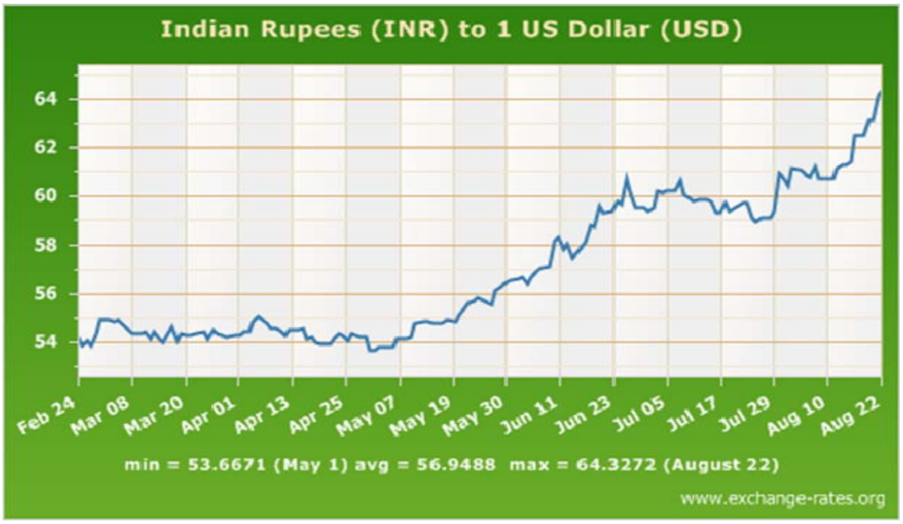
Some of the reports showed the following situation of the Indian





The FOREX Chart showed the following performance of the Indian Rupee

Comparison Between Inr & Usd



Analysis & Interpretations of Findings

By analysing the various aspects related to the concerned topic it was the findings that –

Though the RBI is trying its level best in controlling inflation, due to the inherent supply-driven nature of the inflation, monetary controls remain as futile attempts. Systematic inefficiencies, like improper supply chains, must be immediately addressed by the government to stall inflation. RBI has already done the damage by ruthlessly increasing the base rates and thus compromising the growth and discouraging investments.

In order to control currency depreciation, any central bank is expected to hike the interest rates. Since the prevailing interest rates have already reached a high, RBI is helpless in managing the exchange rates through interest rate hike. Another option left with RBI is to use its foreign exchange reserves to sell dollars in the currency market to improve the value of INR. Though RBI`s argument of non – intervention is justified (Gokarn, 2011), it must strike the right balance between intervention and controlled – intervention. Generally foreign exchange reserves deplete as a result of daily operations of central banks in the wake of domestic currency depreciation. But, in the Indian context, foreign exchange reserves are still containing healthy amounts [exhibit 7] in it and can be accessed for INR control and stalling volatility.

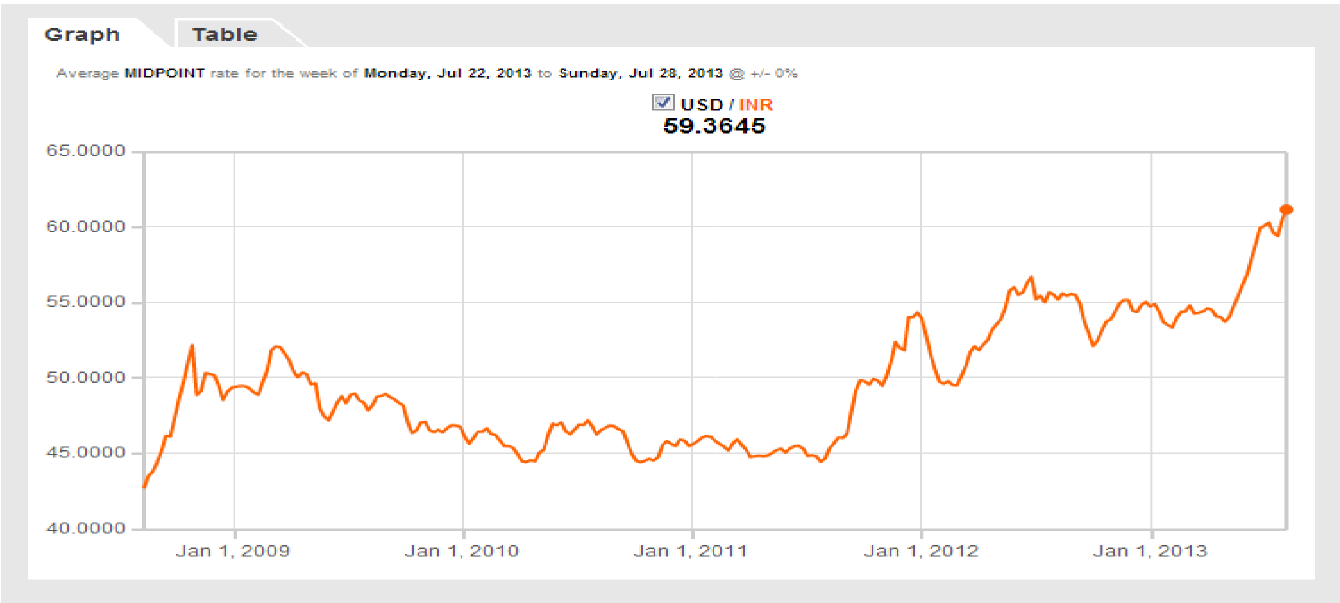
Detailed Chart Showing The Currency`S Performance

CURRENCY PERFORMANCE

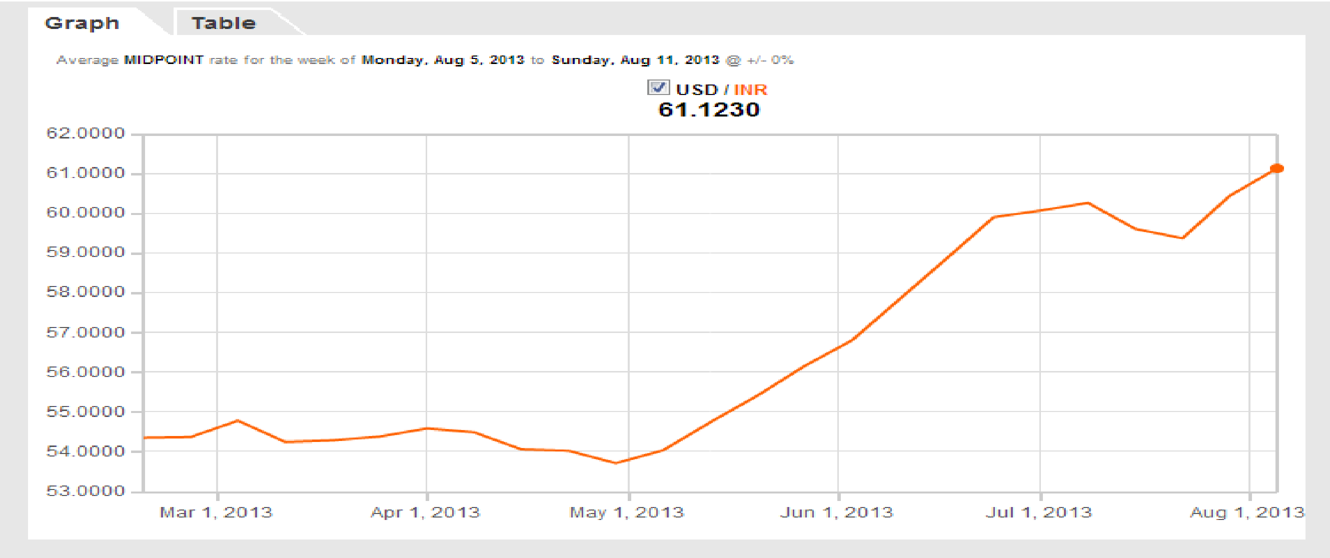
Chart	Start Date	Closing Value	End Date	Closing Value	No of Days	Movement (In %)
A	1-Jan-95	31.38	5-Feb-96	37.9	254	Depreciated 17.20
B	13-Aug-97	35.78	19-Aug-98	43.10	223	Depreciated 16.98
C	6-Aug-02	48.90	31-Mar-04	43.60	401	Appreciated 10.84
D	9-Aug-04	46.18	31-Dec-04	43.46	102	Appreciated 5.89
E	2-Aug-06	46.63	24-Dec-07	39.28	324	Appreciated 15.77
F	7-Jan-08	39.26	2-Mar-09	51.97	279	Depreciated 24.45
G	26-Jul-11	44.07	22-Jun-12	57.12	249	Depreciated 22.86

Exhibits

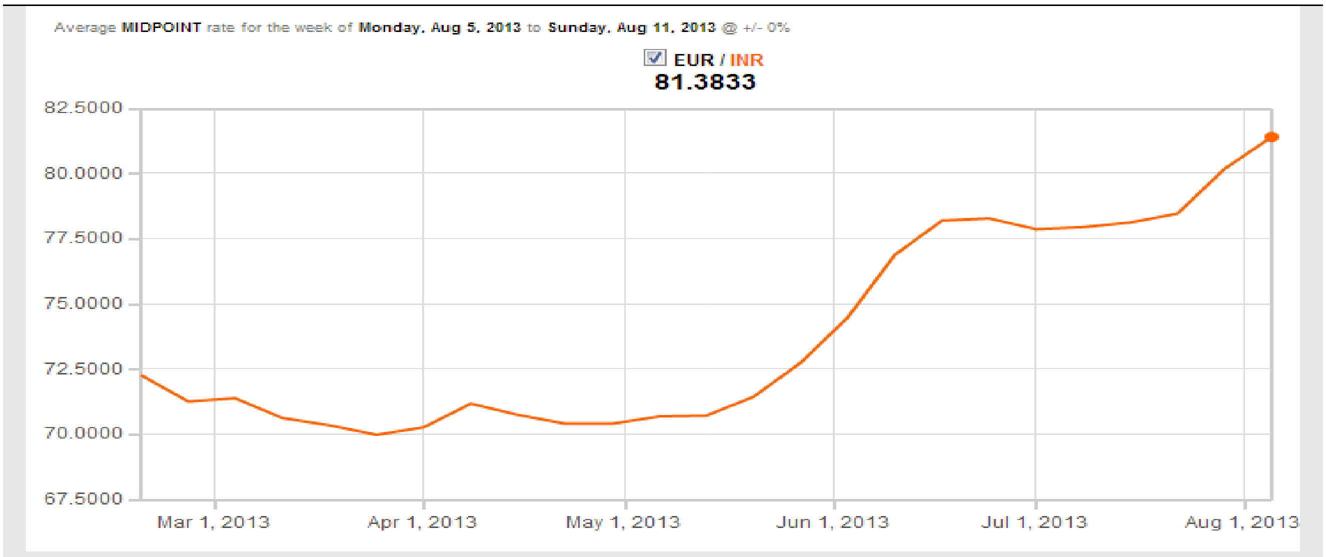
Exhibit 1: Comparison of Indian currency (INR) against American Dollar (USD), British pound (GBP), Europian EURO, Japenese YEN and Chinese YUAN



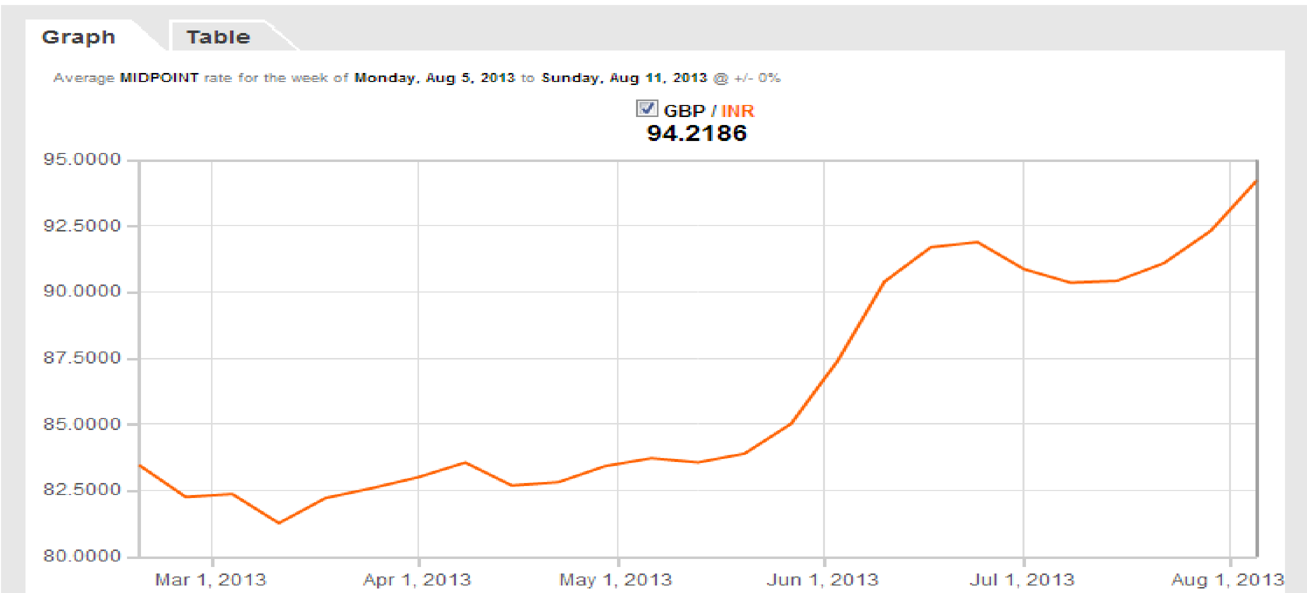
Graph 1: USD against INR for the period of last 5 years



Graph 2: American Dollar (USD) against INR for the period of last 180 days.

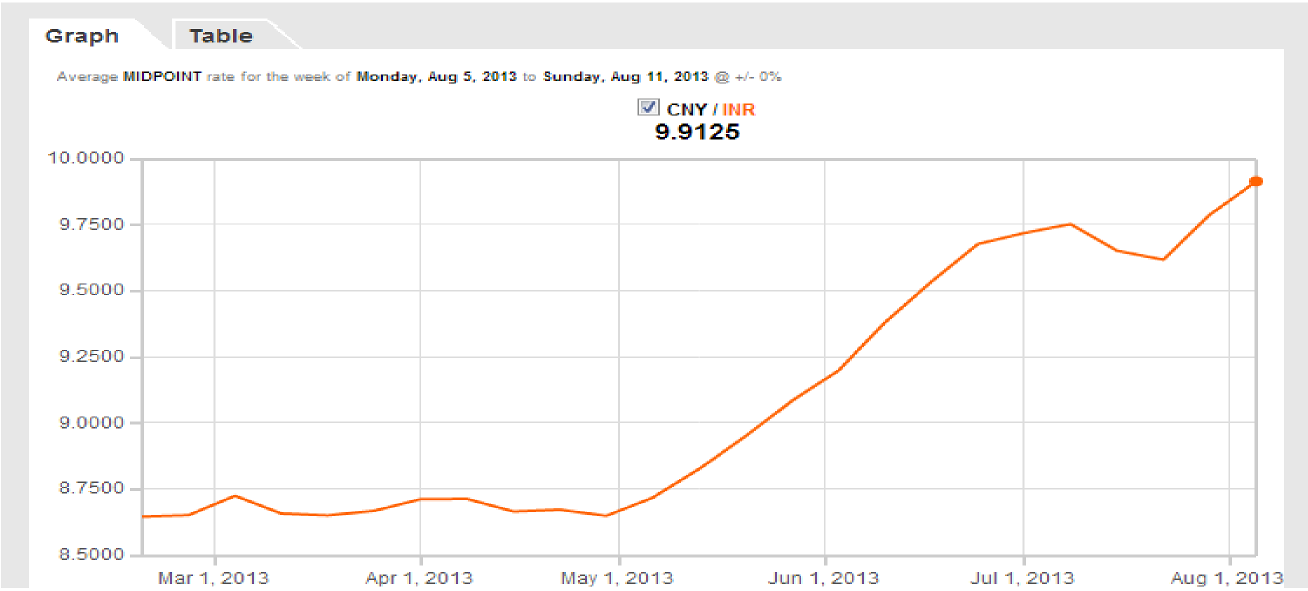


Graph 3: EURO against INR for the period of last 180 days



Graph 4: British Pound (GBP) against INR for the period of last 180 days

Graph 5: Japenese YEN against INR for the period of last 180 days



Graph 6: Chinese YUAN (CNY) against INR for the period of last 180 days

Currency Futures & OTC Arbitrage Rates
08 Aug 2013

CURRENCY PAIR	1st Month			2nd Month			3rd Month		
	OTC Rate	C/F	Differ	OTC Rate	C/F	Differ	OTC Rate	C/F	Differ
GBP/INR	95.38	95.24	-0.14	96.14	95.8	-0.34	96.86	96.36	-0.5
USD/INR	61.57	61.5	-0.07	62.07	61.88	-0.19	62.57	62.23	-0.34
EUR/INR	82.04	81.97	-0.07	82.64	82.45	-0.19	83.24	82.84	-0.4
JPY/INR	63.65	63.49	-0.16	64.11	63.84	-0.27	64.62	64.19	-0.43

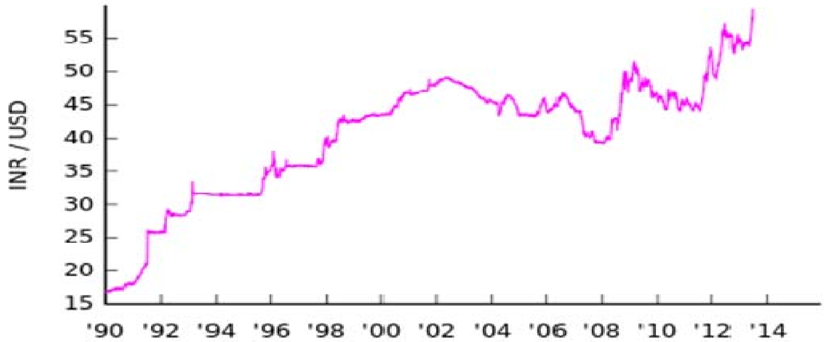
Exhibit 3: June, 2013 Exports and Imports data

EXPORTS & IMPORTS : (US $ Million)		
(PROVISIONAL)		
	JUNE	APRIL-JUNE
EXPORTS(including re-exports)		
2012-13	24923.11	73491.77
2013-14	23785.64	72455.67
%Growth2013-14/ 2012-2013	-4.56	-1.41
IMPORTS		
2012-13	36167.56	115708.50
2013-14	36034.74	122635.73
%Growth2013-14/ 2012-2013	-0.37	5.99
TRADE BALANCE		
2012-13	-11244.45	-42216.73
2013-14	-12249.10	-50180.06
EXPORTS & IMPORTS : (Rs. Crore)		
(PROVISIONAL)	JUNE	APRIL-JUNE
EXPORTS(including re-exports)		
2012-13	139644.68	397884.01
2013-14	138901.73	405104.78
%Growth2013-14/ 2012-2013	-0.53	1.81
IMPORTS		
2012-13	202647.54	625872.80
2013-14	210433.14	684167.73
%Growth2013-14/ 2012-2013	3.84	9.31
TRADE BALANCE		
2012-13	-63002.86	-227988.79
2013-14	-71531.41	-279062.95

Factors affecting the Exchange Rate

1. Inflation Rate

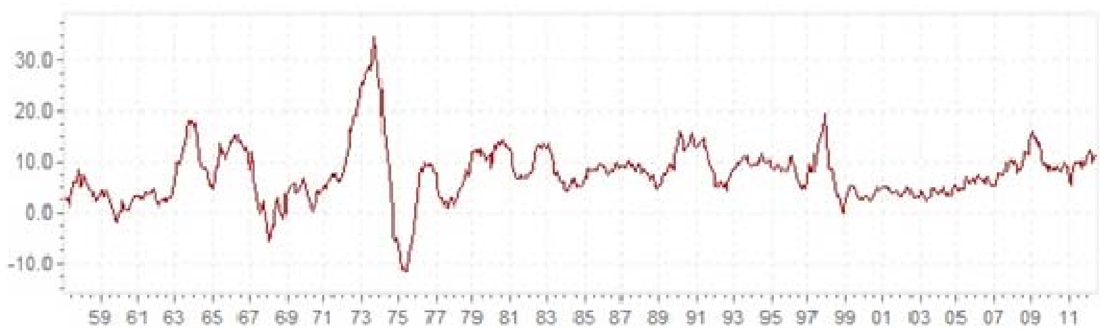
By and large a country with a consistently lower inflation rate faces a rising currency value and high purchasing power as compared to other currencies. Figure shows volatility in Indian Rupee exchange rate in last two decades.



Exchange Rate against Dollar 1990-2013

Source: http://ibnlive.in.com/news/interactive-graph-indian-rupee-vs-us-dollar-dec-1990-to-june-2013/401983-53.html

As a general rule the countries with higher inflation face depreciation in their currency in relation to the currencies of their trading partners . This is also usually followed by the higher interest rates.



Inflation Rates in India 1959 – 2012 In 2013 the average inflation rate is: 11.14% (based on Consumer price index)
Source: (http://www.inflation.eu/inflation-rates/india/historic-inflation/cpi-inflation-india.aspx)

2. Interest Rates

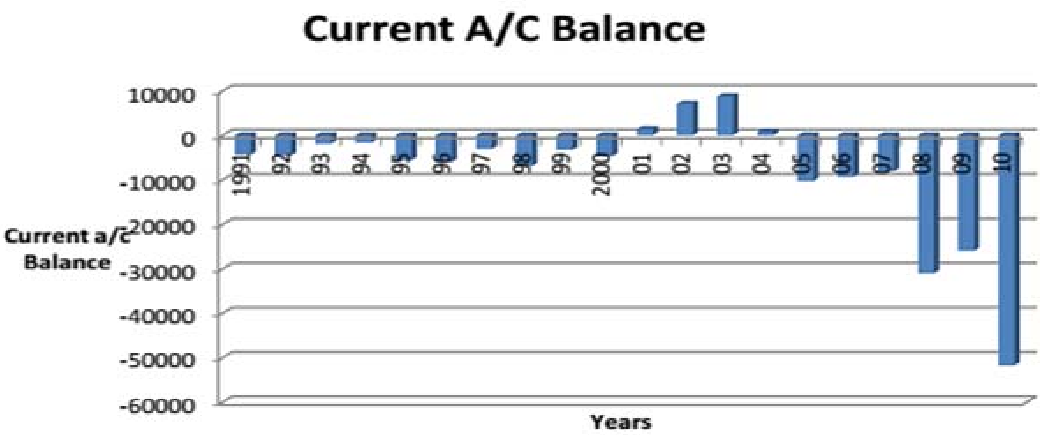
Over the years another important factor for movements in exchange rates has been interest differential i.e. the difference in interest rates between major countries. Currencies with higher interest rates attract large no. of investors seeking a more beneficial opportunities for their investiture. This causes the currency more attractive as a pattern of investment and increases the demand for the currency. The opposite relationship exists for decreasing interest rates, i.e. lower interest rates tend to decrease exchange rates. The interest rate determinations are held in India by the Reserve Bank of India's Central Board of Directors. The prescribed interest rate is the benchmark repurchase rate.

Interest Rate (Lending Rates) in India form 1991-2010

Interest Rate (Lending Rates) in India form 2012- Jul 2013

3. Current-Account Deficits

The current report is a record of the balance of trade between a land and its other partners all over the globe. It reflects all payments & receipts between countries for the purchase or sale of goods, services and payment / receipt of interest and dividends. The current account deficit shows that the state is spending more on international trade than it is earning and in order to balance this deficit it is borrowing capital from foreign authors.

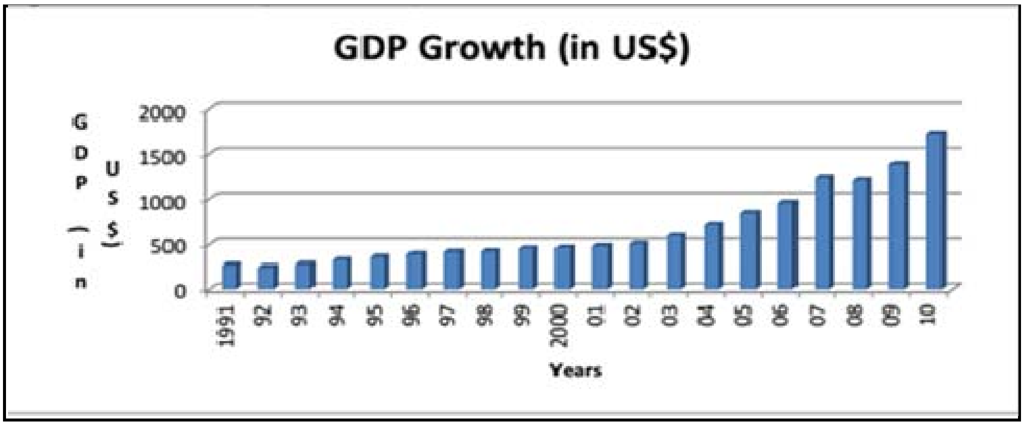


Current Account Balance (Current US$) from 1991-2013

The exchange rate causes a strong correlation with a current account surplus or shortfall in the long term. But there may not be any causal relationship. In font of the floating exchange rate system, the status of current account affects the exchange rate of a country to a certain extent. The current account surplus, mostly results in appreciation of the domestic currency, while its deficits will lead to devaluation of the same.

4. Growth in GDP

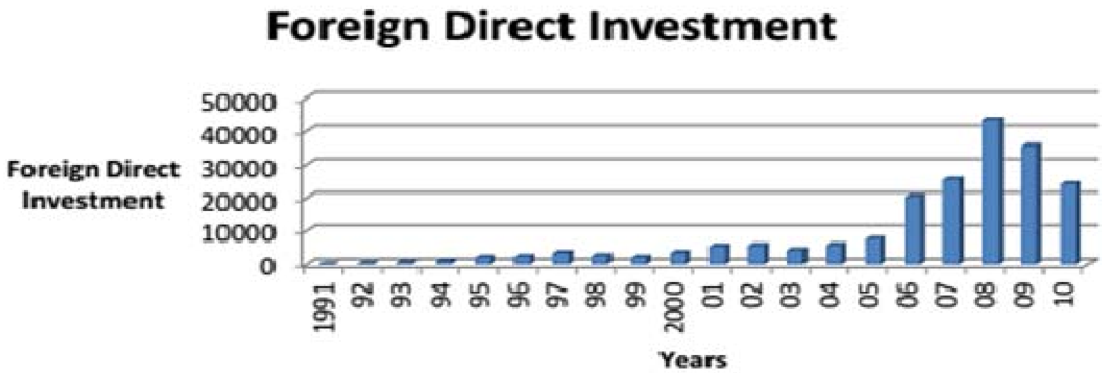
Indian economy encompasses diverse characteristics such as traditional village farming as well as modern agriculture, innovative industries, handicrafts and a large number of services. Services are the major source of economic growth, accounting for more than half of India's total national output with the use of less than one third of its labor force in this sector.



The Gross Domestic Product (GDP) in India has increased by 6.1 percent in the last quarter of 2011 over the previous quarter. For a period of 2000 until 2011, average quarterly GDP Growth in India was 7.45 percent, reaching to its crest at 11.8 percent in December 2003 and a record low of 1.60 percent in December 2002.

5. Foreign Investment & Capital flow

The Foreign Investment flow is increased in the land when it is growing rapidly, such as India, China and Brazil etc.



The need for domestic currency will increase as foreign investors have to trade their currency in society to bribe the local currency. This increased demand will result in the increase in value of the same.

Inherently investors make investment decisions based on two driving factors – "the level of danger"

And corresponding "level of restoration". When the anticipated degrees of risk-return ratio are high the investors are attracted and demand for assets is increased. Central banks monitor and curb the flow of money in and out the country. Thus most of the countries hold significant forex reserves. For e.g. China and Russia alone hold well over a trillion U.S. dollars in their foreign currency reserves.

Statistical Variables Analysis

Impact of various macroeconomic variables on exchange arte has been studied with the help of correlation analysis using SPSS.

The effect of this correlation analysis is as follows:

Interest Rate vs. Exchange Rate:

The interest rate and exchange rate highly correlated, and the statistical analysis proves that there is negative correlation between interest rate and exchange rate for the value of r is - 0.934.

This correlation is significant at 0.01 point.

Inflation Rate vs. Exchange Rate

The inflation rate and exchange rate moderately correlated, and the statistical analysis proves that there is an indirect correlation between the inflation rate and exchange rate for the value of r is - 0.606. This correlation is significant at 0.01 point.

GDP vs. Exchange Rate

The analysis of correlation between these two variable shows that there is a moderate positive relationship between the GDP and Exchange rate as the value of r is 0.525 & this relationship is substantial at 0.05 point.

The statistical results suggest that the relationship between the two variables is not very important

Current Account vs. Exchange Rate

The analysis indicates that there is no relationship between the Current Accounting and exchange rate for the value of r is only -0.120 and this relationship is non pregnant.

Foreign Direct Investment vs. Exchange Rate

The analysis of correlation between these two variable shows that there is a modest positive relationship between the FDI and Exchange rate as the value of r is 0.442 & this relationship is substantial at 0.05 point.

Findings And Conclusion

The statistical analysis of several macroeconomic variables shows that:

H0: This hypothesis is ruled out as it has been found that Exchange rates is correlated with many variables such as interest rate, inflation rate & the GDP Growth rate in either direct or indirect mode.

H1: This hypothesis is ruled out as moderate indirect correlation has been found between two variables.

H2: This hypothesis is taken as strong indirect correlation has been found between interest rate & exchange rate.

H3: This hypothesis are partially accepted as mild direct correlation has been found between exchange rate & GDP growth while between Current account balance & Exchange rate there is a very weak correlation.

On the base of above analysis, it can be concluded that Indian Rupee has shown high volatility over the long time. At that place are several probable reasons associated with it. India was receiving capital inflows even amidst continued global uncertainty in 2009-11 as its domestic outlook was positive. With domestic outlook also turning negative, Rupee depreciation was a natural consequence. Aside from lower capital inflows uncertainty over domestic economic system has also made investors nervous over Indian economy which has further exaggerated depreciation pressures.

Continued research on the benefits and risks of fluoride-

1.) Researchers came to know how the factors as GDP, inflation, FDI and FII affects the Exchange Rate
2.) Researchers came to know how the macro economic factors are interlinked.

Limitations of the research are also identified-

There may be many genes which may be indirectly affecting the exchange rate.

Research data has been taken for a shorter span of time.

Political factors, government policies and industrial environments have been disregarded in the study, while they cause affect the substitution rate.

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