

Study on Variation in Rupee in Relation to Dollar: A Conceptual Analysis

Ajit Kumar

Research Scholar

Department of Applied Economics & Commerce,

Patna University, Patna

E-mail: mailjtkumar@gmail.com

Abstract- The change in rupee is posing a unique set of challenges for the Indian economy. The impact would not be limited to macro economy alone but it will also affect down to the level of firms under various sections of economy. This is conceptual study based on Rupee Dollar relationship in terms of Rupee appreciation that is dollar depreciation and rupee depreciation that is dollar appreciation. It provides valuable insights into impact of changes in currency relations on various sectors of economy keeping in focus economy in general and Indian economy in particular. Pros and Cons of currency appreciation and depreciation are studied as boon and bane for the economic growth. It also provides suggestions or steps needed to control as well as to overcome ill-effects of excessive fluctuations between rupee and dollar keeping in view current trends. The change in rupee value is good for someone whereas it adversely affect to others.

The year 2012 has begun with catastrophic affect for the rupee. It was Rupees 43.96 against a dollar in the July 2011 and now for \$1 it is Rupees 63.16. Rupee hits all time low in On 28 Aug. 2013, the value of a Rupee had fallen at Rs. 68.85, so that one would need around 69 Indian Rupees to buy \$1. This kind of decline will have the sweeping impact on the macro economy of the country, as we are heavily dependent on the import of oil, food items and other crucial raw materials.

Keywords: Appreciation, Currency Fluctuation, Depreciation, Rupee-Dollar.

I. INTRODUCTION

Global economy is much more interlinked than it was earlier due to lot of trade taking place between different countries. It goes without saying that U.S. is major trading partner for many nations and biggest trading importer of goods and services from across the world. Change in any direction in U.S. economy is directly going to affect economy of all related countries. Democratic principle and human capital has given India unique position among world community. Indian economic policies are flexible enough to get adjusted to the other nations. 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 occupying strategic importance among world community.

A. The Political And Economic History Of A Country Can Be Traced Through Its Currency

Under Bretton wood system in 1944 participating countries agreed to try and maintain the value of their currency with narrow margin against dollar and corresponding rate of gold as needed. This made Dollar to be reserve currency and other country started accumulating dollar as foreign reserve. This was finally abandoned in 1971 and U.S. dollar will no longer be converted into gold. In 1980s cross border capital movements accelerated with the advent of computers and technology, extending market continuum through Asian, European American time zones. In 1990s further development lead to development of foreign trade among many countries and they started playing important role in the international economy with U.S. The impact of sluggish U.S. economy and interdependence of Indian economy on U.S. economy cannot be neglected in the current global economic scenario.

In early controlled exchange rate regime, the rupee exchange rate hovered around Rs 4.00 in the 1950s, Rs 5.00 in the 60s, Rs 7.00 in the 70s, and Rs 8.00 in the 80s. In the liberalized era of 90s, the rupee moved to Rs 20s and Rs 40 in the next decade of 2000. During this period, the Government has declared two major devaluations. The rupee was devalued first in 1966 by 57% from Rs 4.76 to Rs 7.50 against the US dollar. In the 90s, the rupee was again devalued by 19.5% from Rs 20.5 to Rs 24.5 against the US dollar.

II. OBJECTIVES

It is all across the place – Rupee has touched all time low. At the time of writing this article, Rupee is quoting at Rs. 63.16. Depending upon which side of the fence you are sitting, you may either be laughing with extraordinary gains which you may be making due to currency depreciation or weeping the hell out due to excessive losses owing to it. There may be other category of people who would not be on either side of the fence but sitting on the fence and are not aware of the impact of currency depreciation on their day-to-day life and hence are not concerned with the currency movements. The objective of this article is to unravel the impact of currency, specifically currency depreciation on the people from all walks of life.

This is conceptual study based on Rupee Dollar relationship in terms of Rupee appreciation that is dollar depreciation and rupee depreciation that is dollar appreciation. It provides valuable insights into impact of changes in currency relations on various sectors of economy keeping in focus economy in general and Indian economy in particular. Pros and Cons of currency appreciation and depreciation are studied as boon and bane for the economic growth. It also provides suggestions or steps needed to control as well as to overcome ill-effects of excessive fluctuations between rupee and dollar keeping in view current trends.

III. RUPEE AND DOLLAR – AS CURRENCY-

Determining what causes currency to weaken or strengthen is an evolving art and it is more of an art than science. In India, level of foreign exchange reserve being low in the past and demand for foreign currencies particularly dollar being heavy, the dollar always used to be at premium. Consequently, rupee used to be weak against dollar in the foreign exchange market which is changing now and rupee is becoming strong.

Currency depreciation is the loss of value of a country's currency with respect to one or more foreign reference currencies, typically in a floating exchange rate system. It is most often used for the unofficial increase of the exchange rate due to market forces. The depreciation of a country's currency refers to a decrease in the value of that country's currency.

The appreciation of a country's currency refers to an increase in the value of that country's currency.

Depreciation and devaluation are two economic events that deal with the value of your country's currency. Both of these situations cause the value of your currency to drop versus the rest of the world. However, they have two different causes and long-term effects on your country's economy.

A. Depreciation

Depreciation happens in countries with a floating exchange rate. A floating exchange rate means that the global investment market determines the value of a country's currency. The exchange rate among various currencies changes every day as investors reevaluate new information. While a country's government and central bank can try to influence its exchange rate relative to other currencies, in the end it is the free market that determines the exchange rate. As of 2012, all major economies use a floating exchange rate. Depreciation occurs when a country's exchange rate goes down in the market. The country's money has less purchasing power in other countries because of the depreciation.

B. Devaluation

Devaluation happens in countries with a fixed exchange rate. In a fixed-rate economy, the government decides what its currency should be worth compared with that of other countries. The government pledges to buy and sell as much of its currency as needed to keep its exchange

rate the same. The exchange rate can change only when the government decides to change it. If a government decides to make its currency less valuable, the change is called devaluation. Fixed exchange rates were popular before the Great Depression but have largely been abandoned for the more flexible floating rates. China was the last major economy to openly use a fixed exchange rate. It switched to a floating system in 2005.

IV. MOVEMENT OF RUPEE AGAINST 1 US DOLLAR SINCE 1973

These movements shows how from 70's the rupee had regularly depreciated till 2001 and then it has started fluctuating and also gradually appreciating due to constant change in the global as well as Indian economy. Interest rate is price of money and higher the supply of any normal good its price must drop. When supply of money decreases interest rate increases which makes money more costlier and it lead to the situation when foreign currency price of local currency also increases which results into appreciation of local currency. E.g. say, rate of interest increases from 10% to 14% due to decrease in supply of money it will make value of money to increase and ultimately foreign currency price of local currency increases say, between us \$ &Rs. From 1 US \$ = Rs.41 to Rs.40 that is appreciation of rupee. Rate of exchange between both the currencies is determined by market forces which are political, economical and psychological in nature.

RBI introduced foreign currency rupee options from 2003 to neutralize the currency risk on country's large external liability portfolio and ensure smooth functioning of the markets. Foreign currency rupee options are options to purchase or sell one currency at a price denominated in another currency. It was with the aim to help banks, corporate, residents and non-residents to better manage their currency risks against adverse movements of the rupee against foreign currency especially the dollar. Dollar is depreciating because the country has run a persistently large amount of current deficits and is now unable to finance it with foreign money as yield on U.S. assets have declined. Today overseas customers demand price sheets and catalogues denominated in their currency.

❖ **Impact of Depreciation and Appreciation of Rupee on Indian living in India**

Effect on	If Rupee depreciates	If Rupee appreciates
Importers	Imports become costlier	Imports become cheaper
Exporters	Exporters earn more	Exporters earn less
Indian Who Wish to Go on Holidays Abroad	Trip is costlier	Trip is cheaper

V. RUPEE APPRECIATION IN RELATION TO DOLLAR -

The appreciating rupee is posing a unique set of challenges for the Indian economy. The impact would not be limited to macro economy alone but it will also affect down to the level of firms under various sections of economy. On 7th may 2007 \$1 US = Rs.40.57 which is 9 yr high rupee value against dollar. RBI has accumulated reserves by buying dollars thereby reducing its supply. Buying of dollars has released rupees that have added to money supply. Heavy dollar inflow and selling pressure from exporters have pushed rupee higher. Increase in flow of funds through foreign institutional investors is another important reason for appreciation of rupees. The appreciating rupee is going to affect various sectors of

economy in different ways may be positively or negatively.

A. Measurement of Volatility: 2000- April 2015

Volatility in exchange rate refers to the amount of uncertainty or risk involved with the size of changes in a currency's exchange rate. Volatility in the rupee-dollar exchange rate during various episodes of heightened volatility in the FOREX market in the last fifteen years have been computed using standard deviations of daily FOREX market returns, which have been annualized. An analysis of volatility in various phases of exchange rate pressures shows that volatility in rupee-dollar exchange rates has exhibited mixed trends in the last fifteen years of market determined exchange rate.

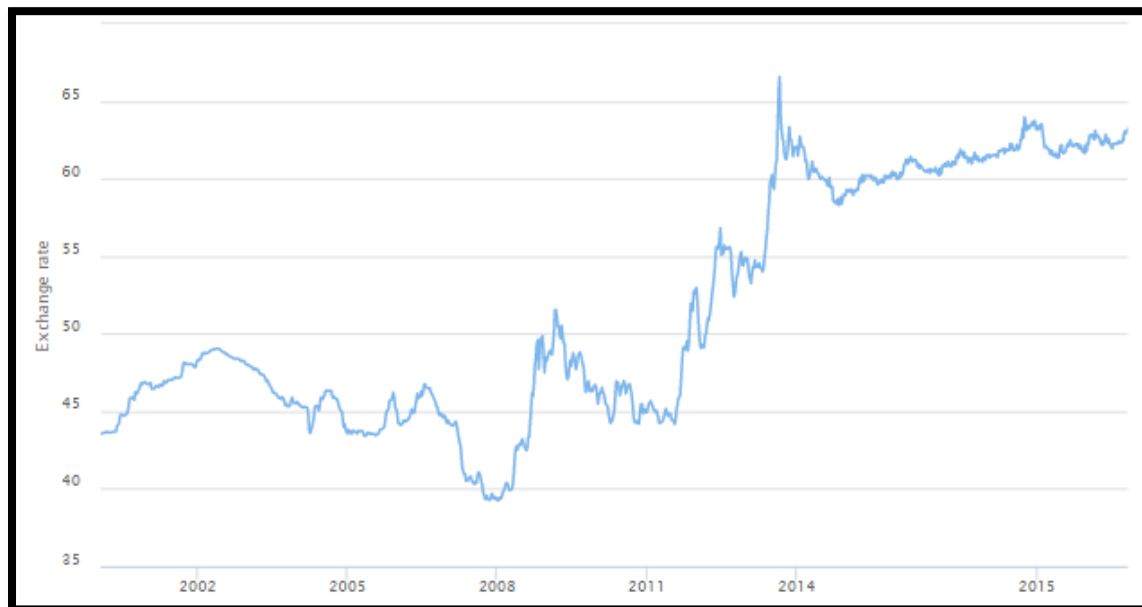


Figure 1: Rupee- Dollar Exchange rate movement from 2000 to April 2015.

VI. RUPEE APPRECIATION IN RELATION TO DOLLAR AS A BOON

- Exporters are perhaps the biggest beneficiaries of the Rupee depreciation as every dollar of their sale fetches them more Rupees. Hence if they don't reduce their prices, with the same quantity of sales, they earn more in terms of Indian Rupees.
- Since import cost will decrease energy dependent sectors will benefit more comparing to others. Companies that source raw materials from the global market and are largely domestic demand driven could witness improvement in margins.
- It is also beneficial for the capital goods sector as large number of equipment and machineries are imported.
- It is also a good sign for government's financial health because in the long run a stronger rupee would be sound for the Indian economy and will bring

India's purchasing power at par with other currencies.

- Oil marketing companies which import crude oil will also be benefited.

VII. RUPEE APPRECIATION IN RELATION TO DOLLAR AS A BANE:

- Exports which constitute about 12% of India's \$854 billion economy would have grown faster had the rupee not appreciated to a 9 year high and eroded earnings of the exporters.
- An appreciating rupee impacts our export competitiveness adversely. Exports of goods which compete only on price with very low margins are expected to come down whereas more value added exports which have higher import content or which are fewer prices sensitive would be less affected.
- India's foreign structure does not support strong rupee since it includes leather, textiles, gems and

jewelry and most of the manufacturers and exporters are medium and small sized who are operating on low margins and they cannot absorb currency risks.

- Hedging of currency is not popular in India as what it is in other developed countries due to high costs.
- For IT companies and exporters, the rising rupees means a fall in the operating margins and increased costs as they will receive less rupees for each dollar earned. Approximately, two-thirds of India's IT revenue is in dollar terms.
- The textile business with hardly 3 to 5 % profit gets directly affected by appreciating rupee since export will go down. As per Cotton Textile Promotion Council for the year ending January, 2007 in the case of US textile import from India had grown only by 5% whereas from China, Indonesia, Bangladesh and Cambodia it had grown by 27, 26, 20 & 23 % respectively which shows that appreciating rupee has made our export uncompetitive.
- Hotel industry would be affected as major portion of their sales is from abroad and there is appreciation of rupee.
- Strengthening rupee is cause of concern for commodity sector. US being the largest importer, majority of the Indian commodity exports are dollar denominated. The metal companies especially the iron-ore exporters would be badly affected as they will have to give up the gains accruing from higher global commodities prices on account of falling dollar.

VIII. RUPEE DEPRECIATION IN RELATION TO DOLLAR:

Since independence till recently rupee was continuously depreciating. It had reached the level of 49.09 in May, 2002. However FOREX inflow from service export and NRI remittance witnessed solid growth which resulted in current account surplus and a turnaround for the country running in trade deficits in the past. India's medium term export policy for 2002-07 has recommended gradual depreciation of the rupee to substitute direct export subsidy, which is forbidden under WTO regime. Lower rupee helps exporter in the sense that he can lower his price and sell in the overseas market.

IX. RUPEE DEPRECIATION IN RELATION TO DOLLAR AS A BOON:

- Exports can grow faster if rupee depreciates since exporter can attract overseas buyers.
- A depreciating rupee can increase our export competitiveness which is very much essential for any economy to grow. Exporters of goods which compete on price with very low margins can also survive in the foreign market in the sense that they can lower the price and increase sales volume.
- India's foreign structure also support weak rupee since it includes leather, textiles, gems and jewellery and most of the manufacturers and exporters are

medium and small sized who are operating on low margins and they cannot absorb currency risks but weak rupee can allow them to sell their product at lower price.

- For IT companies and exporters, the falling rupees means an increase in the operating margins as they will receive more rupees for each dollar earned. Approximately, two thirds of India's IT revenue is in dollar terms.
- The textile business with lower profit margins gets directly benefited by depreciating rupee since export will go up. v Hotel industry would be affected as major portion of their sales is from abroad and there is appreciation of rupee.
- Weakening rupee is welcome step for commodity sector. US being the largest importer, majority of the Indian commodity exports are dollar denominated. The metal companies especially the iron-ore exporters would be benefited as they will have gains accruing from lower global commodities prices on account of rising dollar.

X. RUPEE DEPRECIATION IN RELATION TO DOLLAR AS A BANE:

- The biggest loser from depreciation of the rupee are the importers as they have to pay more in terms of dollars i.e. less dollar denominated goods can be purchased by paying higher amount of rupee.
- Since import cost will increase energy dependent sectors will lose more comparing to others.
- Companies that source raw materials from the global market and are largely domestic demand driven could witness decrease in their profit margins.
- It is not beneficial for the capital goods sector as large number of equipments and machineries are imported and they will become costly.
- It is not a good sign for government's financial health because in the long run a weaker rupee will make India's purchasing power lower as compare with other currencies.
- Oil marketing companies like BPCL, HPCL, and IOC which import crude oil will be adversely affected as they have to pay higher import bills.
- Telecom companies like AIRTEL, Idea with huge requirement for import capital expenditure stand to lose from a fall in the rupee value.
- As far as foreign exchange markets are concerned, the rupee may lose its value as currency due to depreciation not being a good sign for any currency.

XI. RUPEE APPRECIATION/DEPRECIATION IN RELATION TO DOLLAR - A NEUTRAL EFFECT:

- Earnings of sectors like shipping, ship building etc. are in dollars. However their expenses are usually in dollars, therefore it usually provides a natural hedge

to a large extent and they would not get highly affected.

- Gems and jewelry industry, where exports are more of a value added in nature, e.g. where gold is imported, processed to create jewelry, which is exported back would be less affected.
- In case of pharmaceutical companies where only a part of their export is to US and since they also hedge their exports do not get highly affected by rupee appreciation.

XII. SUGGESTION/STEPS TO CONTROL EXCESSIVE FLUCUATIONS :

- The government should guarantee minimum exchange rate and if the market moves sharply against the exporters then they should be compensated with subsidy.
- A range may be fixed around a particular rate say 4% around Rs.44 and the rupee movement should be restricted around that range.
- Hedging of currency is another option which needs to be made popular in India. It can be done in various ways like forward contracts or buying options. Forward contract is the one in which future price is locked in. It can really provide safeguard against risk and help to survive in foreign market. Small and medium enterprises should be allowed to book forward contract without underlying exposures or past records of export or import.
- RBI should come up with measures to reduce interest rate on export credit and Public Sector banks should ensure credit to medium and small exporters under the priority sector.
- The way in which government is giving tax exemptions for service rendered in India and utilized for exports, this should be done for service rendered outside India and utilized for exports.
- Incentives should be given to control cost and to remain competitive in the global market.

XIII. CONCLUSION

The initial success story of India was clearly based on factor driven economy based on labor arbitrage that is providing low cost labor in comparison to another country. At this stage development is sensitive to global business cycle and exchange rate fluctuation. We need to move towards being investment driven economy that is efficiency driven in the form of infrastructure development, improving skill of work force and make that investment which translate into tangible productivity across the board. Final stage which can make India to be developed economy is to be innovation driven economy that can create unique value of India at global economy level. We need to accelerate reform process that would make economy resistant to external shocks and changes in economy cycles and currency fluctuations. The bottom line is our policy should concentrate on enhancing our capability in manufacturing, promote entrepreneurship and

provide incentive for innovations. We need to remember that the challenge which we are facing is not only about currency risk but it is about moving to growth and development.

All in all, depreciating rupee is bad for companies that import things and good for companies that export. Alternatively, appreciating rupee is good for companies that import things and bad for companies that export.

REFERENCES

- [1] YOJNA October 2013.
- [2] ICAI journal, June.
- [3] C.R.L.Narsimhan (2003) “Rising Rupees Hidden Massage”, The Hindu, April 3 2003.
- [4] Shankar Acharya (2007) “Exchange Rate Policy” , Business Standard, April 26.
- [5] Amit Kapoor (2007) “Rising Rupee and India Growth Story”, The Economics Times, August 29.
- [6] M K Venu (2007) “Is the us facing liquidity trap?”, The Economics Times, September 4.
- [7] Shruti Chauhan & Paramita Chatterjee (2007) “Ship Your Worries”, The Economics Times, September 11.
- [8] M.Y.Phansalkar(2005) “All about Foreign Exchange and Foreign Trade”, Published by English Edition.