Trends in the dollar rupee rate and its implications on India's imports and exports

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Received: December 10, 2018 Accepted: January 16, 2019

ABSTRACT: *India got freedom from British rule on Aug 15, 1947. At that time the Indian rupee was linked to the British pound and its value was at par with the American dollar. There was no foreign borrowing on India's balance sheet. India being a developing economy with high inflation, depreciation of the currency is quite natural. Depreciation of rupee is good, so long as it is not volatile. A random depreciation that we have seen in the last few months is bad and it has hurt the economy. This paper tries to explore the causes and impact of rupee depreciation on the Indian economy, particularly the country's imports and exports, and also tries to suggest ways to stabilise the Indian Rupee against the US Dollar.*

1. INTRODUCTION

- The price of one currency in terms of the other is known as the **exchange rate**. Since there is a symmetry between the two currencies, the exchange rate may be defined in one of the two ways. First, as the amount of domestic currency required to buy one unit of foreign currency, i.e. a rupee-dollar exchange rate of Rs 50 means that it costs Rs. 50 to buy one dollar, and second, as the cost in foreign currency of purchasing one unit of domestic currency. In the above case, we would say that it costs 2 cents to buy a rupee.
- There exist 3 types of systems for the Determination of the Exchange Rate, which are as follows-

1.1 Flexible Exchange Rates

In a system of **flexible exchange rates** (also known as **floating exchange rates**), the exchange rate is determined by the forces of market demand and supply. In a completely flexible system, the central banks follow a simple set of rules – they do nothing to directly affect the level of the exchange rate, in other words they do not intervene in the foreign exchange market (and therefore, there are no official reserve transactions). The link between the balance of payments accounts and the transactions in the foreign exchange market is evident when we recognise that all expenditures by domestic residents on foreign goods, services and assets and all foreign transfer payments (debits in the BoPi.e Balance of Trade accounts) also represent demand for foreign exchange.

1.2 Fixed Exchange Rates

The pegged exchange rate system is one in which the exchange rate is pegged at a particular level. Sometimes, a distinction is made between the fixed and pegged exchange rates. It is argued that while the former is fixed, the latter is maintained by the monetary authorities, in that the value at which the exchange rate is pegged (the par value) is a policy variable – it may be changed. There is a common element between the two systems. Under a fixed exchange rate system, adjustment to BoP surpluses or deficits cannot be brought about through changes in the exchange rate. Adjustment must either come about 'automatically' through the workings of the economic system or be brought about by the government. A pegged exchange rate system may, as long as the exchange rate is not changed, and is not expected to change, display the same characteristics. However, there is another option open to the government – it may change the exchange rate.

1.3 Managed Floating

It is a mixture of a flexible exchange rate system (the float part) and a fixed rate system (the managed part). Under this system, also called **dirty floating**, central banks intervene to buy and sell foreign currencies in an attempt to moderate exchange rate movements whenever they feel that such actions are appropriate. Official reserve transactions are, therefore, not equal to zero.

- The USD/INR pair tells the trader how many Indian Rupees (the quote currency) are needed to purchase one U.S. dollar (the base currency).

2. STATEMENT OF THE PROBLEM

"To study the trends of movement of foreign exchange rates of USD vs INR."

3. OBJECTIVES

1. To study the trends of movement of foreign exchange (UDS vs INR) for 5 years.
2. To analyze the reasons for the observed trends in foreign exchange rates.
3. To suggest measures to cope up with the fluctuations in the foreign exchange rate.

4. RESEARCH METHODOLOGY

The study is based on secondary data collected from https://www.poundsterlinglive.com.
Time period of the data is 5 years i.e. 2014-2018. A descriptive study has been done to analyze the data. However, the scope is limited to only USD vs INR rates.

5. LITERATURE REVIEW

Ayushsingh, Vinayak Mishra, Akhilendra B. Singh, August 2016, depreciation of rupee reduces the inflow of foreign capital, raises the external debt pressure, and also grows India's oil and fertiliser subsidy bills. The most positive impact of depreciation of rupee is the stimulation of exports and discouraging imports and thus improving the current account deficit. But, even after significant increase in the exports and sales in the research year, Indian companies reported a decline in their overall profitability.
DeepaDivakaran.N, February 2014, the researcher suggests that global factors have greatly contributed towards the depreciation of rupee. She suggests that the government must make bonds available to non residential investors and boost the export intensive sectors. Additionally, she believes that the RBI should sell the forex reserves in order to deal with the rupee depreciation problem.
Dr. Partap Singh, September 2012, the researcher regards Europe's debt crisis as the most prominent reason for rupee depreciation. Imports of unnecessary items such as gold are needed to be restricted in India. It is concluded that the fall in the value of Indian rupee has some consequences which could have mixed effects on Indian economy. Management of foreign capital flows is a challenge for the Indian government.
SuhasAvhad, October 2016, depreciation of rupee feeds directly and indirectly into general inflation, which is a continuing problem even as output growth decelerates, and therefore hits common people hard. Due to fall in the value of rupee, energy prices have inflated. The government should concentrate on correcting the economic fundamentals and improve its coordination with the RBI.
Dr. Nikhil Saket, September 2013, it is not only the globally traded price of fuel but also the exchange rate that determines domestic oil prices. Going by the way the economies in the euro zone and the US have been behaving, it would be naïve to expect that the export earnings would be contributing significantly to foreign exchange inflows in the near future.

6. DATA ANALYSIS

Given below is the data of USD vs INR exchange rates for 5 years i.e. 2014 to 2018. The data has been collected on a quarterly basis. The table shows the USD vs INR exchange rate for a period of 5 years. Mean and CAGR (Compound Annual Growth Rate) have been calculated for each year.

Table 1– USD to INR exchange rate

	2014	2015	2016	2017	2018
JAN	62.685	62.0155	67.8473	67.4462	63.5825
APRIL	60.315	63.6057	66.348	64.3	66.51
JULY	60.555	63.871	66.735	64.2	68.535
OCTOBER	61.455	65.4051	66.7305	64.755	73.96
MEAN	61.2525	63.724325	66.9152	65.1753	68.146875
CAGR	-0.00494199	0.013392862	-0.0041407	-0.010128192	0.0385199

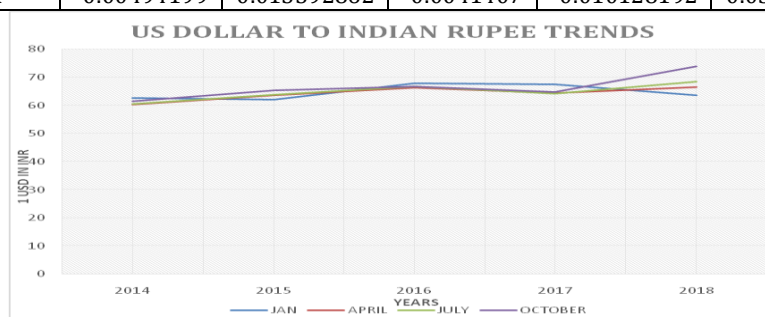

Fig.1

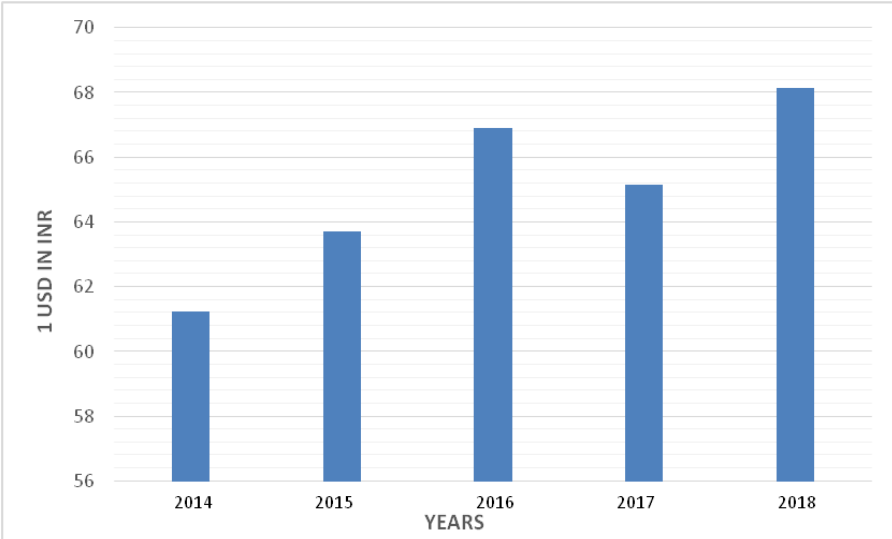

Fig.2

As it can be observed from Fig.2, the average USD vs INR exchange rate rose continuously from 2014 to 2016. Following which, the average rate fell to about 65.17 INRs for 1 USD in the year 2017. The rate showed a steep hike from 2017 to 2018. During the time period from 2014-2016, the Indian rupee's averagevalue against the US Dollar dropped continuously. It was because of the boom in north American oil production and crashes in the price of oil. When Indian oil marketing companies bought oil, they paid in dollars. This pushed up the demand for dollars and drove down the value of the rupee against the dollar. Gold, like oil, is bought and sold internationally in dollars. When Indian importers bought gold, it pushed up the demand for dollars and the process drove down the value of the rupee.

However, during 2016-2017, the Indian rupee's average value against the US Dollar rose to around 65 rupees for one dollar. A major reason for the same lies in the fact that Foreign Investment Portfolios(FIPs) poured in money into the Indian stock market. When these investors brought their dollars into India, they needed to convert these dollars into rupees, to be able to buy stocks.Hence, they needed to sell their dollars, to buy rupees. When this happened, the demand for the rupee went up and pushed up its value against the dollar. This was precisely why the rupee appreciated or gained in value against the dollar. In February and March 2017, the FIPs invested close to Rs408 billion in the Indian stock markets. Over and above this, the FIPs also invested Rs314 billion in Indian debt markets buying Indian bonds. This investment of Rs722 billon made by the FIPs in the Indian stock and bond markets essentially pushed up the demand for the Indian rupee, and in the process led to the appreciation in the value of the rupee against the dollar.

Overall, it can be comprehended that the dollar versus rupee rate has been greatly volatile during the past 5 years. The exchange rate was at a low of 60.315 in April 2014. The figure peaked at 73.96 in October 2018. The Compound Annual Growth Rate (CAGR) for the USD vs INR rate was the highest in 2018, being0.0385199, which means that the rate increased by 3.8% in 2018. It was the lowest in 2015(0.01339286), meaning it grew by only 1.3 % in that year. The average USD vs INR rate was a low of 61.2525 in 2014, and reached a high of 68.146875 in 2018.

7. IMPACT

Currency depreciation is the fall in the value of a currency in the exchange market. Hence, 'depreciation of the Indian rupee against the US dollar' means that now one Dollar can be exchanged for more Rupees than before. The implications of this depreciation on the imports and exports can be discussed with regard to two areas, which are as follows-

7.1 A General Impact

When a currency of a country depreciates as a result of demand and supply conditions or is devalued by the Government, the prices of the country's exports in terms of foreign currency (say dollar) will fall.This will cause the increase in quantity demanded of domestic exports. As a result, the domestic exports will increase. On the other hand, depreciation or devaluation of the domestic currency will make the imports from foreign countries more expensive in terms of the domestic currency when it depreciates or is devalued.

Thus, higher prices of imports will induce individuals and firms in the country to import less and they will make an attempt to substitute domestically produced goods for imports from abroad. Thus, as a result of depreciation or devaluation and consequently increase in exports and decline in imports, the net aggregate demand for domestically produced goods will increase.

And if level of output, especially industrial output is lower because of demand recession, the increase in net aggregate demand or increase in expenditure on domestic output will cause expansion in output and is therefore likely to increase GNP or real national income.

This is illustrated in Fig. 3 where as a result of increase in net exports aggregate demand curve shifts to the right. As a result, given the short-run aggregate supply curve the levels of GDP (National income) and price level increases. Thus a devaluation or depreciation can therefore serve as a stimulus to the economy.

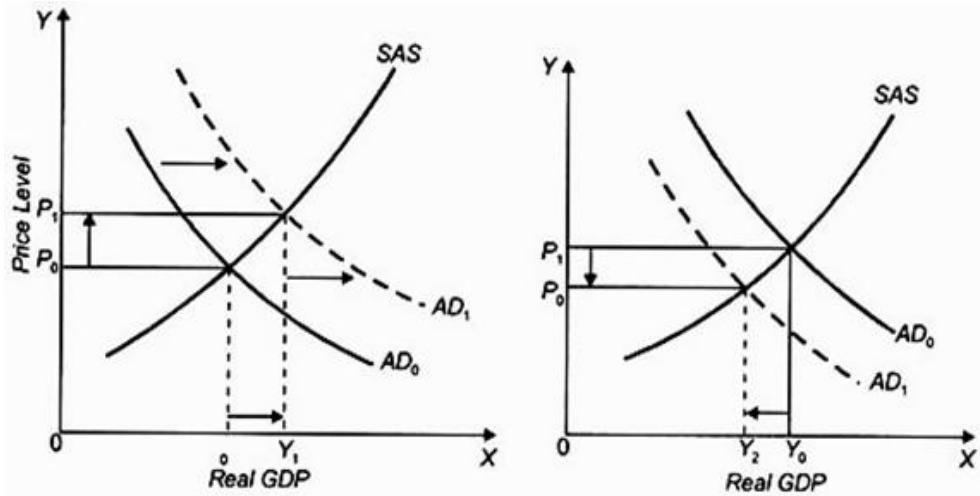

Fig.3

7.2 Impact on Indian imports and exports

The direct and immediate impact of the exchange rate is on the exports and imports of a country. When the rupee depreciates, it loses value with respect to the dollar. This means it takes more rupees to exchange with a dollar.

Most of the international trade happens in US dollars. Therefore, as rupee depreciates, exports become more profitable, because the exporter earns more rupees for exchanging dollar. On the other hand, imports become expensive as the importer needs to pay more rupees for the dollars billed. Industries linked to exports like pharma and IT benefit with depreciation, whereas those industries linked to imports (or having vital components of their product imported) have to bear higher input cost, which is ultimately passed on to the end users.

Petroleum is India's largest import item. Any price rise in petroleum has a trickle-down effect on the cost of goods where transportation is an important component of the cost. For example, food grains and vegetables. Similarly, for industries where petroleum products are the major input factors.

Foreign portfolio investors (FPIs) made a net withdrawal of about Rs 83,146 crore from the Indian markets in 2018. This comprises Rs 33,553 crore from equities and Rs 49,593 crore from the debt market, according to data available with depositories. This was the worst year for Indian capital markets in terms of overseas investment since 2002, the last year for which segregated FPI data for equity and debt markets are available.

With hike in crude oil prices, Oil importers took a hit on their profit margins. As fuel permeates almost all sectors of the economy, retail inflation rose on a broad basis.

Importers of capital goods saw shrinkage in margins as well. An already weak gems and jewellery sector was hit harder. On the other hand, sectors such as Information technology, textiles and others that export goods benefitted in a big way.

8. REASONS FOR DEPRECIATION

As it can be observed from Figure 1, on 30 April 2014, one would be would be entitled to 60.315 Rupees in exchange for one Dollar, whereas on 31 October 2018, one would be entitled to 73.96 Rupees in exchange for one Dollar. This depreciation has occurred due to numerous factors, some of which are as follows-

8.1 Hike in crude oil prices

After the US and China, India is the largest crude oil importing country in the world. the country imports

more than 80% of its crude oil requirements, thereby making it more vulnerable to changes in the international oil market. Therefore, when the prices of crude oil rose in 2018, India's total import cost also increased, leading to the Indian rupee depreciating hugely against the US dollar.

8.2 Current account deficit

The current account deficit is a measurement of a country's trade where the value of the goods and services it imports exceeds the value of the goods and services it exports. The current account represents a country's foreign transactions and, like the capital account, is a component of a country's balance of payments. In June 2018, India's current account deficit rose to 42%, approximately $160 billion. An increasing current account deficit in India leads to an escalation in the demand for Dollar Because then India requires more Dollars than before to finance its growing deficit, and also to pay for its imports. An increase in the demand for a currency leads to its appreciation. Furthermore, if the US Dollar is appreciating against Indian Rupee, it means that the domestic currency is depreciating.

8.3 The global market scenario

With the beginning of a trade war between the USA and China, the price of the imported commodities has gone up which has increased the outflow of the dollar from the Indian market. Initially, US President Donald Trump imposed tariffs on a number of Chinese goods worth billions following which, in a retaliatory manner, China too imposed tariffs on American products and raised duties on certain goods. Since both the US and China are among the world's largest economies, the trade war is set to affect the global economy. Furthermore, The Indian Rupee is already under pressure from high crude oil prices and the ongoing trade war could spark another round of capital outflows.

8.4 FPI outflows

Foreign portfolio investors (FPI) are those who passively hold securities and other financial assets. the investor does not have direct ownership of the financial assets. FPIs have pulled out nearly Rs. 48,000 crore from the Indian capital markets in the first six months of 2018, making it the fastest outflow in a decade. FPIs withdrew a net sum of Rs. 6,430 crore from equities besides Rs. 41,433 crore from the debt markets during the January-June period of the year, taking the total outflow to Rs 47,836 crore.

8.5 Passive Reserve Bank of India (RBI)

Typically, when the rupee weakens, the central bank sells dollars from its reserves to recover it. So far, though, the Reserve Bank of India (RBI) has not intervened aggressively to shore up the domestic currency.

9. SUGGESTIONS

A volatility has been observed in the USD vs INR exchange rate during the past 5 years. The trends had some positive as well as negative impacts on the Indian economy, as discussed above. Some suggestions are listed below in order to cope up with the volatility in the foreign exchange market.

9.1 The RBI can ensure that export earnings come back to the country on time while importers should be urged not to rush in to buy dollars in advance.

9.2 The government should focus on exports and to the extent possible, especially on the tax credit/refund part, clear the coast for exporters. SMEs (small and medium enterprises) which are dominant in the export market have had tax refund issues and this needs to be sorted out.

9.3 The channels for external commercial borrowing should be looked at judiciously. While urging companies to explore the market makes sense, it should be noted that un-hedged positions can put on pressure on debt servicing. Nevertheless, in these conditions, such borrowings would be helpful.

9.4 The capital flows need to be monitored proactively and this is where FPIs (foreign portfolio investments) matter. The strong inflow of FPIs has the power to rein in the rupee.

10. CONCLUSION

The USD vs INR exchange rate has been greatly volatile during the last 5 years i.e. from 2014 to 2018. The exchange rate was the highest in October 2018 (73.96) and it was the lowest in April 2014 (60.315). The primary reasons for the depreciation of rupee against the dollar are the ongoing trade war between US and China and the increasing crude oil prices. As a result of the depreciation, Indian exports have increased while the imports have decreased as exports became more profitable. Due to the depreciated value of the Indian rupee, Foreign portfolio investors (FPIs) made huge withdrawals from the Indian markets. A further study is suggested on the projected trend of the USD vs INR exchange rate.