

RUPEE DEPRECIATION- CAUSES AND CONSEQUENCES

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ABSTRACT

This paper studies the real causes of the depreciation of the Rupee in the Indian Economy in the long run. Indian rupee stood at 71.18 against USD as on Feb. 2019. The researchers in this field interpret the situation in different manners. Some of them are of the view that it will increase exports on one hand and on the other hand, it leads to higher cost of imported goods. There are leaders who proclaim that it is a golden run, whereas others say it will slow down the overall economic growth. The trends in exchange rate of Indian currency are not satisfactory. The post- liberalization period reveals that the exchange rate is highly depreciating. Before liberalization, Indian govt. took some hard steps to cope with the situation of rupee depreciation. For an instance, RBI, on the behalf of govt., devalued the currency majorly two times in 1966 & 1991. But, after 1993, Managed Exchanged Rate System has been adopted. Our paper presents a brief view about the causes and consequences of rupee depreciation and initiatives taken by Indian govt. and central bank to tackle this situation.

KEYWORDS: Rupee Depreciation; Current Account Deficit; Inflation; Forex Reserve; Exchange Rate System.

INTRODUCTION

Rupee depreciation means a decrease in the value of rupee with respect to other currencies. Depreciation is an automatic process. By automatic, we mean that it is not done by RBI deliberately. It depends on demand and supply rule. For the past few years, rupee has been depreciating drastically with respect to USD. It means USD is becoming expensive in exchange for INR. In 2018, INR was considered to be one of the worst performing currencies in Asia. In August 2018, it reached the mark of Rs.70 per USD and after that it leveled-off.

RESEARCH METHODOLOGY

The research paper is based on empirical study. It is a type of descriptive research paper.

Objective of Study:

- 1). The first objective of this paper is to highlight the main causes or reasons of rupee depreciation against USD.
- 2). The second objective is to explain the impact of rupee depreciation on Indian Economy.

Data Collection

For the purpose of the study, secondary data is used. The data is taken from reliable sources like Ministry of Commerce and Industry, RBI, IMF etc.

CAUSES OF RUPEE DEPRECIATION

INR is depreciating continuously against USD in the global market. Following are the main causes which contribute in currency depreciation:

Increased oil import bills:

Increased oil imports are one of the main reasons of rupee depreciation. It is because India imports it in a very large quantity. Oil import bills are rising since 1970s. This is because in 1973 OPEC(organization of petroleum exporting countries) has raised oil prices by more than 4 times. Prior to hike in oil prices, oil imports were merely 12-13% of India's exports. But after 1973-74, it has increased rigorously. In 2014-15 it was 44.4% of total exports that means a little less than half of total export receipts were used just for oil imports.

financail year	India crude oil import bill since 2006	
	CRUDE OIL IMPORTS (MILLION TONNE)	Crude oil import bill
FY 6	99.4	171702
FY 7	111.5	219029
FY 8	121.67	272699
FY9	132.77	348304
FY10	159.25	375277
FY11	163.59	455276
FY12	171.72	672220
FY 13	184.79	784652
FY 14	189.23	864875
FY 15	189.43	687416
FY 16	202.85	416579
FY 17	213.93	470251
FY 18	220.4	566450
FY 19	228.6	881282

From table it is clear that India's import bill of crude oil has been increasing for many years. For FY19, it is estimated to be Rs.8,81,282 (in crore). It is very alarming that with change in every dollar per barrel of crude oil prices, India's import bill are affected by Rs. 823 Crore (or USD 0.13 billion)

Demand and Supply rule

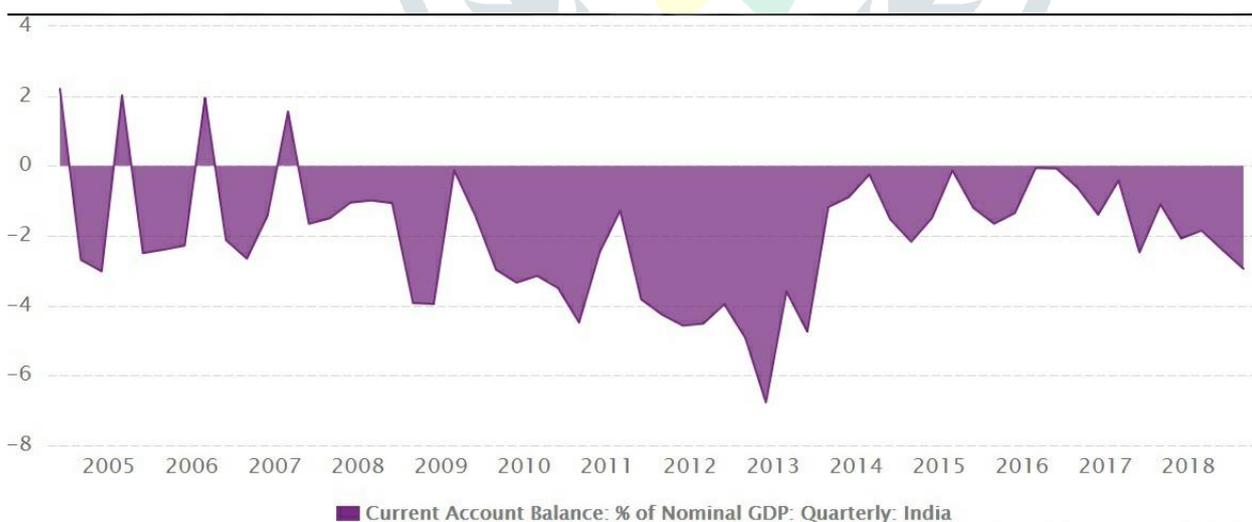
Currency depreciation is an automatic process. It is not done by the central bank of the country. Rather, it depends on demand and supply of the currency in the global market.

Ceteris paribus, when demand of USD is more than its supply in the global market, then, according to law of demand, price of USD will go up in terms of other currencies. Therefore, rupee will depreciate in terms of USD. Against it, ceteris paribus, when demand of USD is less than its supply in the global market, then, rupee will appreciate in terms of USD. This is how demand and supply rule works in the appreciation and depreciation of a currency.

Increase in CAD

A widening Current Account Deficit (CAD) is also a main cause for rupee depreciation. CAD occurs when import payments of goods and services of a country are more than its export receipts. In India's context of rupee depreciation, energy crisis play a vital role in CAD.

According to Economic Survey 2017-18, India's exports are less than its imports since 1950 which means that India's Current Account is in deficit since the planning has been started. In 2012-13, highest CAD was recorded, \$190.34 billion, which was the highest in the post-independence period. In 2016-17, deficit was recorded to be 108.5 billion.



From above graph, it is clear that India's Current Account is in deficit for many years. Above graph shows the Current Account balance in percentage of nominal GDP (Quarterly).

Unreasonable high imports

Another main cause behind rupee depreciation is unreasonable high imports, i.e., imports of gold and coal. In India, there is a trend of wearing gold and diamond ornaments on auspicious occasions. So, there is more demand for gold. Also, in marriage season, demand for gold further increase. This results in more demand for gold than its supply in the domestic market. Therefore, India has to import gold to satisfy this increasing demand and more imports results in rupee depreciation. From the table given below, it can be observed that percentage of gold in India's total imports was 8.3% in FY16. For April-February, FY18, 7.5% is gold in total imports.

IMPORT DETAILS

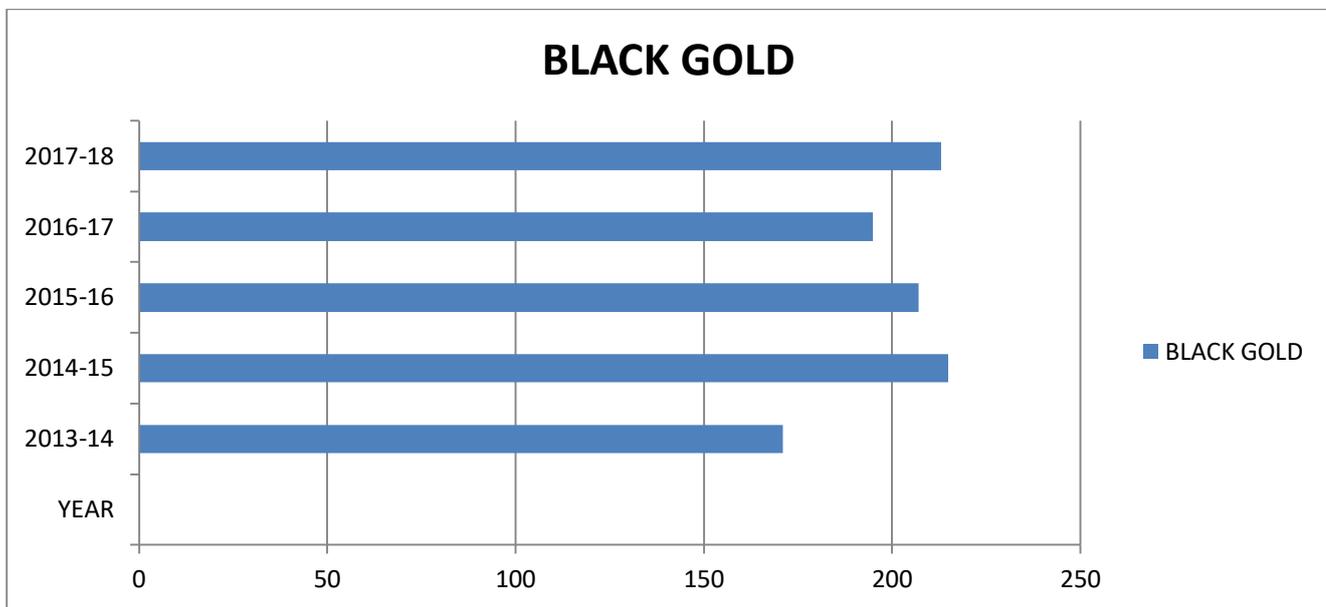
	GOLD	TOTAL	%
FY15	34.46	448.03	7.7
FY16	31.77	381.01	8.3
FY17	27.51	384.36	7.2
FY18	31.06	416.87	7.5

India I also importing coal in a large quantity. Coal, in India, is used as a main source of energy in industries. Therefore, to meet the demand for coal of industries, India has to import coal. Although, India is endowed in coal, yet, it has to import it to meet the country's demand. The reason behind this is the problems standing in the way of increase in its production.

Following table shows that India is importing a large amount of coal from abroad:

BLACK GOLD

YEAR	IMPORT IN MILLION TONNES
2013-14	171
2014-15	215
2015-16	207
2016-17	195
2017-18	213



CONSEQUENCES

Now let us have a look at how depreciation of rupee affects Indian Economy. Depreciation of rupee definitely reduces the inflow of foreign capital. The currency depreciation will benefit some of the export oriented sectors.

1. **More Exports & lesser Imports:** - when a currency depreciates export increases because now domestic currency becomes cheaper in terms of foreign currency. More exports are considered to be good for a country until it becomes equal to its imports. In this situation, exports of a country will become equal to its imports and Balance of Payment will be neutral. The country having higher exports will be happier with a depreciating currency India, on the other hand, does not enjoy this because of crude oil and gold consist a major portion of its import basket. India's biggest export item i.e. crude oil and depreciating rupee increases the cost of Imports. Exports means you are sending to another country. After depreciation what has happened the value of INR has come down which means you are earning more now. During depreciation the exporters gain and income of the exporters is high. Whereas importers earlier had to pay less but imports have become expensive.
2. **Unemployment in the economy:** - Travelling abroad has now become costlier as Indians have to pay more rupees to buy Dollars for overseas trips. Foreign Education has become more expensive. Every single fall in INR will burden the Indian Economy which leads to increase in fiscal deficit. All this will affect the companies in the nation as In order to cut their cost they now resort to retrenchment to cut down expenditure. This has led to Unemployment in the economy.
3. **Inflation:** - a continuous depreciation in the INR leads to increase in Inflation. The central bank cannot cut down policy rates. A person who has taken loan now faces burden of higher Interest rate. Loan taken from US is much cheaper in terms of Interest rate than that in India. So there is difference in Interest rate as well. This puts a depreciating pressure on the currency. In long run it will affect the

competitiveness of the economy. The gains made from export performance are likely to be offset by this adverse affect.

4. The currency depreciation proves to be an advantage for IT sector, textile, pharmaceuticals, gems and jewelers, power and fertilizers. Most of the companies working in IT sector receive the major part of their revenue from US. Any company receiving any kind of income or receipt in terms of US dollar will be now getting more value. A depreciating rupee is better for NRIs repatriating money home as the dollars are now more valuable.

Measures taken by RBI and Government of India to curb the rupee fall

1. There are number of steps taken by both RBI and Government of India to overcome this situation. For instance, RBI can sell forex reserves and buy Indian rupees leading to demand for rupee. RBI can take steps to increase the supply of foreign currency by expanding market participation to support Rupee. Maintaining a competitive real exchange rate is imperative for boosting intermediate and long-term economic growth and maintaining the Balance of payment. RBI can ease capital controls by increasing the FII limit on investment in government. To attract NRI deposits, RBI liberalize deposit schemes and some banks raise rates for overseas Indians. RBI has exempted this deposits from cash reserve ratio and statutory liquid ratio requirements.
2. The government also plans to increase the inclusion of FDI in various sectors. The government also plans to take some hard steps to cut off some of the wasteful expenditure such as import of nonessential items to avoid stressed economic situations.

Conclusion

The fall in the value of currency is not a good indicator but an alarm to take timely action. This research paper helps to find out the real causes and consequences of rupee depreciation against the USD. After liberalization the exchange rate is not satisfactory and the reasons are clear. Wider current account deficit impacted the value of rupee drastically which results in higher fiscal deficit. It also studies various steps government and central bank can take to tackle this situation. To attract investments, RBI can ease capital controls by increasing the FII limit on investment. The study showed that after currency depreciation people are struggling with inflated prices of the commodities of daily use. The currency crisis is a serious issue and need to be handled systematically. The most positive impact of rupee depreciation is increased exports which helps to improve current account deficit.

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