An Analytical Study of Devaluation of Indian Currency

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Abstract

Over the years, the Indian rupee has devalued itself every year, it cost in year 2019 at 68 in comparison to Rs 67 in 2018 to buy one American dollar. The Indian Rupee has fallen in value against a basket of currencies since independence in 1947 many times. The first major devaluation of the rupee happened in 1966 when it was pegged against the US dollar at Rs 4.75/$. Devaluation means decreasing the value of nation's currency relative to gold or the currencies compare to other nations. Devaluation of the Indian Rupee conducted in 1966 and 1991 has stabilized the economy which was facing a severe economic crisis prior to 1991.Lot of Economic reforms which are prevalent today has been the results of reforms which comes in place after 1991.

Whenever the rupee has been devalued, exports have become cheaper and more competitive, but imports have become costlier. The objective of the paper is to study the factors that leads to decline of the rupee against dollar its impact on Indian economy and study the factors which government should take to strengthen the Indian currency. Study observed various possible factors to increase the value of rupee against dollar one can think of is to increase the export and decrease the import. Rate of interest on investments should be increase in the economy so that it will attract more foreign direct investment in our treasuries, corporate bonds etc. In the long run the weakening of Indian currency adversely impacts the Indian economy

Key Words: Rupee devaluation, Economic Crisis, Exchange rate, GDP, Inflation

1. Introduction

Over the years, the Indian rupee has devalued itself every year, it cost in year 2019 at 68 in comparison to Rs 67 in 2018 to buy one American dollar. The Indian Rupee has fallen in value against a basket of currencies since independence in 1947 many times. The first major devaluation of the rupee happened in 1966 when it was pegged against the US dollar at Rs 4.75/$. Devaluation means decreasing the value of nation's currency relative to gold or the currencies compare to other nations. Devaluation is usually undertaken as a means of correcting a deficit in the balance of payments, Inflation and GDP Growth for the nations. Some analyst view in a Country weakening the value of currency could actually foreigners stop the investing in the country, High inflation rate of domestic product, New Export and Import policy, External debt, Tariffs and quantitative restriction which would make it current account (trade) deficit on trade practices. The Indian rupee is going under great stress as overseas investors are paring their exposure to Asia's third-largest economy. The exchange rate between the Indian Rupee and the US Dollar has gone over the roof.

2. Objectives of the study

1. To study the various factors responsible for Devaluation of rupee and its impact on Indian Economy
2. To study the measures which can strengthen the Indian currency

3. Research Methodology: The kind of research conducted here is exploratory research. The information which is obtained is from various secondary sources.

Period of the study: 11-year data has been selected i.e from 2008 to 2018.

Variable selected: The study is impact of depreciation in rupee on Indian economy. Two factors GDP and inflation has been selected for that. So the variable selected is currency prices, GDP and inflation

4.Review of literature:

Arora (2014) studied the real implications of the depreciation of the rupee on the Indian economy and shows that in the long run, the Indian economy has more to lose and less to gain with weaker rupee. Research shows that the Indian Rupee has depreciated significantly against the US Dollar marking a new risk for Indian economy. To attract investments, RBI can Ease capital controls by increasing the FII limit on investment in government and corporate Debt instruments and introduces higher ceilings in ECB's. Government can create a stable Political and economic environment. However, a lot depends on the Global economic outlook and the future of Eurozone which will determine the future of INR.

Soni & Prashar (2013) Devaluation of Indian rupee has several consequences giving mixed effects on Indian economy. The main impact is higher cost of imported goods, boost exports, capital intensive projects become more expensive to execute, it will slow down the overall economic growth by increasing the interest rate and dissuade flow of FIIs. The author studies the real reasons of the depreciation of the rupee on the Indian economy and shows that in the long run it adversely impacts the Indian economy

Yadav et.al (2013) reviews that an observed that famine of 1965 was one of the major causes of devaluation of Indian rupee. The food shortage situation in India accelerated borrowings from International Organizations and other countries which lead to severe deficit in India's financial accounting and weakening of Indian currency. There was also a drastic decrease in India Exports to the Easter European counties of around a decline of overall of 12% in 10 years.

Agarwal. (2012), in article, "Effect of devaluation of Indian currency in Indian economy" say that devaluation happens as a method to rectify BOP imbalance. He mentions in his paper that that rather than devaluation depreciation of the currency is favorable which would enhance the export and in turn increase the economy by increase in employment helping the economy to grow. **Bhawna Kalra(2012),**This paper talks about the reasons for devaluation pre & post liberalization. Author is trying to study the effect of the INR depreciation on the India's economy. He is also mentioning that in the continuing weaker INR is more of concern than being favorable. Author suggests that central govt active participation is required to keep stable currency. Harberger **(2003)** studied the impact of economic growth on real exchange rate. He found that there is no systematic connection between economic growth and real exchange rate. **Husain et al. (2004)** found in their study that little access to international capital is available for the weaker and less developed countries, so low rate of inflation and higher level of durability is associated with fixed exchange rate regime in those countries. However, they found no robust relationship between economic performance and exchange rate regime in the developing economies. They also found that advanced economies may experience durable and slightly higher level of growth rate without higher level of inflation in flexible exchange rate regime.Eduardo Borensztein(IMF) analysed that Huge and sudden depreciations usually occur when an exchange rate peg is uncontrolled, often in the context of solid market burden or a balance of payments emergency. While in these situations there are always clear signs of overvaluation of the local currency, determining the magnitude of the essential nominal depreciation poses difficult questions.

5.Data Analysis

Year	**Inflation**	**GDP growth (%)**	**Currency**
2008	8.35	1.187	48.45
2009	10.83	1.324	46.68
2010	12.11	1.657	44.81
2011	8.9	1.823	53.26
2012	9.3	1.28	54.77
2013	10.92	1.857	61.89
2014	6.37	2.035	63.33
2015	5.88	2.09	66.32
2016	4.97	2.264	67.95
2017	2.49	2.439	63.92
2018	2.44	2.9	67.28

Source (World Bank)

6. Findings

6.1 Reasons for Devaluation of Indian rupees

Rupee has been depreciating for a long period. A country like India is heavily dependent on oil import; we have seen imbalance in our Balance of payment due to the high depreciation of the Indian Rupee. There are many other reasons for the fall in the Indian Currency which are as

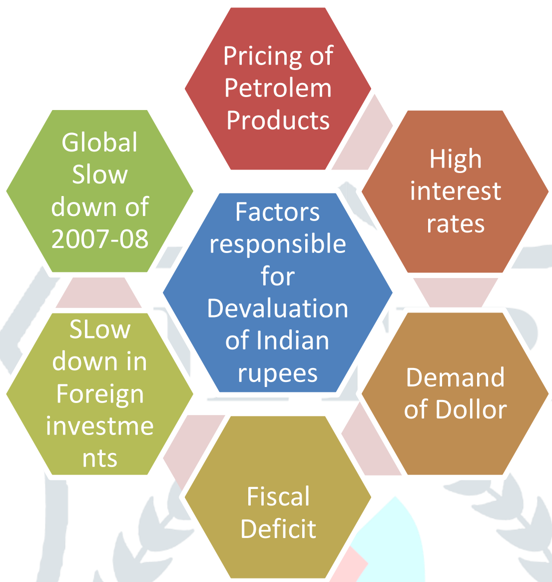

Figure 1: Diagram showing reasons for currency devaluation

6.2 Factors which can contribute to the strengthening of Indian currency:

1) Higher rate of interest rate will help promotion of strong currency because this will help foreign investors to get higher returns on their investment.
2) All the countries have problem of fiscal but so do many other nations around. Tight fiscal discipline and anti-inflationary monetary policies will help to strengthen our currency.
3) Stability is probably what governments seek for their currencies, more so than strength. A strong currency makes a country's exports more expensive, hurting that nation's trade competitiveness. On the other hand, a weak currency makes imports more expensive, boosting domestic inflation. So the ideal course is to aim down the middle and avoid destabilizing fluctuations.
4) Changes in market inflation cause changes in currency exchange rates. A country with a lower inflation rate will experience an appreciation in the value of its currency. The prices of goods and services increase at a slower rate where the inflation is low. A country which has constantly low inflation rate exhibits a

rising the value of currency while a country with higher inflation rate will diminish the value of currency and is usually accompanied by higher rate of interest.

6.3 Impact of rupee depreciation on Indian Economy

Devaluation of the Indian Rupee conducted in 1966 and 1991 has stabilized the economy which was facing a severe economic crisis prior to 1991.Lot of Economic reforms which are prevalent today has been the results of reforms which comes in place after 1991.

Whenever the rupee has been devalued, exports have become cheaper and more competitive, but imports have become costlier. A weak rupee will make Indian produce more competitive in global markets and that will be fruitful for India's exports. Exports are unable to leverage the weak rupee fast enough given the speed of its decline. In fact, many exporters are caught out because of fixed price contracts in rupees wherein they cannot get the benefits of its rapid fall. Rise in adverse Trade deficit because of costlier imports, worsening the current account deficit. This will also have an adverse impact on the Forex reserves and capital inflows. Continuous Depreciation in rupee provides less room for RBI to cut policy rates which means continuation of high interest loan regime in India. It also puts a negative impact on the tourism industry and on students who wants to pursue their education from abroad. Rise in inflation and other consumer products for which the raw material is imported from outside.

7. Conclusion

History of Indian currency evidenced that devaluation of Indian Rupee helped Indian economy in every crisis. Devaluation of currency makes export cheaper and import costlier which ultimately improves the Balance of Payment of the domestic country. Again, it is also one of the fact that it will impact the economy adversely the long run. Researchers have laid down various factors regarding Rupee appreciation against Dollar. Study observed the other possible factor to increase the value of rupee against dollar one can think of is to increase the export and decrease the import. Rate of interest on investments should be increase in the economy so that it will attract more foreign direct investment in our treasuries, corporate bonds etc. Domestic economy should be open up for foreign capital FDI. The import of gold should also be reduced. When the import of gold reduces the demand for foreign currency will also reduce thus it will strengthen Rupee. Researcher also observed the various factors like, Asian financial Crisis of 1997, Global financial slowdown of 2007-08, European sovereign debt crisis, inelastic export bills of petroleum products, Europeans sovereign debt crisis responsible for the weakening of Indian Currency.

To appreciate the value of rupee India has to work on all the factors that have been mentioned above and needs to take correct decision based on the above-mentioned factors. As import are more than export India should decrease import and increase export which will increase in inflow of foreign currency in the country with this price of the product should also be controlled then only there can be increase in demand. If demand increases, it will lead to increase in exports as well.

Foreign direct Investment is also important because it will lead to increase in flow of foreign currency in the country. We need to attract foreign investors to increase FDI this can be done by improving our economic conditions and relaxations in the FDI limits in many sectors which in turn is interrelated with the value of rupee. Government should also think of launching of new financial instruments to attract sovereign wealth funds

India also needs to concentrate on transport, infrastructure and storage facilities. India should not be just inventing and producing goods, safekeeping them and supplying to needful consumer at the right time. To decrease the expenses and to increase the savings capacity utilization of available resources is must by doing this India can condense current account deficit.

India should improve its investment environment and attract investors from both domestic as well as foreign market it will prevent downward pressure on the rupee. The success of any economy lies in the ability of the Government in implementing the policies in an effective manner policy to stem devaluation in Rupee

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