Depreciating Indian Rupee: Trends and Issues

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Abstract: - Indian rupee has been depreciating since May 2013 creating many dimensional trends and issues to be looked at or to be examined. If a currency is depreciating it implies that the value has gone down in relation to another currency. Presently, the value of rupee has declined from nearly Rs. 55 to a dollar to nearly 69 rupees a dollar. This is because portfolio investors are now taking back their money from emerging markets causing demand for dollars (international currency for payments) to increase hence, pulling down Indian currency. The present paper analyzing the deprecating trends since independence in the context of Indian economy and also discusses issues which have come up due to depreciation of Indian rupee.

Key-Words: exchange rate, depreciated rupee, inflation, foreign investment, devaluation.

1. Historical Perspective

Indian rupee has an unparallel history since the ancient times to the present rough-and tumble of a globalised economy, with each era's coinage and worth, broadly imitating the current political, social and economic environment. {Choudhry 2013}.

The history of rupee had started right from 6th and 7th centuries when for the first time punch marked coins were used as Indian currency. The 'rupiya' that has transformed into the modern day rupee, was first introduced by emperor Sher Shah Suri-the modern rupee's precursor-as a silver coin in the 16th Century. The same remained largely unchanged till the early part of 20th Century.

In 1947 when India got independence, one could exchange a rupee –worth a US $ then –into 16 annas, but in terms of value, this was no loose change. At that times, for an anna one could buy a kilo of ghee, now priced any where between Rs. 300 and Rs. 400 which means about 2000 times increase.

Indian rupee exchange rate evolved in terms of fixed regime wherein both Government and Central Bank of the Country (Reserve Bank of India) determined the exchange rate of its currency into another currency. Similarly, China also determined its Yuan exchange rate in terms of market ruled system.

From the year 1947 to 1971, India had followed a "par value" system wherein the exchange rate of Indian rupee was fixed at 4.15 grains of fine gold. But unfortunately, the devaluation of Indian rupee in 1966 resulted into the reduction in the "par value" of Indian rupee to a lowest level of 1.83 grains of fine gold.

Devaluation of 1966:

In the monetary history of India, for the first time, Indian Government had announced the devaluation of Indian rupee through intervention in the forex market with devaluation of 37.5 per cent and the result was that US dollar was become more expensive from Rs. 4.75 to Rs. 7.50. This was not done as a matter of choice but as a matter of compulsion, in order to increase Indian exports to bring more foreign exchange to the exchequer so that development needs could be met.

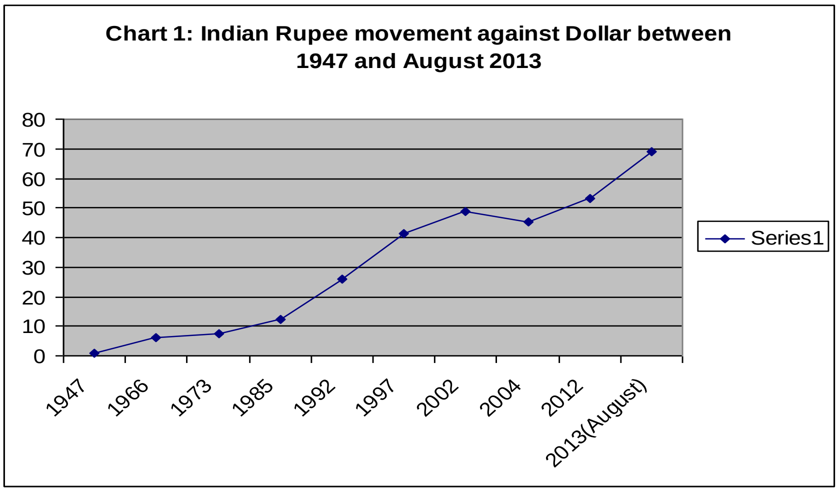
For every dollar, a devalued currency (rupee) gives them more in terms of rupees. This step encourages them to slash unit value fro their respective products in the global market so that these will remain competitive. This devaluation was inevitable as India faced two external aggressions one with China in 1962 and the other one in 1965 with Pakistan and these two wars had ruined Indian economy. Hence, there was no option before the managers of the Indian economy just to get for devaluation so that country should increase exports, liberalize imports and enhance country's chances fro receiving more foreign aid to finance its developmental needs on the other and also to show the world the devaluation as policy tool for effective currency administration.

Devaluation was not an aid in itself. It was an instrument; it was essential if freeing the market was to work. Whether formally or de facto, it had to come sooner or later; and was in purely economic terms and spirit, it made sense to get it. {Lewis 1966}.

After the elapse of 25 years, Indian economy confronted with precarious balance of payment crisis, the then Finance Minister, took another major step in the form of devaluation of Indian rupee in 1992 and 1996 in order to increase exports and earn precious foreign exchange in US dollars. Accordingly, Indian rupee's value went down from Rs. 25 a dollar to Rs. 32 to a dollar. That was the last time India used devaluation as an economic policy instrument. Thereafter the most significant thing happened was transformation from fixed – regime to fully market determined exchange rate regime

2. How Rupee has moved against dollar?

Since independence of India, rupee has been on the fall against dollar (Chart 1). From an exchange rate of 1 rupee is equal to US 1 dollar in 1947 the exchange rate has touched a value of rupees 68.80 equal to 1 US dollar in August 28, 2013.



Source: Prepared by the author from the data given RBI Bulletins; Mumbai 2013.

Over the last few weeks, the Indian Government and RBI has initiated a lot of steps to boost the currency value as well as easing out Foreign Direct Investment (FDI) rules, hence, making funds costlier fro banks and also slapping foreign exchange controls on the individuals and firms.

Indian companies are facing a grim situation now with free-falling rupee forcing consumers to check their spending. The currency blow is landing just as a consumer firms look toward a boost from their strongest annual sales period (September top December). Indian firms can not plan more than a couple of months out as a fast falling rupee value drives up the cost of imports, forcing them to raise prices even as consumer spending crumbles. India's consumers, whose spending helped the Indian economy passing through the global financial crisis in 2008, are now closing their wallets, squeezing firms from car makers to shampoo manufacturers.

Indian firms that import finished products or raw materials are the worst hit as these are crumbling to hold into margins while balancing the need to raise prices with out deterring buyers. India's total consumption expenditure which is comprised of both private and public expenditure has increased by a margin of 3.3 per cent in January-March 2013 as compared to 9.3 per cent in the same period of 2012. Total consumption expenditure as a relative share of India's Gross Domestic Product (GDP) gone down to 65.9 per cent in the IV quarter of 2012-13 from 72.1 per cent in the I quarter of the same fiscal year.

Indian firms are not only cutting back on big –ticket purchases namely- refrigerators, TVs or expensive branded apparel but even staples including soaps, ketchup and cosmetics. According to a Survey, monthly bills for the middle class (driven force of the Indian economy) went up by 15 to 20 per cent in a month across major cities as the falling rupee drove up prices of petroleum goods and edible oil {ASSOCCI June 2013}.

Another publication has opined that even deep-pocketed consumers are cutting back, with five –star hotels and fine dinning restaurants witnessing decease of 20 per cent in sales in the last three months of 2013 after unit value of imported food ingredients and sprits rose. {ASSOCCI August 2013}

3. Causes for Depreciation of Rupee

There are as many reasons for currency sinking. Some of them are more important to be mentioned below:

1. Continuous increasing current account deficit (CAD). Gap between what Indian economy earns from the rest of the globe and what Indian economy has to pay to the rest of the world is pushing up demand for the dollar. India's large fiscal deficit and current account deficit have impacted market confidence. The current situation presents a challenge, obviously, to the Indian Government, but also opportunity for the Government to continue with its policy efforts on a variety of fronts.(Rice 2013) The Indian economy is battling depreciating rupee and low investors confidence. The Indian rupee has dropped over 23 per cent since April and touched a low level of 68.80 to a dollar in the current month (Indian Express[a] 2013).

2. Policy inaction: there is a persisting voice that perception of lack of clarity on policy horizon resulting into fanning speculative demand;

3. Falling foreign exchange reserves: India's forex reserves are enough to cover imports of seven monthly only and thereafter it will become difficult for Indian Government to finance its imports which are on the rise;

4. Economic recession: India's GDP growth came down to a decade low figure of 5 per cent in 2012-13 and 4.5 per cent in January-March quarter of 2013-14, resulting into outflow of funds from the country as the foreign investors are losing confidence in Indian economy for further investment.(The Hindustan Times [a] 2013) During the last four months; the net FII inflows have turned negative (Chart 2). The recent out flows of FII was triggered by the global bond sell-off on US Federal signals that raised the prospects of interest rates hardening in the US. The rise in bond yields in the US lead to a withdrawal of capital from emerging markets economies. The US Federal Reserve has hinted at winding down the program to pump in billions of dollars amid recovery signs in the US economy. Part of this money may come to into Indian equities.

5. Dependence on foreign money: CAD was financed by foreign money for many years. Withdrawal of money by overseas investors is leading to weakness in rupee.

6. Recovery in the US: Recovery in the US economy is making the greenback stronger against other currencies of the globe.

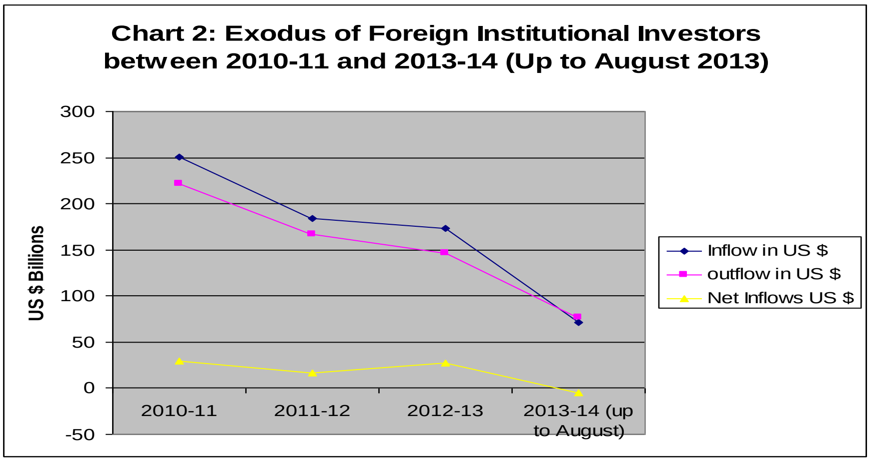
7. Stimulus withdrawal: Indications are there that the US economy may withdraw or ease fiscal stimulus package could tighten liquidity in global markets;

8. Capital controls: The decision of Indian Government to impose restrictions on capital flows has not gone down well with markets and as a result the markets did not response on expected lines.

9. Global trends: Rupee is following the trend seen in the currencies of other major emerging economies; and

10. Speculative trading: Speculative trading in the currency markets is putting further onus on Indian rupee.

11. Portfolio investors are now withdrawing money from emerging markets causing demand fro dollars to rise pulling down local currencies.



Source: Prepared by the author from the data released by Ministry of Finance; Government of India; New Delhi; 2013.

4. Chronicle of Rupee Depreciation

-In November 2011, cabinet approves decision to allow DSI in multi-brand retail but political opposition coerces to bottle it up;

-In January 2012 Reserve Bank of India cuts Cash Reserve Ratio (CRR) by a margin of 0.5 percentage points giving extra money amounted to RS. 32,000 crore fro banks to lend;

-In March 2012, Indian Government announces a proposal to retrospectively tax corporate deals resulting into spooking investors;

-In July-Oct 2012, present Finance Minister (P. Chidambaram) returns and announces fiscal consolidation roadmap; diesel prices raised; allow FDI in multi-brand retail;

-In May 2013, US Federal Reserve chief (Raghuram 2013) hints at withdrawing cheap money policy (cut in interest rates) amid signs of recovery in the US economy which has recorded more than 2 per cent in current quarter; and

-In July-August 2013, Reserve Bank of India slaps forex controls on individuals and firms; curbs gold imports; appointment of new Governor (Hindustan Times[b] 2013); and FDI policy overhauled.

5. How depreciating rupee does affect people?

The following are the major affects of rupee falling:

A falling rupee means that India needs to shell out more cash to import fuel, and this raises the prices of transporting products; resulting into higher inflation;

Higher rate of inflation means RBI will hesitate to cut interest rates;

Hence, consumers required to keep paying bigger chunk of their income every month towards repaying house loans, even as the cost of food and petrol rises and the prospect of salary hikes recede.

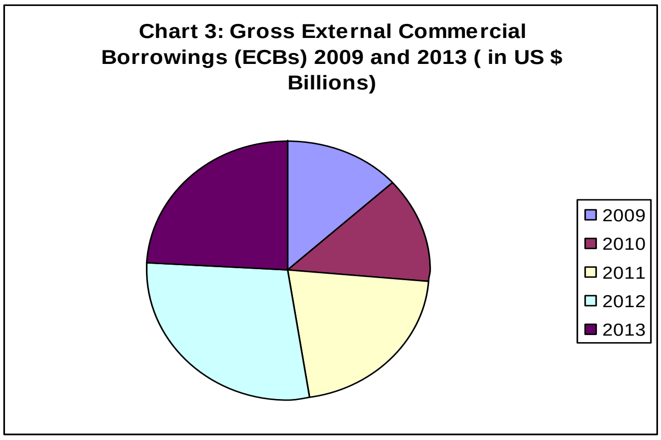
Effects on ECB:

The significance of External Commercial Borrowings has been on the rise over the years (table 1). This testified from that fact the share of this segment in India's total external debt (Chart 3). In 1990-91 when India had faced a crisis and transformed its economy into globalize economy by announcing the New Economic Policy (NEP), the relative share of this segment was just 12.1 per cent. In 2012-13, the relative share has increased enormously and touched a figure of 31.0 per cent of India's total external debt, hence, reflecting a greater reliance on private funding by Indian companies. (ICRA 2013) However, the recent increasing rupee depreciation might discourage companies to continue with this route as the debt service commitment in terms of rupee would rise sharply. This would erode the potential savings expected while availing the ECB avenue.

Table 1: Trends in Gross External Commercial Borrowings between 2009 and2013

Financial Year	Gross ECBs in US $ Billions
2009	15.2
2010	15.0
2011	24.1
2012	32.6
2013	27.6

Source: Handbook of Statistics; RBI; Mumbai 2012-13; and BOP Statement June 2013



Source: Prepared by the author from the data given in Table 1.

6. Other side of Depreciation of Rupee

Falling of rupee is a good arbitrage fro Non-Resident Indians (NRIs) as non-resident external account offers two-way fungibility which means there are no restriction for transferring money from NRE account to foreign account. The result is that NRIs raise cheaper loans abroad and remit money to India.Most NRIs are using this route to remit money

The NRIs in the Middle East region seems to have struck goldmine after the steep fall in the rupee since May 2013. The 25 per cent depreciation in the value of rupee is even tempting NRIs to take loans at cheaper rates in various Middle East countries and the remit the money to India to take advantage of the fall in the rupee value.

According to SLBC statistics, remittances to the State of Kerala, which receives the maximum NRI money in the country, have crossed the all time high figure of Rs. 75,000 crore in the first five months of the fiscal year as compared to Rs. 60,000 crore at the end of last fiscal year {SLBC 2013}.This means NRIs have two advantages at a time by the depreciation of rupee. They get interest of 9-10 per cent in India and on conversion they get more rupees in their account in India. These NRIs could be taking loans to bring to India and make more money out of it. If these trends continue, Banks in Kerala will witness a jump of 45-50 per cent in NRIs remittances in the current fiscal year. {Surendran 2013}.

Interest rates are comparatively low in the Middle East economies. The benchmark rtes in Kuwait and Saudi Arabia are 2 per cent; Qatar 4.5 per cent and UAE 1.36 per cent. Under Foreign Exchange Management Act (FEMA), there is no curb on remittances to India under the NRE to NRO account, which are maintained in Indian rupee and can accept remittances in foreign currency.

Regulatory Measures taken by RBI:

Indian Government boldest attempt yet to stem a rout in the rupee delivered only a modest lift in the currency but sent bond and stock prices tumbling, resulting into concern the unexpected measures inflict too much pain for limited gain. Here is given below a list of measures taken in respect of depreciation of rupee by Indian Government and Reserve Bank of India between January 2013 and July 2013.{Indian Express[b] 2013}

a) RBI eases rules and procedures for the exporters to access Forex Markets;
b) RBI relaxes collateral rules for foreign investors in futures and options in stock exchanges;
c) RBI eases overseas borrowing norms fro firms under investigation;
d) RBI removes restrictions on open position limits fro rupee currency pairs;
e) RBI mulls easing out hedging norms for exporters and importers;
f) RBI cuts time frame fro exporters to repatriate earnings;
g) Indian Government further tightens gold import rules;
h) RBI extends buyback time period for foreign currency convertible bonds until December 31;
i) RBI allows telcos to refinance rupee loans until March 2013;
j) RBI tightens gold lending norms for regional rural banks;
k) RBI eases out rules and procedures for low-cost builders to access overseas loans, hedge entire borrowing;
l) RBI relaxes some forex option premium payment rules and regulations;
m) RBI asks exporters to realize dollar earnings, bring them back into country within one year;
n) RBI restricts loans against gold coins by cooperative banks;
o) Indian Government asks RBI to advise banks not to sell gold coins;
q) RBI extends gold import curbs on nominated and trading agencies;
r) RBI tightens liquidity, lifts short-term rates, caps banks' funding, and announces bonds sale worth 120 million rupees;
s) RBI extends relaxation of the all-in-cost ceiling for issues of external commercial debt;
t) Indian Government tighten regulations, rules, and procedures for derivatives trading in currency markets;
u) RBI eases out rules for non-bank assets finance companies to raise debt overseas;
v) RBI introduces provisioning, capital requirements for bank exposed to corporate with unhedged FX;

7. What should be done now?

India must go for the following steps to prevent further rupee fall.

1. Reserve Bank of India could open a dollar window for oil firms to buy dollars directly from the Central Bank instead of buying from markets;

2. The RBI could hold auctions to buy bonds from oil firms, providing them dollars or other non-rupee currencies;

3. RBI should ask exporters to convert part, or entire overseas foreign currency earnings in the market immediately, providing near-term relief to the rupee;

4) RBI should also ask banks to limit net overnight open position limits, making it difficult to short the rupee and prevent speculative trading;

5) RBCI could issue rules and procedures delaying or staggering import payments, which are typically made at the end of the every fiscal/financial year;

6) Indian Government should review sectors namely defense, or revive pension and insurance reforms;

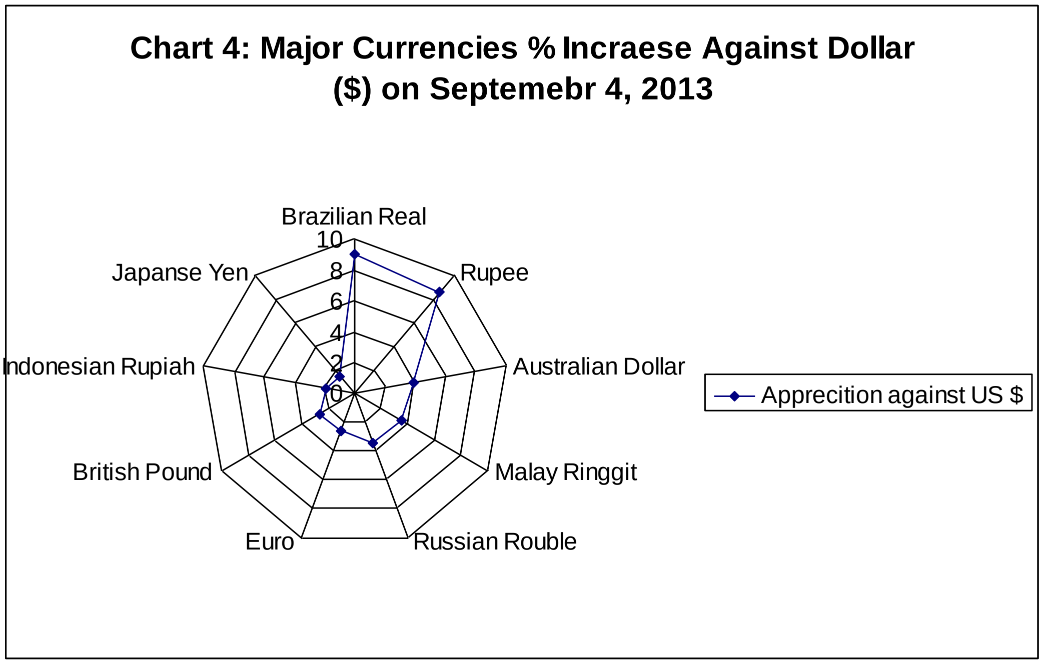
7) Indian Government further could issue a sovereign bond through SBI to non-resident Indians to get more dollars.

8) Indian Government should set to float a first-of-its-kind a proxy sovereign bonds that would allow Government owned firms to dig deep into the pockets of foreign pension and institutional funds to stem the rupee slide, raise funds fro building highways and also test international investors' confidence which is on the decline. This step alone could bring an additional US $ 11 billion or RS. 60,000 crore rupees, that are crucial to strengthen the rupee that has fallen by nearly 20 per cent.

8. The Rajan Effect

The rupee has gained 9 per cent in its value in relation to dollar since September 4, 2013. The most noteworthy feature of Rajan effect is that now rupee is among the best performing currencies in the world

[Chart 4]. There are two contributory factors to this trend. One the Governor of RBI has infused positivity in the market and second because of the delay in the US tapering.



Source: Prepared by the First author from the data given the Hindustan Times; New Delhi; October 18, 2013; P. 13.

There are many contributory factors for the appreciation of rupee against dollar:

1. Opening of SWAP Window for fresh dollar deposits mobilized from the NRIs;
2. Increasing the borrowing limit of banks from overseas;
3. Allowing exporters, importers to practically rebook cancelled forward exchange contracts;
4. Deferring of US Federal Reserve unwinding of its stimulus package;
5. Fall in gold and silver imports by a margin of 80 per cent to US $ 0.8 billion in September 2013.

9. An Alternative as Prevention

In order to check the volatile currency (Rupee), Indian Government is planning to pursue country's ten major trading partners to accept payments in rupee for some of their exports. This proposal is the outcome of the recommendation of the Committee appointed in August 2013 to study and suggest currency swaps. Under this alternative, Indian Government would ask its major trading partners currency swaps, especially oil exporting countries so that the trade deficit could be narrowed down. India has earlier this year also begun paying for oil imports from Iran in rupee that could help save US $ 8.5 billion in the current fiscal year. Indian Government also planning to target oil producing nations namely- Iraq, Venezuela as well as South Korea for making similar arrangements.

China has also shown keen interest in such arrangement to start trade in terms of Yuan-Rupee and Japan too is largely willing to do trade in Yen-Rupee in coming times.

10. Developments in last 8 months of 2014

World tremors shook the Indian financial market and as a result, Indian rupee tumbled from a high of 60.69 in first week of August 2014 to 61.73 in the second week of August 2014. Added to this, Indian rupee registered its largest single day decline in last 6 months of 2014 as heavy dollar outflows from the domestic share and debt markets continued as foreign investors pared their respective holdings.

The decline in rupee value by 65 paise touched a value of Rs. 61.49 against US one dollar. The Indian currency dropped 1.06 per cent in the third week of August which is being considered as the biggest fall in

Indian rupee since January 24, 2014. If tension rises and crude oil prices go up, the Indian rupee could fall further.

The Indian rupee could test its psychological resistance at 61 for one dollar in current week of August 2014. If it manages to breach this level, it could strengthen further to 60.70 in coming weeks. On the other of it side, a reversal from 61 would leave the Indian rupee under pressure. In this regard, the rupee could be range-bound between 61 and 61.75 for some time with bearish bias. Declines below 61.75 for one dollar could drag it to 62 in the month of September 2014.

The medium-term view remains negative, with a bearish head-and-shoulder pattern on the existing chart. Key resistance for Indian rupee is stood at 60.50 and 60.0. A decline to 62.35 appears likely in the medium term. The present outlook for the rupee will turn bullish only of it breaks the psychological 60 level. But under the present world uncertainty, a break looks less probable at the moment.

11. Conclusion

It is evident from above analysis that Indian rupee is in crisis and no breakthrough has been possible. There will be more pain ahead as the globe settles down to a new normal state. The present scenario may need policies that result in increasing the economic misery for people in the near term. The measures taken by the new Governor of RBI has contributed for 9 per cent appreciation of Rupee. The latest initiative in terms of rupee trade with major trading partners may go a long way in easing out the pressure on Indian rupee and mat narrowed down current trade deficit (CAD).

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