# Depreciation of Rupees & Its Impact on Indian Economy

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**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. The Indian Rupee has depreciated significantly against the US Dollar marking a new risk for Indian economy. Grim global economic outlook along with high inflation, widening current account deficit and FII outflows have contributed to this fall. RBI has responded with timely interventions by selling dollars intermittently. But in times of global uncertainty, investors prefer USD as a safe haven. To attract investments, RBI can ease capital controls by increasing the FII limit on investment in government and corporate debt instruments and introduce 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.

**Introduction ;** Depreciation refers to a fall in the value of the domestic currency which is caused by the demand for foreign currency exceeding its supply in the market. In such a situation one has to pay more than before to get units of foreign currency. This fall takes place in the market and on its own. Market determined exchange rate serves the purpose of aligning the domestic economy with the world economy was the price route. As consequences the domestic price gets linked up with those of the world price. With the liberalizations and globalization of the economy in recent years, imports are bound to increase. The lessening of restrictions on imports and lowering of tariff on imports which the economic reform implies, an increase in imports has in fact taken place. Again with trade having become an important element of the new strategy of growth.

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. Right from the beginning of year 2013, the value of rupee has been depreciating. Well looking at the current situation of the depreciation of the Indian rupee against the dollar the questions that strike my mind are that what has caused such depreciation wherein rupee jumped from the 52 mark to 68 in a 15 month period and what have been the effects of such a depreciation on the health of Indian economy and the Indian industry.High growth coupled with a market driven exchange rate bears well for the economy. However, when growth falters and macroeconomic parameters start appearing vulnerable, one of the first casualties is the exchange rate. Currently, there is no clarity on whether we have seen the worst of the storm or it is just the beginning. The problems are manifold. Persistent high inflation and fiscal deficit, increasing subsidies, faltering exports and slowing industrial production point towards an economy, which is moderating in growth. Monetary policy has so far been ineffective in reversing the inflation trajectory. Fiscal stimulus appears non-existent, especially when the government has added to the subsidy bill by giving a go ahead to the food security bill. In this weakened environment, the rupee has depreciated by close to 20% in the past few months.

Talking about the reasons for the depreciation of rupee a series of activities have led to the current scenario. Since the great depression of 2008, the Indian economy had been continuously slowing down. IIP index had been falling and the growth had been perpetually shrinking. All industries were suffering losses and the rate of unemployment in the nation increased. The basic fundamentals of the economy had been vexatious. However, Indians kept on importing from the world market. The high import of gold and crude oil in such a situation burdened the current account deficit and caused it to rise to unreasonably high level of 6.8%. This weakened the Indian position in the international arena. Foreign Institutional Investors (FII's) lost faith in the Indian economy and started withdrawing money from the Indian markets. Foreign entrepreneurs reduced Foreign Direct Investments (FDI's) in the Indian industry. Thus, the valuable forex which was required to finance the current account deficit did not flow in the system which further worsened the deficit. The major event that triggered the rupee to depreciate by such a pace was the statement of the US Federal Bank's chairman Mr. Ben Bernanke wherein he expressed the unwinding of the bond purchase programme in the US. The US had been printing money to bolster its economy. Now with the revival of the economy the Chairman plans to unwind the programme. This statement led to unrest in the US economy and the US investors started withdrawing money from the overseas market. With the increased demand of dollar, the prices of dollar in the global markets rose and the prices of all other currencies weakened against the dollar, among which rupee was one. But because of the already existing current account deficit and reduced growth the Indian currency was badly hit. Rupee came to an all time low of 61.08 against the dollar.

**Effect of Depreciation**

1.Trade deficit will widen because of costlier imports, worsening the currentaccount deficit. 2.Fuel price will keep petroleum subsidy in check, but fertilizer subsidy will rise. 3.Spending on any kind of foreign exchange denominated spending will increase. 4.Capital inflow will slow or reverse. 5.Spending on discretionary goods will increase. 6.Forex reserves could fall putting pressure on rupee. 7.In case of weak demand companies may not be able to pass on higher inputs costs. 8.The government and the RBI have issued a series of measures in recent days designed to reduce the current account deficit and bolster the rupee, including increases in the import duty on gold, the end of duty exemptions for flat screen televisions brought in by airline passengers and restrictions of outward direct investment by Indian companies and individuals. 9.Exports are unable to leverage the weak rupee fast enough given the speed of its descent. In fact many exporters are caught out because of fixed price contracts in rupees wherein they cannot get the benefits of its rapid fall. The balance of payments is tilting sharply against us. 10.The Indian stock- market will take a hiding as opposed to a beating. 11.Global rating agencies will revise our rating downwards to "Junk" status, making international borrowing difficult and even more expensive. 12. If the automated devaluation brought on by the rupee makes some asset classes attractive, there may be slight recovery because of arbitrage opportunities and bottom-fishing.

This depreciation of the Indian rupee has impacted the government, the industry and the individuals of the nation. With the depreciation of rupee the imports have become costlier and thus importing crude oil becomes a burden. With every single value fall a burden of Rs.9000 crores is created on the government in the form of subsidy. This has caused the fiscal deficit of the government to increase. At the industry level the cost of borrowing has been increased for the companies which had taken foreign loans. The increased liability has burdened companies which now resort to retrenchment to cut down expenditure. This has led to unemployment in the economy. Further with depreciation, the prices of imported raw material and technology have increased which has caused the overall costs of the companies to increase. At the individual level the prices of all imported goods have increased. Students going broad to study now have to shed 20% extra for every dollar. This has caused the cost of foreign studies to increase which burdens the Indian familie The Government of India, RBI and the Finance Ministry have taken a lot of measures to solve the menace. The import duty on gold has been raised to 8% against the original level of 2% to curb the imports of gold in the nation. According to P Chidambaram India has imported 1017 tonnes of gold in 2013 and he targets to bring it down to 700 tonnes. The interest rates have been increased by the RBI governor to reduce the supply of rupee in the market. This will also ensure that the much needed foreign investments flow in the economy and inflation is checked. RBI also announced open market operations of 12000 crores to restrict the supply of Indian rupee in the market. Government also plans to increase the cap of FDI in various sectors like insurance, defence and retail to attract foreign investors. The conditions which were imposed on Walmart to enter India have now been withdrawn by the government so that it enters India as soon as possible and bring with it the direly required FDI. The finance ministry is also considering the option of bond issue so as to arrest dollars from the market.

**Conclusion:**

The rupee's decline affects everyone in the economy because it feeds directly and indirectly into general inflation, which is a continuing problem even as output growth decelerates, and therefore hits common people hard. There are several ways in which the falling rupee immediately has an inflationary impact, one of the most important of which is the price of energy. Since the misguided decontrol of oil prices, 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. The govt. should concentrate on correcting the economic fundamentals rather than indulge in soap operas in a run up to the election. A better co-ordination with RBI is required rather than blame game. Apart from all the political parties should come together in fixing the problem and getting back the investors confidence.

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