The Macroeconomic Effects of Exchange Rate Movement in India

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***Abstract*—The relationship between the values of local currencies in terms of foreign currencies and export competitiveness of any country is very complex. This relationship will become more complex if there is the heavy dependence on imported resources in the exported products. During last five years Indian rupee has weakened many times and reached to a level of 65.1806 for a dollar in March 2018. Since April 2013, the local currency lost around 18% to the US currency. Indian economy which as of now experienced vast financial and current account deficiency unfavorably influenced by exchange rate pressure. This paper endeavors to investigate the impacts of exchange rate movement in India and its effect on the Indian economy. The conditions which have been made for the economy because of the devaluation of rupee against dollar uncovers that there has been a solid and critical negative effect of this money unpredictability on numerous sectors.**

***Keywords*—Impact of Rupee, Dollar Fluctuations, Exchange Rate**

I. INTRODUCTION

Exchange Rate Concept

Currency fluctuations are a natural outcome of the floating exchange rate system that is the norm for most major economies. The exchange rate between two currencies is that rate at which one currency will be exchanged with another currency. It is also known as a foreign-exchange rate, forex rate. Exchange rate of one currency versus the other is influenced by numerous fundamental and technical factors.

These incorporate relative supply and demand of the two monetary standards, financial execution, viewpoint for expansion, loan fee differentials, capital streams, specialized help and protection levels, etcetera As these elements are for the most part in a condition of never-ending motion, cash esteems change starting with one minute then onto the next. In any case, in spite of the fact that a cash's level is to a great extent expected to be controlled by the hidden economy, the tables are regularly turned, as enormous developments in a money can direct the economy's fortunes.

In basic terms exchange rate is only the estimation of one nation's currency regarding another currency.

With regards to global exchange, an exchange rate (otherwise called a conversion standard, between two monetary forms is the rate at which one currency will be traded for another).It is likewise viewed as the estimation of one nation's cash as far as another money. E.g.an interbank conversion scale of 66 Indian Rupees (INR) to the United States Dollar (USD) implies that INR 66 will be traded for each USD 1 or that USD 1 will be traded for every INR 66.

In this case it is said that the price of a dollar in terms of rupee is INR 66, or equivalently that the price of a rupee in terms of dollars is USD 1/66.

Exchange rates can be broadly categorized in two types namely fixed and floating. Fixed exchange rates are chosen by national banks of a nation, floating exchange rates are based on the dynamics of demand and supply.

Exchange rates are resolved in the foreign exchange (forex) market, which is available to an extensive variety of various kinds of purchasers and dealers, and where money exchanging is constant: 24 hours daily aside from ends of the week. The spot exchange rate alludes to the present conversion standard.

The forward exchange rate suggests a swapping scale that is alluded to and exchanged today yet for development and bit on a particular future date.

The exchange rate is a key money related variable that influences choices made by outside trade speculators, exporters, shippers, brokers, organizations, budgetary establishments, policymakers and sightseers in the developed and the developing world. Exchange rate vacillations influence the estimation of worldwide speculation of portfolios, aggressiveness of fares and imports, estimation of global stores, money estimation of obligation installments, and the cost to travelers as far as the estimation of their cash.

Developments in exchange rates along these lines have critical ramifications for the economy's business cycle, exchange and capital streams and are subsequently significant for understanding money related improvements and changes in financial arrangement.

Indian Rupee Movement

In the recent past it may be observed that there are fluctuations in the value of Indian Rupee against US Dollar. It is observed that INR prices keep fluctuating all the time. Sometimes we need more rupees to buy one unit of foreign currency and sometimes we need fewer rupees to buy one unit of foreign currency. This adjustment in rupee cost is known as rupee appreciation or devaluation. When estimation of rupee increases it is appreciationof Rupee (winds up expensive) and less rupees can get one unit of another money.

This is otherwise called fortifying of rupee as now INR is worth more than the other currency. Suppose exchange rate changes to 1USD = INR 64, it may be said that rupee has appreciated as 1$ can buy fewer INR.

Alternately, INR devaluation is when rupee value diminishes (turns out to be more affordable) and more rupees can get one unit of another currency. This is otherwise called debilitating of rupee as now INR worth is not as much as another currency. If exchange rate changesto 1USD = INR 68, it may be said that rupee has depreciated as 1$ can buy more INR.

Currency price is always stated in relation to another currency. So when one currency appreciates the other currency depreciates.

Exhibit 1 indicates effects of exchange rate changes (either positive or negative) in general.

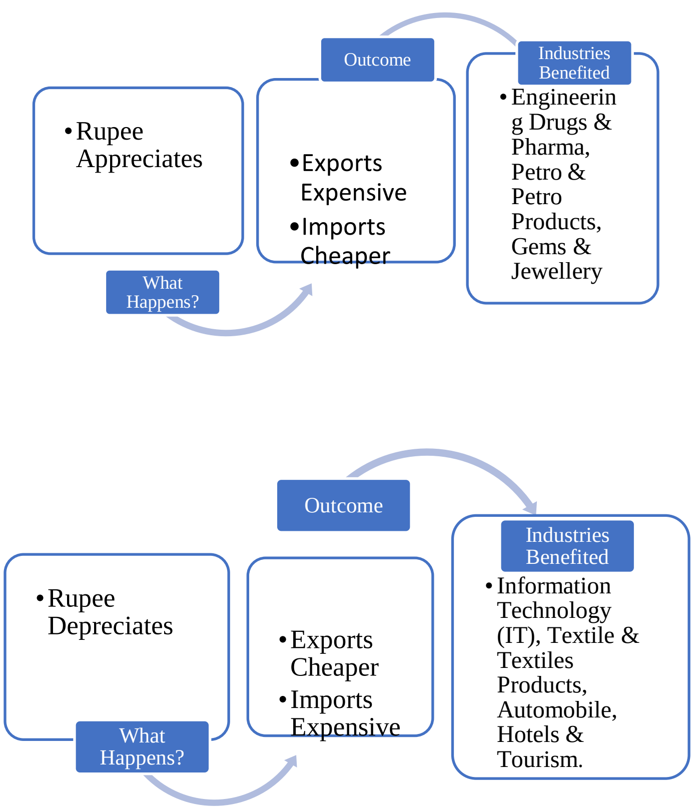

Exhibit 1: Effects of exchange rate changes in general [5]

Currency price is always stated in relation to another currency. So when one currency appreciates the other currency depreciates.

Exhibit 2 indicates past five year chart for Indian Rupee against US Dollar.

Exhibit 2: Past five year chart for Indian Rupee against US Dollar [6]

From the above chart, it was observed that value of Indian Rupee against US Dollar has grown from 54.8105 in April 2013 to 65.1806 in March 2018. This indicates that INR is depreciated over the last five years.

Effect of Exchange Rate Changes

Effects of exchange rate changes are wide spread and affect any country's economy irrespective of its status such as developed, developing or underdeveloped. It has a direct impact on the following aspects of the economy:

Merchandise Trade: As stated earlier, this is related with any country's international trade, or its exports and imports. As a rule terms, a unstable currency will push the exports and make imports costlier. This diminishes the nation's exchange shortage (or expanding excess) after some time. For instance, expect you are a U.S. exporter who sold a million things at $10 each to a purchaser in Europe two years prior, when the conversion scale was €1=$1.65The cost to your European buyer was therefore € 6.06 per item.Your purchaser is presently negotiating a superior cost for a vast order, and in light of the fact that the dollar has declined to 1.75 for every euro, you can stand to offer the purchaser a value reprieve while as yet clearing in any event $10 per gadget. Regardless of whether the new cost is €5.71, which adds up to a 5.77% rebate from the past cost.

The depreciation in the domestic currency is the major reason why the export business has remained competitive in international markets. Now in case of the situation opposite to this, significantly stable currencies makes the exports dearer, thus lowers the export competitiveness and in turn make imports inexpensive. Now this may result in widening of the trade deficit.

Economic Growth: The basic formula for an economy's GDP is C + I + G + (X – M) where:

C = Consumption

I = Capital investment by businesses and households

G = Government spending and

(X – M) = Exports minus imports, or net exports

From the above, it is evident that the more the value of net exports, the more is the country's GDP.

Capital Flows: Foreign funds inflows are attracted by the countries that have stable governance mechanism (in place), progressive economies and steady currencies. A country is required to maintain relatively steady currency to attract more external investments such as foreign investors. Otherwise, the prospect of investment deletion imposed due to currency downgrading may deter external investments. Capital flows may be divided into categories viz. FDI and foreign portfolio investment.

- o FDI (Foreign Direct Investment): In this case, external investors have stakes in existing organizations and / or creation of new facilities overseas.
- o Foreign Portfolio Investment: in this case external investors invest in overseas securities.

- It is observed that FDI is a decisive basis of investments for emerging markets such as China and India, whose growth would be hampered if such investments were unavailable.
  Any country or governing authorizes tend to prefer FDI as compared to foreign portfolio investments, since the latter are often akin to "hot money" that can run off the country when the business hits rough ride. This fact is commonly referred to as "capital flight". This may be initiated due to any unwanted causes such as planned or anticipated depreciation of the currency.
- o Inflation: A devalued currency can result in "imported" inflation for countries that are substantial importers.The exchange rate influences the rate of inflation in various immediate and roundabout ways: Changes in the prices of imported goods and services – this has a direct effect on the consumer price index.For instance, an upsurge of the exchange rate normally decreases the cost of imported buyer products and durables, raw materials and capital types of gear.
- o Commodity costs: Many items are evaluated in dollars – so an adjustment in the Rupee – Dollar exchange rates directly affects the Indian cost of wares, for example, petro items and engineering products. A stronger dollar makes it more expensive for India to import these items.
- Interest Rates: As mentioned earlier, the exchange rate point is a key aspect for most central banks in the context of formulation of the monetary policy. A stable domestic currency exerts a drag on the economy, achieving the same end result as tighter monetary policy (i.e. higher interest rates).
- Unemployment: The exchange rate affects unemployment in many ways:
  - o An exchange rate appreciation may lead to slow economic growth of real GDP because of a reduction in net exports (reduced injection) and a rise in the demand for imports (an increased leakage in the circular flow).
  - o A reduction in demand and output may cause job reduction as organizations seek cost control. Some job reductions are provisional – indicating short term variations in export demand and import penetration. Others may be enduring in nature when an import constitutes a major part of the domestic market. Thus a higher exchange rate can have a negative multiplier effect on the economy.
  - o Some industries are more exposed than others to currency fluctuations – e.g. sectors wherein a large proportion of total output is exported and where demand is highly price sensitive (price elastic).

To summarize, there exists many reasons for an economy taking the rough path. It may be possible that such critical situations may arise in to economy and grabbed more attention of RBI and Indian govt. towards this scenario. It may be noted that there are numerous factors that may cause currency depreciation, i.e. economic, political, corruption etc., but some factors require greater attention and should be analyzed objectively than the others.

II. CONCLUSION

To conclude, it lots depends on global economic scenario what is the future of Indian currency.

The decrease in the value of currency money influences a considerable measure of monetary development pointers. Deterioration of rupee decreases the inflow of outside capital, ascent in the external debts, and furthermore increases India's oil and fertilizer subsidy liability. The best effect of deterioration of rupee is the spur in exports and daunting imports and subsequently enhancing the current account deficit. In any case, even after thrust in exports and revenue during current period, Indian organizations are revealing enormous foreign currency deficits because of the devaluation of Indian rupee. This lowers the general productivity of these organizations.

In the context of imports, for country like India, imports are of absolute necessity. Dismal worldwide monetary viewpoint alongside high price rises, expanding current account shortfall and FII surges have added to this fall. RBI has reacted with convenient intercessions by selling dollars discontinuously. In any case, in the midst of worldwide volatility, investors tend toward USD as a safe bet. To pull more investments, RBI can ease capital regulations by expanding FII restrictions on investment in government and corporate debt instruments and allow higher limits in ECB's. Government can make a stable political and financial condition. However, a lot depends on the Global economic outlook and the future of Eurozone which will determine the prospect of INR.

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