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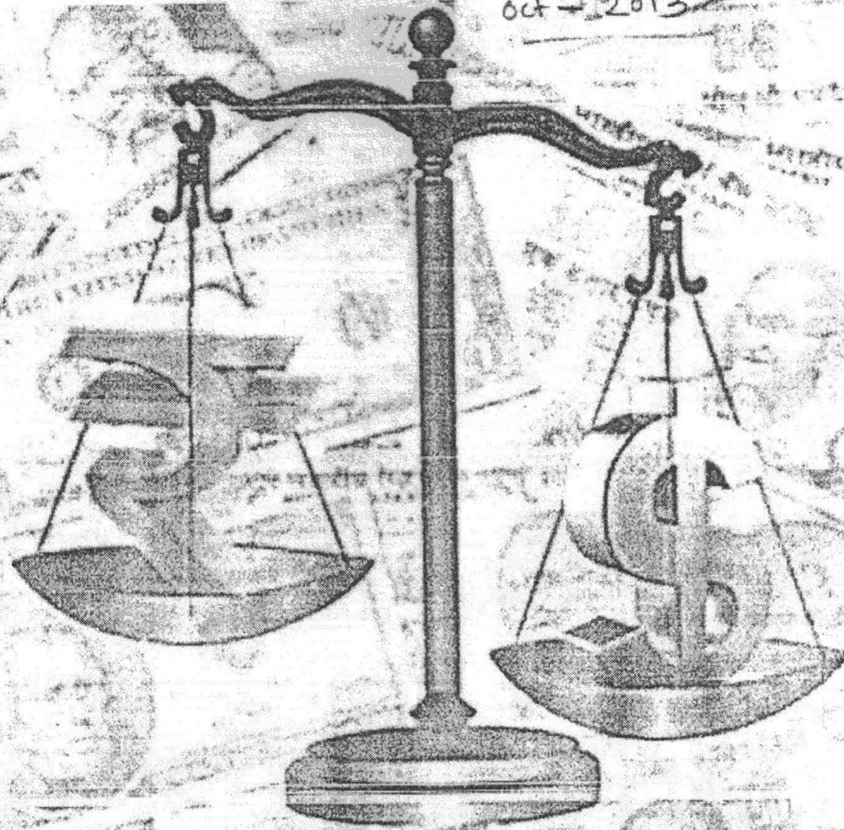

National Seminar on

The Devaluation of Indian Rupee

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Organised By

Karmavir Keshavlalji Harakchandji Abad Arts,
Shriman Motilalji Girdharilalji Lodha Commerce & Science College
(Jain Gurukul) Neminagar, Chandwad – 423101
(Dist. Nashik) Maharashtra – India

24	Devaluation of Currency And Cause	Dr.D.B.More	155-158
25	Devaluation of Indian Rupee : Causes, Impacts And Suggestions	Prof. Smt. B. D. Patil	159-164
26	Effect of Devaluation Of Indian Currency In Indian Economy	Dr. A. M. Thakare, Prof. D. K. Mandavdhare	165-167
27	History of Devaluation Of The Indian Rupee	Prof. Dr. K T Khairnar	168-172
28	Devaluation of Rupee In Reference To Economic And Political Instalrility	Dr.Manda B.Kulkarni	173-174
29	रूपये का गिरता रूपया मूल्य – आर्थिक संकट की घंटी	मीना बिल्लौरे	175-175
30	भारतीय रुपयाचे अवमूल्यन : कारणे	डॉ.सुरेश सामाले	176-178
31	भारतीय रुपयाचे अवमुल्यन	प्रा. डॉ. प्रकाश तितरे, प्रा. बंडू जांभूळकर	179-182
32	Devaluation of Indian Rupee	Dr. Vaishali Hajare	183-184
33	भारतीय रुपयाची घसरण : कारणे, परिणाम आणि उपाय योजना	प्रा. चंद्रकांत बन्सी माळी	185-192
34	रूपये की तुलना में डॉलर ही क्यों ?	स्मृति सिंह	193-194
35	थेट परकिय गुंतवणुक : किरकोळ बाजारपेठेवर दुरगामी परिणाम	प्रा. डॉ. सुनील पंढरीनाथ उगले	195-199
36	Causes of Devaluation Of Indian Rupee Against US$	Prof. Dipali N. Bhosale, Dr. Ganesh M. Agnihotri	200-204
37	Effect of Devaluation on Indian Economy	Dr. S. K. Pagar	205-209
38	रूपयाची घसरण: कारणे आणि परिणाम	डॉ. सुरेश पाटील,	210-214
39	रुपयाची घसरण एक कारणमिमांसा	डॉ. सुरेश क. मगरे	215-220
40	Causes of Devaluation of Indian Rupee	Asst.Prof. Sohani Parasharam Ratan	221-224
41	भारतीय रुपयाचे अवमूल्यन कारणे, परीणाम व उपाय.	प्रा. व्हि.आय.गिरासे, प्रा.डॉ.डी.आर.जगताप	225-228
42	Remedies on Devaluation of Indian Rupee	Mr.Ravindra D.Wagh, Mr.Arvind K.Raut	229-231
43	Devaluation of Rupee – Its Causes, Impact and Remedy	Prof. Ramesh Ingole	232-237
44	रुपयाचे अवमुल्यन कारणे आणि उपाय	प्रा.मानवते यु.एच.	238-242
45	Devaluation of Indian Rupee – It's Causes, Impact & Remedies	Asst. Prof. Nitin. P. Jain	243-248
46	भारतीय रूपयाचे अवमूल्यन आणि त्याची सद्यस्थिती	प्रा. आर.एस. वानखेडे, प्रा. व्ही.के.गाढे	249-254
47	Effect of Devaluation of Banking, Industry and Agriculture.	Prof. Shelar B. L.	255-258
48	Why Value of Rupee Gets Devaluated?	Smt. Kadam Ashadadasaheb, Dr. V.G.Mamde	259-263

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"DEVALUATION OF INDIAN RUPEE: CAUSES, IMPACTS AND SUGGESTIONS"

Prof. Smt. B. D. Patil
Associate Professor,
Dept. of Economics,
Arts, Com. & Sci. College,
Ozar Mig Nashik.
Mob. No. 8600900334
Email: bdpatil59@gmail.com

Abstract:

India is facing an economic crisis. Devaluation and depression of rupee and overall international scenario affects the Indian economy. The Indian rupee has depreciated significantly against the US Dollar making a new risk for Indian economy. Since its Independence in 1947; India has faced five major financial crisis and consequent for devaluation of its currency. These crises were in 1966, 1991, 2008, 2011 and 2013. This paper is an attempt to find out the causes of these five crises.

Devaluation means a fall in the value of domestic currency relative to gold or the currencies of other nations. It is usually used to denote the unofficial increase of the exchange rate due to market forces .Some analysts are of the view that weakening the value of currency could actually have some positive outcomes for the economy since a weaker currency will boost exports, will lead to higher cost of imported goods and make some capital extensive projects more expensive to execute. But the fall in rupee too quickly would pose a danger that the foreigners will stop investing in the country, will increase the cost of dollar loans taken by companies and increase foreign debt. It will slow down the overall economic growth by increasing the interest rates.

Key words: Devaluation, depreciation, USD, FII, FDI, financial crises, fiscal deficit, capital flow forex, current account deficit.

Objectives of the study:

1. To study the valuation history of Indian rupee with respect to the US dollar.
2. To study the various causes of devaluation.
3. To find out the impacts of devaluation of rupees.
4. To suggest some measures for improvement.

Research Methodology:

This study is based on secondary data collected from various documents of RBI and finance ministry, Government of India and reference books. The primary data is collected by the researcher from the various magazines and web sites.

 ISBN : 978-93-83414-38-3

Introduction:

Devaluation in simple sense means the 'Reduction in value'. Devaluation in modern monetary policy is a reduction in the value of a currency with respect to those goods, services or other monetary units with which that currency can be exchanged. 'Devaluation' means official lowering of the value of a country's currency within a fixed exchange rate system, by which the monetary authority formally sets a new fixed rate with respect to a foreign reference currency. The value of a currency is determined relative to the value of other currencies i.e. how much of the other currency can be bought by one unit of your home currency. In general, this is the exchange rate of this currency pair and it fluctuates over time with currencies gaining or losing value against each other. When a currency reduces its value against other currencies, this process is called devaluation.

History of Indian Rupee with respect to the US Dollar:

After Independence, in the initial years from 1950 to 1973, Indian rupee was linked to British Pound. In 1966 the devaluation was the first major financial crisis the Government faced. In 1975, the connection between Indian rupee and pound was broken. After that, rate of Indian rupee was linked to a "basket of currencies" of India's major trading partners.

Again in 1991 Union Budget, Indian rupee was devalued and the Government also opened up the economy. This was then followed by several reforms liberalizing the economy and exchange rate regime shifted from fixed to floating one Indian rupee and its exchange rate historically were as follows :

Table No. 1 : Exchange rate of Indian Rupee as against US Dollar

Year	Exchange Rate (Rupee per USD)
1950	Rs. 4.79
1960	Rs. 4.77
1970	Rs. 7.56
1980	Rs. 7.86
1990	Rs. 17.50
1995	Rs. 32.42
2000	Rs. 44.94
2008	Rs. 48.88
2010	Rs. 46.21
2011	Rs. 55.39
2012	Rs. 57.15
2013 (May)	Rs. 54.73
2013 (July)	Rs. 61.21
2013 (September)	Rs. 67.00

(Source: SEBI)

The above table indicates the history of Indian rupee with respect to dollars during the last sixty three years. It is clear that up to 1980, Indian rupee has relatively stable

 ISBN : 978-93-83414-38-3

exchange rate with USD. But during the period of 1990 to 1995 the exchange rate reduced drastically from 17.50 to 32.42. It means the gap of devaluation was 14.92. 1990 to 1995 was the period when Indian economy was moreover free but rupee still continued depreciating from 17.50 to 32.42. After the year 1995 the downfall has been rapid and reached a low of 67.00 in the month of September 2013

Causes of the Devaluation of Rupees :

The value of any currency in the international market is decided by the forces in market. Simply speaking, if the demand of any good or services is greater than its supply, it becomes dearer or costly. Exactly the same holds well for international currencies as well. Exchange rates are expressed as a comparison of two currencies and they are always relative.

1. **International Economy:** The role of speculation, the under-performing international economy, Euro-zone crisis, sovereign defaults etc. have raised profound uncertainly in international market. In such circumstances and investors feels it safe to buy dollars rather than any alternative assets. This has increased the demand of dollar in international economy and rupee along with many currencies has been adversely affected.

2. **Flight of Foreign Investment:** Foreign institutional investments (FII) are prominent source of demand for rupee. It is well known fact that Indian stock market is dominated by overseas investors. Overseas investors are keen on investing in India only when economy and stock markets are performing well. To invest here, they require rupee. This will increase the demand for rupee and will result in higher value of rupee. On other hand, when these investors are pulling money out of Indian stock market, rupee will be depreciated.

3. **Constraints Among Market Forces:** In elastic import bill it is said that there are invisible hands of market forces which tend to take corrective actions in case of anomaly. The same is theoretically true for an international currency that depreciates in such causes, when currency depreciates the import become costlier while export becomes cheaper.

4. **Currency Account Deficit:** India's current account deficit is more than the expected level, which means the country needs to buy more foreign currency to pay out bills. More demand for the foreign currency will reduce the value of country's currency.

5. **Impact of Rupee Depreciation :**
   IMPORTS: It makes imports more expensive.
   EXPORTS: It makes exports more profitable.
   FOREIGN DEBTS: It increases repaying of foreign debts of Indian Government.
   SERVICING: It increases burden on servicing of Indian Government.

6. **Gold and Oil Imports :** The excessive dependence of India on importing gold from African countries and oil products from OPEC countries is reducing revenue the Government generates from exports. Consequently, in the

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present economic scenario one dinar is equivalent to almost 130 rupees approximately.

7. **Lack of Energy Resource:** This is supplementary point for the previous one. A large scale import of household cooking gas and subsidies on the gas tend to pressurize Indian economy.

8. **Decreasing Fiscal Deficit:** When the Government's total expenditure exceeds the revenue that is generated excluding the money from borrowings is called the Fiscal deficit. Lack of energy resources and subsidies that the Government offers on each cooking gas are increasing the fiscal deficit.

9. **Decreasing Budget Deficit:** A financial situation in which an entity has more money going out than coming in is called decreasing budget deficit. The term "budget deficit" is most commonly used to refer to government spending rather than business or individual spending.

10. **Poor performance of share market:** One of the major sources of dollar flows into India is the share market. Foreign investors, invest in the shares rates. These are held in reserve by the banks who in turn sell to Indians for meeting their dollar needs. However, when the share market is not performing and indexes are falling, the foreign investors, in order to not lose further, sell their share holdings and convert the earned rupees in to dollar and take this out of India for use elsewhere. In this manner, in a very short period of time, there is a large drop in the supply of dollars and its value with respect to rupees rises sharply.

11. **Continued Global Uncertainty:** Due to economic uncertainty prevailing in European countries and all over the world the investors have stayed away from the risky investment and this has significantly affected the investment in India. Any outward flow of currency of or decrease in investment will put pressure on exchange rate. This global uncertainty has impacted on the domestic factors like current and capital account and caused depreciation of rupee.

12. **Capital Account Flows:** Deficit country needs capital flows and if other countries generate surplus capital outflows, India needs dollars to finance its current account.

13. **Low Growth and high inflation** is also one of the major reasons behind the devaluation of rupee.

Impact of Devaluation of Rupee :

1. **Morale dampener:** Except NRIs, who stand to gain the most on account of the rupee weakness, most Indians are worried because of the rapid decline in the rupee. "We are close to crises situation. Nothing anybody does is materially going to control the fall.... With each passing day, nervousness is increasing."
2. **Higher EMIs** "Central banks around the world resort to high rates to stem depreciation in the currency. That's because higher interest rates could bring

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in higher capital in flows necessary to finance current account deficit. The reserve bank may not hike rates, but it will certainly hold the rates for a "prolonged period". That means living with high equated monthly installments.

3. **Stuttering Growth:** India's GDP grew by 5 per cent in 2012-13. This GDP was the slowest in a decade. The sharp depreciation and the stringent monitory policy of RBI will lower growth expectation.

4. **Slowdown in foreign investment:** Weak growth prospects will lead to a slow-down in capital inflows, hurting investment in crucial infrastructure sector.

5. **Rising Inflation:** Global commodities have 35% weightage in India's wholesale inflation basket, and as the rupee weakness, the prices of commodities go up. It is estimated that 10 per cent depreciation in the rupee adds 60-80 basis points to headline inflation.

6. **Higher fuel Price:** Petrol prices have been hiked twice this month. Such hikes will become a recurring feature as rupee weakness further. Crude, which is priced in dollars, is India's biggest import item and a depreciating rupee increases the cost of imports. The worst part is India will have to pay more for fuel even though global prices have hit a year-low.

7. **Greater volatility in stocks:** Foreign funds have sold net dollar 6.7 billion from May 22 to June 24, 2013. The BSE Sensex has fallen 8% over the same period. Foreign funds are likely to sell more because the weakness in the rupee makes their investment unattractive. Shares in companies with higher FII holdings will be under pressure.

8. **Corporate profits:** Exports will gain, but companies dependent on imported raw materials will see a sharp impact on their bottom line. A weak rupee also exposes companies to unhedged overseas loans.

9. **Costlier foreign Education:** Those planning to go to the U.S. will have to sell out at least rupees 2-4 lakh more for their expenses because of the sharp fall in the rupee, according to industry body Assocham estimates.

10. **Costlier Foreign Travel:** Travelling abroad will be costlier as you will how to pay more rupees to buy dollars for your overseas trip / vacation.

Following are the suggestions for the improvement:

1. RBI can sell forex reserve and buy Indian rupees leading to demand for rupees. It will help to appreciate the exchange rate of the money.
2. To raise the rate of interest on foreign investment that will result which are the invested by the foreigners.
3. India should increase export and reduce imports. By exporting more than the import India has to get more foreign currency.
4. To change some policies of F.D.I. and to attract more foreign investments.
5. To improve the growth rate of the countries it will increase the flow of foreign currency.

 ISBN : 978-93-83414-38-3

6. To create market opportunities for foreign depositors and consumers.

Conclusion :

Devaluation basically can be either planned or market driven. It has both the positive and negative effects. In order to tackle the economic problems, the Government takes initiative to devalue its own currency. Here devaluation is planned, whereas devaluation arises due to market conditions and external environment system. This is referred to as Market driven devaluation. It arises due to external environment factors which are basically uncontrolled like interest rate, Balance of Trade, money supply and growth, inflation etc.

However sometimes need arises in order to devaluate currency like Overvaluation of the currency associated with import substitution for industrialization as opposed to export pro motion policies, to relieve an unfavorable balance of trade, to rise the national income per capita, to increase the competitiveness in the foreign markets.

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