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   RESEARCH METHODOLOGY

   RESULTS & DISCUSSION

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RUPEE FALLING: DOLLAR IS ON HORSE RIDE

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ABSTRACT

For the last couple of months, Indian rupee has become the worst performing Asian currency against the dollar. Indian currency is performing worst among all the major emerging economies. In the first week of July 2013, it crossed the psychological barrier of Rs. 60 and reached to an all time high of Rs.61 to the dollar. The Indian Rupee has depreciated to an all time low with respect to the US Dollar. We are experiencing a tough time with Rupee depreciation every day. The Indian rupee touched a lifetime low of 68.85 against the US dollar on August 28, 2013. The rupee plunged by 3.7 percent on the day in its biggest single-day percentage fall in more than two decades. Since January 2013, the rupee has lost more than 20 percent of its value, the biggest loser among the Asian currencies. *Several factors like the slowing economy, rising inflation, around 5% fiscal deficit and a high current account deficit, have been blamed for the rupee depreciation. However, there are many other reasons thriving in the picture. This paper attempts to give insight into depreciation of the rupee and enables the readers to know the valid as well as probable reasons behind the rupee falling. Other side this paper also touches upon measures to be taken to arrest the rupee falling. Primarily this papers covers rupee movements over the years. Secondly, talks about reasons for rupee depreciation with statistical evidences. Lastly, this paper suggests remedies to be taken to arrest the Rupee fall against Dollar.*

KEYWORDS

Economy, depreciation, plunged, inflation, fiscal deficit, current account.

INTRODUCTION

The underlying objective of this study is to find out the dynamics, forces causing rupee falling in the exchange rate of Indian rupee against dollar and remedies to be taken to control the depreciation of rupee. Exchange rates play a dominant role in a country's level of trade that is crucial to almost every free market economy in the world. Therefore, exchange rates are closely studied analyzed and governmentally manipulated economic measures. Exchange rate influences the return of the individual investors, institutional investors, profitability of the firm, growth of specific sectors, and economy of the given country at a large.

LITERATURE REVIEW

Most previous researches about the behavior of exchange rates have been devoted to explain and forecast exchange rate levels and not their volatility. Several structural models have been suggested to capture the pattern of exchange rates, such as monetary exchange rate models and portfolio balance models. However, none of these models was able to outperform a naive random walk model in forecasting in sample exchange rate (see, for instance, Meese and Rogoff, 1983).

Simon (1997) found that exchange rate and current account have direct and positive relationship with inflation and both exchange rate and current account are the key factors that badly affect the small economies.

Edwards (2000) investigated the dynamic association between exchange rate regimes, capital flows and currency crises in emerging economies. The study draws on lessons learned during the 1990s, and deals with some of the most important policy controversies that emerged after the Mexican, East Asian, Russian and Brazilian crises. He concludes that under the appropriate conditions and policies, floating exchange rates can be effective and efficient.

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.

Due and Sen (2006) examine the interactions between the real exchange rate, level of capital flows, volatility of flows, fiscal and monetary policy indicators and the current account surplus for Indian economy for the period 1993Q2 to 2004Q1. The estimations indicate that the variables are co integrated and each Granger causes to the real exchange rate.

The principal aim of this study is to find out the dynamics, forces causing rupee falling in the exchange rate of Indian rupee against dollar and remedies to be taken to control the depreciation of rupee. Exchange rates play a dominant role in a country's level of trade that is crucial to almost every free market economy in the world. Therefore, exchange rates are closely studied analyzed and governmentally manipulated economic measures. Exchange rate influences the return of the individual investors, institutional investors, profitability of the firm, growth of specific sectors, and economy of the given country at a large.

METHODOLOGY

This research has been carried out in order to investigate the impact of various macroeconomic variables on the volatility of foreign exchange rate. The research is based on secondary data, to compile the report with some variables ten years annual data for the period of 2000 till date was collected. The relationship between Exchange rate and Macro-economic variables such as, foreign remittances, Balance of trade, current accountant, Foreign Direct Investment, GDP etc. has been analyzed with the help of statistical data and graphs.

THE RUDIMENTS OF RUPEE

The Indian currency has witnessed a slippery journey since Independence. Many geopolitical and economic developments have affected its movement in the last 66 years. When India got freedom on August 15, 1947; the value of the rupee was on a par with the American dollar. There were no foreign borrowings on India's balance sheet. To finance welfare and development activities, especially with the introduction of the Five-Year Plan in 1951, the government started external borrowings. This required the devaluation of the rupee.

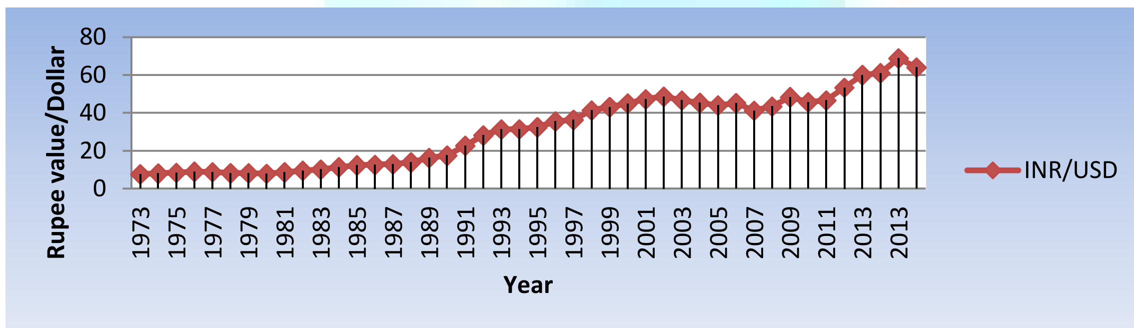
After independence, India had chosen to adopt a fixed rate currency regime. The rupee was pegged at 4.79 against a dollar between 1948 and 1966.Two consecutive wars, one with China in 1962 and another one with Pakistan in 1965; resulted in a huge deficit on India's budget, forcing the government to devalue the currency to 7.57 against the dollar. The rupee's link with the British currency was broken in 1971 and it was linked directly to the US dollar. In 1975, value of the Indian rupee was pegged at 8.39 against a dollar. In 1985, it was further devalued to 12 against a dollar.

In 1991, India faced a serious balance of payment crisis and was forced to sharply devalue its currency. The country was in the grip of high inflation, low growth and the foreign reserves were not even worth to meet three weeks of imports. Under these situations, the currency was devalued to 17.90 against a dollar.1993 was very important. This year currency was let free to flow with the market sentiments. The exchange rate was freed to be determined by the market, with provisions of intervention by the central bank under the situation of extreme volatility. This year, the currency was devalued to 31.37 against a dollar. The rupee traded in the range of 40-50 between 2000 and 2010.It was mostly at around 45 against a dollar. It touched a high of 39 in 2007.The Indian currency has gradually depreciated since the global 2008 economic crisis.Liberalising the currency regime led to a sharp jump in foreign investment inflows and boosted the economic growth.

Value of Rupee against Dollar since 1973 till date

Year	INR/USD	YEAR	INR/USD	YEAR	INR/USD
1973	7.66	1988	13.91	2003	46.6
1974	8.03	1989	16.21	2004	45.28
1975	8.41	1990	17.5	2005	44.01
1976	8.97	1991	22.72	2006	45.17
1977	8.77	1992	28.14	2007	41.2
1978	8.2	1993	31.26	2008	43.41
1979	8.16	1994	31.39	2009	48.32
1980	7.89	1995	32.43	2010	45.65
1981	8.68	1996	35.52	2011	46.61
1982	9.48	1997	36.36	2012	53.34
1983	10.11	1998	41.33	2013	60
1984	11.36	1999	43.12	2013	61
1985	12.34	2000	45	2013	68.85
1986	12.6	2001	47.23	2013	63.99
1987	12.95	2002	48.62		

Average annual currency exchange rate for the Indian Rupee (Rupees per U.S. Dollar) is shown in this table: 1973 till date.



HOW IS THE VALUE OF RUPEE IS DETERMINED AGAINST DOLAAR

Typically, the value of a currency against another is decided based on demand. If people buy the currency, the currency becomes stronger and vice-versa. The same thing holds for the dollar and the rupee rate. As with other commodities, **market forces** of **demand and supply** are the major determinants of the value of rupee against the dollar. In a scenario, when the demand for dollar witnesses an uptrend, the value of rupee in its respect depreciates, which consequently lowers the purchasing power of the rupee. Current value of rupee that stands at nearly 63 against the dollar can be used to explain strength of the domestic currency against the dollar. The domestic currency value has depreciated considerably as now 63 rupees are required to buy an amount equivalent to 1$.

THEORIES OF CURRENCY

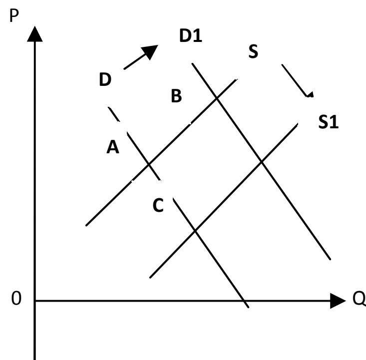
Many theories there have been written in respect to the main determinant of future exchange rates. Although the majority of these theories give adequate reasons in order to explain what actually determines the rates between the currencies, we can argue that there are many factors that may cause a currency fluctuation. Consequently, there is little that can be alleged in respect to the theory that better answers the question of what finally determines the exchange rates.

Here below, we will refer to the main theories regarding the determinants of the exchange rates.

SUPPLY AND DEMAND

As stated earlier, the exchange rate, just like commodities, determines its price responding to the forces of supply and demand8. Therefore, if for some reason people increase their demand9 (shift of the curve from D to D1) for a specific currency, then the price will rise from A to B, provided the supply remains stable. On the contrary, if the supply10 is increased (shift of the curve from S to S1), the price will decline from A to C, provided the demand remains stable (figure P1).

FIGURE P 1: SUPPLY AND DEMAND FOR FOREIGN CURRENCY



P: shows the exchange rate, Q: shows the mount of currency demanded and supplied
A, B, C: Show the equilibrium exchange rate
Any excess supply (above the equilibrium point) or excess demand (below the equilibrium point) will increase or decrease temporarily foreign currency reserves accordingly. Finally, such disequilibrium situations will be eliminated through the pricing, e.g. the market itself.

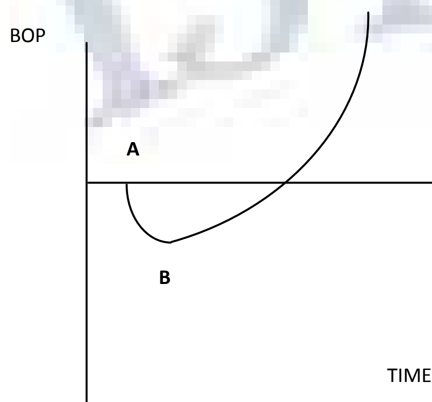
PURCHASING POWER PARITY (PPP)

By definition the PPP states that using a unit of a currency, let us say one euro, which is the purchasing power that can purchase the same goods worldwide. The theory is based on the 'law of one price', which argues that should a euro price of a good be multiplied by the exchange rate (€ /US$) then it will result in an equal price of the good in US dollars. In other words, if we assume that the exchange rate between the € and US $ states at 1/1.2, then goods that cost € 10 in the EU should cost US$ 12 in the United States. Otherwise, arbitrage11 profits will occur.
However, it is finally the market that through supply and demand will force accordingly the euro and US dollar prices to the equilibrium point. Thus, the law of one price will be reinstated, as well as the purchase power parity between the euro and US dollar. Inflation differentials between countries will also be eliminated in terms of their effect on the prices of the goods because the PPP will adjust to equal the ratio of their price levels12. More specifically, as stated in their book (Lumby S. & Jones C. 1999) "the currency of the country with the higher rate of inflation will depreciate against the other country's currency by approximately the inflation deferential".
In conclusion, it can be argued that the theory, although it describes in a sufficient way the determination of the exchange rates, is not of good value, mainly because of the following two disadvantages. Firstly, not all goods are traded internationally (for example, buildings) and secondly, the transportation cost should represent a small amount of the good's worth.

THE BALANCE OF PAYMENTS (BOP) APPROACH

The balance of payments approach is another method that explains what the factors are that determine the supply and demand curves of a country's currency. As it is known from macroeconomics, the balance of payments is a method of recording all the international monetary transactions of a country during a specific period of time. The transactions recorded are divided into three categories: the current account transactions13, the capital account transactions14, and the central bank transactions15.
The aforementioned categories can show a deficit or a surplus, but theoretically the overall payments (the BOP as a whole) should be zero – which rarely happens. As stated earlier, a currency's price depreciation or appreciation (the change in the value of money), directly affects the volume of a country's imports and exports and, consequently, a likely fluctuation in the exchange rates can add to BOP discrepancies.
For example, a likely depreciation will increase the value of exports in home currency terms (the larger the exports demand elasticity the greater the increase).
Conversely, the imports will become 'more expensive' and their value will be reduced in home currency (the larger the imports demand elasticity the greater the decrease).
Consequently, we can argue that unless the value of exports increases less than the value of imports, the depreciation will improve the current account. More specifically, we can finally assess the impact of the currency's depreciation on the current account only by considering the price sensitivity of imports and exports.
The **Marshall Lerner** Condition shows that if the sum of the price elasticity of demand for imports and exports is greater than one, then a fall in the exchange rate will improve the current account of BOP.
$Hx + Hm > 1$
Hx: Price elasticity of exports volumes
Hm: Price elasticity of import volumes
The **J curve effect** illustrates that in the short-term a depreciation of the currency can initially worsen (from A to B) the current account balance before it improves its position (figure P2). This is due to the low price elasticity of demand for imports and exports in the immediate outcome of an exchange rate change.

FIGURE P 2: THE J CURVE EFFECT



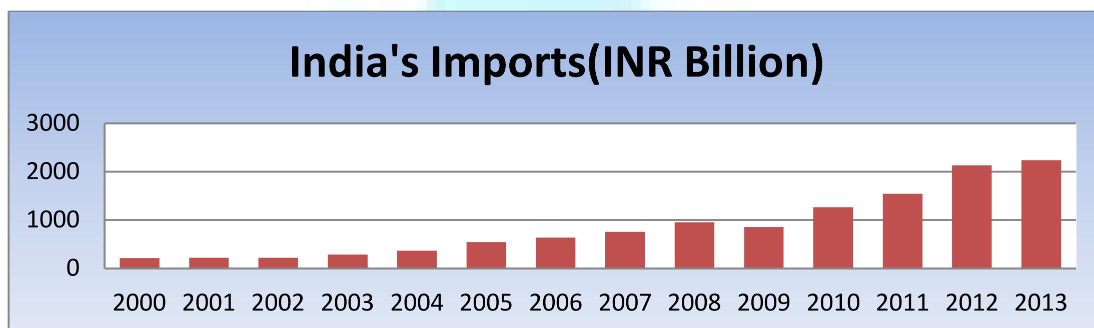
WHY VALUE OF INDIAN RUPEE IS FALLING?

INCREASING IMPORTS

Imports in India increased to 2342.13 INR Billion in August of 2013 from 2277.60 INR Billion in July of 2013. India Imports averaged 377.71 INR Billion from 1978 until 2013, reaching an all time high of 2475.94 INR Billion in January of 2013 and a record low of 4.98 INR Billion in April of 1978. India is heavily dependent on coal and foreign oil imports for its energy needs. Other imported products include: machinery, gems, fertilizers and chemicals. India's main import partners are China (12 percent of total imports), United Arab Emirates, Switzerland, Saudi Arabia, United States, Iraq and Kuwait. This excess imports results in more demand for foreign currency and value of Dollar is tremendously rising.

Year	Imports (INR Billion)
2000	212.33
2001	215.63
2002	216.04
2003	280.62
2004	361.67
2005	540.42
2006	636.72
2007	754.45
2008	951.34
2009	850.22
2010	1261.75
2011	1541.72
2012	2129.92
2013	2239.52

The above table shows the imports in INR Billion by the end of March every year from 2000 till date. Source: www.tradingeconomics.com, www.rbi.org.in.

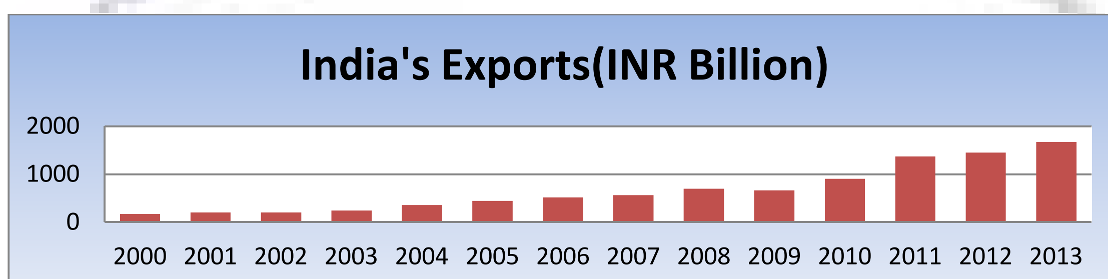


LOW EXPORTS BASE

Exports in India increased to 1652.02 INR Billion in August of 2013 from 1544.27 INR Billion in July of 2013. India Exports averaged 253.15 INR Billion from 1978 until 2013, reaching an all time high of 1672.52 INR Billion in March of 2013 and a record low of 3.75 INR Billion in May of 1978. India's main exports are engineering goods (19 percent of total exports), gems and jewelry (15 percent), chemicals (13 percent), agricultural products (9 percent) and textiles (9 percent). India is also one of Asia's largest refined product exporters with petroleum accounting for around 18 percent of total exports. India's main export partners are United Arab Emirates (12 percent of total exports) and United States (11 percent). Others include: China, Singapore, Hong Kong and Netherlands. India's exports are confined to some set of products as mentioned above as well as the portion of the imports is always more against the exports.

Year	Exports (INR Billion)
2000	168.23
2001	200.89
2002	201.82
2003	245.41
2004	353.96
2005	443.67
2006	514.26
2007	566.28
2008	696.3
2009	661.69
2010	905.73
2011	1368.57
2012	1451.23
2013	1672.52

The above table shows the exports in INR Billion by the end of March every year from 2000 till date. Source: www.tradingeconomics.com, www.rbi.org.in.

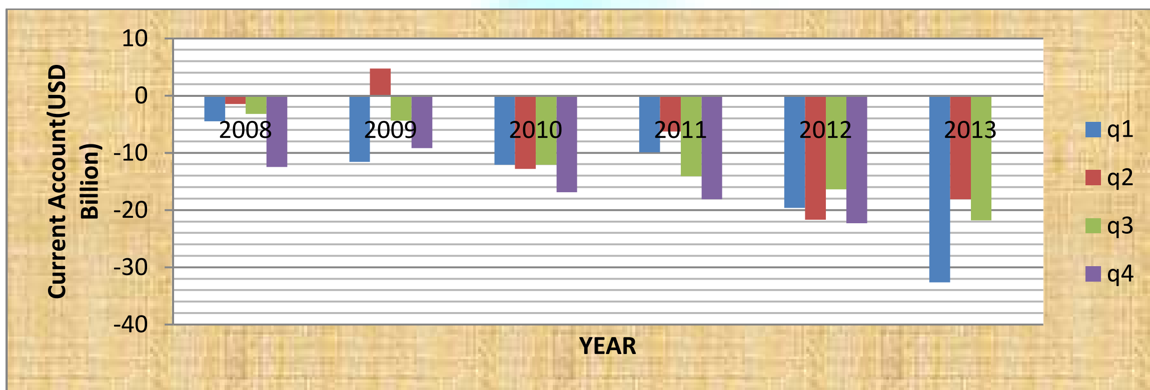


Growing current A/C deficit (CAD) - In simple terms, it refers to the difference between the export bill and the import bill. When import bill exceeds exports, we term it as deficit. When CAD increases i.e (imports increase), it tends to mount pressure upon rupee (as there is more demand of dollars in the market to settle the import bills), as a result of which value of rupee depreciates.

India recorded a Current Account deficit of 18.10 USD Billion in the first quarter of 2013. India Current Account averaged a deficit equivalent to 1.51 USD Billion from 1949 until 2013, reaching the best surplus at 7.36 USD Billion in March of 2004 and the worst deficit at 32.63 USD Billion in December of 2012. Current Account is the sum of the balance of trade (exports minus imports of goods and services), net factor income (such as interest and dividends) and net transfer payments (such as foreign aid).

	India's Current Account(USD Billion)			
year	**q1**	**q2**	**q3**	**q4**
2008	-4.5	-1.5	-3.2	-12.5
2009	-11.6	4.7	-4.4	-9.2
2010	-12.1	-12.8	-12.1	-16.9
2011	-9.9	-6.3	-14.1	-18.1
2012	-19.6	-21.7	-16.4	-22.3
2013	-32.63	-18.1	-21.8	0

The above table shows the current account in USD Billion by the end of each quarter every year from 2008 till date. Source: www.tradingeconomics.com, www.rbi.org.in.

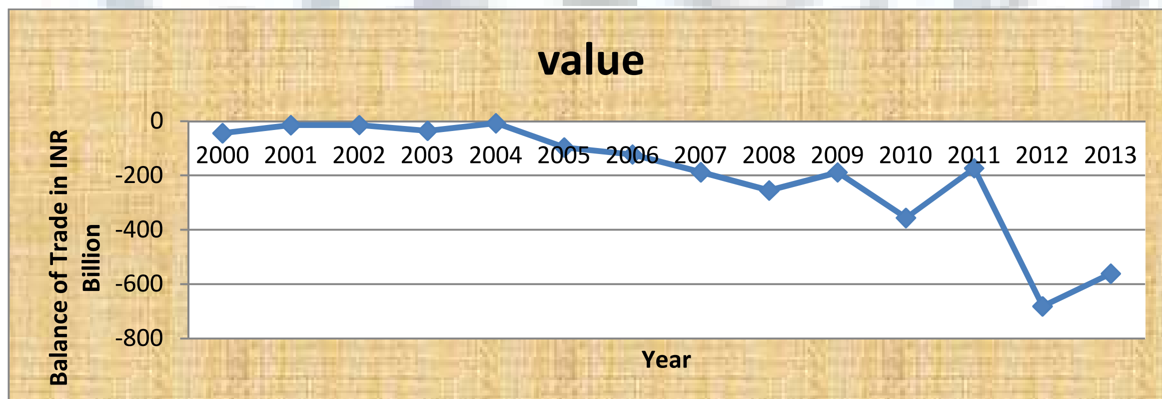


POOR BALANCE OF TRADE

India recorded a trade deficit of 690.11 INR Billion in August of 2013. India Balance of Trade averaged -124.08 INR Billion from 1978 until 2013, reaching an all time high of 13.91 INR Billion in April of 1991 and a record low of -1111.46 INR Billion in October of 2012. India had been recording sustained trade deficits due to low exports base and high imports of coal and oil for its energy needs. India is leading exporter of petroleum products, gems and jewelry, textiles, engineering goods, chemicals and services. Main trading partners are European Union countries, United States, China and UAE.

Year	Balance of Trade(INR Billion)
2000	-44.1
2001	-14.74
2002	-14.23
2003	-35.21
2004	-7.71
2005	-96.76
2006	-122.46
2007	-188.17
2008	-255.04
2009	-188.53
2010	-356.02
2011	-173.15
2012	-681.42
2013	-561.19

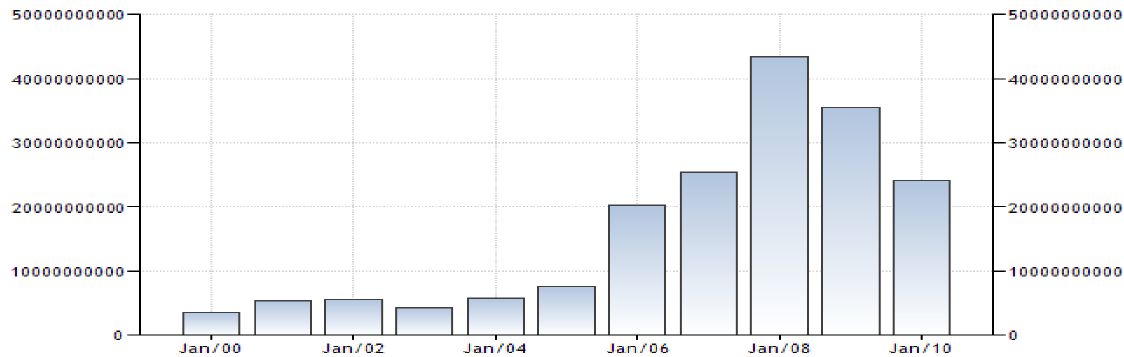
Balance of trade value (INR Billion) is taken by the end of March every year from the year 2000 till date.



F.D.I:- Indian govt has been taking several steps in past to boost F.D.I across sectors in the Indian economy. F.D.I is seen as one of the key factor in boosting a country's economy, as it allows the inflow of foreign exchange (currency) into the country. Except defense sector, F.D.I has been increased up to 100% in several sectors. e.g Multi brand Retail. But, major foreign giants are not taking much interest in the same.The reason according to analysts, lies in the credibility of the govt. Two major political parties in India has held opposite stance on the issue of F.D.I in retail; (one in favor and other in against). Elections are due in May 2014, and investors fear continuity in the policy changes.

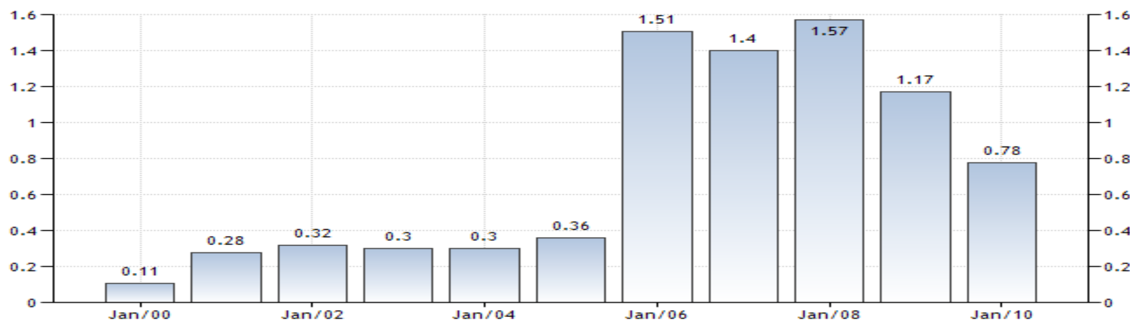
VOLATILITY IN FOREIGN DIRECT INVESTMENT; NET INFLOWS (BoP; US DOLLAR) IN INDIA

The Foreign direct investment; net inflows (BoP; US dollar) in India was last reported at 24159180719.95 in 2010, according to a World Bank report published in 2012. Foreign direct investment are the net inflows of investment to acquire a lasting management interest (10 percent or more of voting stock) in an enterprise operating in an economy other than that of the investor. It is the sum of equity capital, reinvestment of earnings, other long-term capital, and short-term capital as shown in the balance of payments. This series shows net inflows (new investment inflows less disinvestment) in the reporting economy from foreign investors.



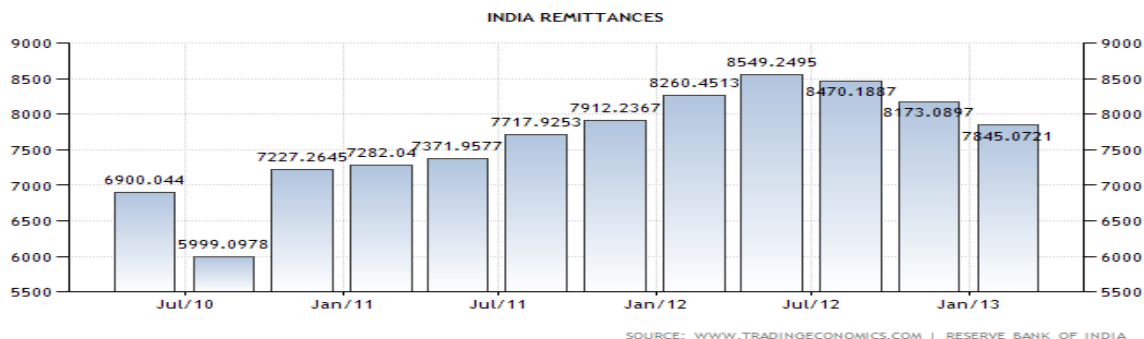
INCREASING FOREIGN DIRECT INVESTMENT; NET OUTFLOWS (% OF GDP) IN INDIA

The Foreign direct investment; net outflows (% of GDP) in India was last reported at 0.78 in 2010, according to a World Bank report published in 2012. Foreign direct investment are the net inflows of investment to acquire a lasting management interest (10 percent or more of voting stock) in an enterprise operating in an economy other than that of the investor. It is the sum of equity capital, reinvestment of earnings, other long-term capital, and short-term capital as shown in the balance of payments. This series shows net outflows of investment from the reporting economy to the rest of the world and is divided by GDP.



FALL IN REMITTANCES

Remittances in India decreased to 7845.07 USD Million in the first quarter of 2013 from 8173.09 USD Million in the fourth quarter of 2012. Remittances in India are reported by the Reserve Bank of India. India Remittances averaged 7657.98 USD Million from 2010 until 2013, reaching an all time high of 8549.25 USD Million in May of 2012 and a record low of 5999.10 USD Million in August of 2010.



Declining GDP- From past few years, India has been registering slowdown in its GDP growth rate. This has been mainly attributed to contraction in mining and manufacturing industry. GDP has been registered to be growing at a rate of 4.4 % in April to June quarter (2013). This has led to low confidence of potential investors in the Indian economy due to which flow of foreign currency (in the form of investments) into the country is declining steadily, leading to depreciation of rupee.

The Gross Domestic Product (GDP) in India expanded 4.40 percent in the second quarter of 2013 over the same quarter of the previous year. GDP Annual Growth Rate in India is reported by the Ministry of Statistics and Programme Implementation. India GDP Annual Growth Rate averaged 5.83 Percent from 1951 until 2013, reaching an all time high of 10.20 Percent in December of 1988 and a record low of -5.20 Percent in December of 1979. In India, the annual growth

rate in GDP at factor cost measures the change in the value of the goods and services produced in India, without counting government's involvement. Simply, the GDP value excludes indirect taxes (VAT) paid to the government and includes the original value of products without accounting for government subsidies.

OTHER FACTORS DETERMING RUPEE FALL

Fear of Increase in oil price: - The Price of crude Brent oil (from which Petrol is extracted) in the international market has reached $116 per barrel (28th Aug 2013) and is heading towards $120 per barrel, due to which there is increase in the fear of rising oil prices. Speculation of U.S attacking on Syria is adding fuel to the fire of rising oil prices. India is a major importer of oil; roughly 80 % of oil is imported in India.Oil imports are settled in US dollars in India, now as price of crude is rising in international market, in order to pay the import bill of crude oil, Indian oil firms have to buy dollars by selling Rupee in the international market, as a result of which demand of dollar increases in the Forex market consequently value of rupee decreases.

Food security bill causing rupee fall: - Recently, Food Security bill was passed through Lok Sabha, which has led to the speculation in market that passage of Food Security Bill will add pressure on the reserves thereby contributing to Fiscal Deficit. This has hurt the Investors Sentiments, due to which investors are not showing confidence in Indian Economy.

There is another factor that can put pressure on the rupee. In a particular year when the government is not able to procure enough rice or wheat to fulfil its obligations under right to food security, it will have to import these grains. But that is easier said than done, specially in case of rice. "Rice is a very thinly traded commodity, with only about 7 per cent of world production being traded and five countries cornering three-fourths of the rice exports. The thinness and concentration of world rice markets imply that changes in production or consumption in major rice-trading countries have an amplified effect on world prices," a CACP research paper points out. And buying rice or wheat internationally will mean paying in dollars. This will lead to increased demand for dollars and pressure on the rupee.

Running F.I.I's:- Foreign Institutional Investors (F.I.I)are not showing confidence in Indian economy, due to political Instability, Increase in number of scams, and improving (recovering)US economy, F.I.I's are withdrawing from Indian markets and diverting their investments into the US market.

Increasing coal imports :- Due to Coal Allocation Scam (Popularly known as Coal gate Scam), Supreme Court suspended the previous allocation of Coal Blocks due to which, despite having abundant Coal reserves in India, we had to import coal, which led to outflow of Forex reserves which added to CAD woes.

Connection between rupee depreciation and general elections: Historical data reveals that there is a certain connection between rupee depreciation and general elections. In most general election years except 2004, the rupee depreciated against the dollar. The statistics speak for themselves. "1984 – down 21%; 1989 – down 24%; 1991 – down 22%; 1996 – down 19%; 1998 – down 13%; 1999 – down 14%; 2004 – up 14%; 2009 – down 25%; 2013 (till now) – down 20%." All the evidence pointing to the nature of the rupee's depreciation bears out one thing strongly: that the value of a rupee falls whenever a general election is around the corner. Economists like to explain this phenomenon this way: every government is inclined to spend extra money to satisfy vote banks before an election. So this unproductive expenditure highly influences the rupee to depreciate, forcing the government to intervene to notch up its value. Similarly, the political class starts to bring back its money hidden in foreign lands to fund elections. Due to the weak rupee, they would like to get a higher price for the same amount. That explains why governments like to put on a show of confidence that there is nothing seriously wrong with the plummeting value of the rupee, which is just a transitory phase of volatility that will surely pass off with time.

Performance of dollar with respect to other currencies: The central banks across Japan and countries in the Eurozone have been bringing out a lot of money and this has meant that both Yen and Euro have lost their value. Compared to this the US Federal Reserve is giving hints that it will end the fiscal stimulus so that the dollar becomes stronger with respect to other currencies such as the Indian Rupee at least for the time being. Till now in 2013, the US dollar index has become stronger by 1.91%.

Volatility in the equity market: The equity markets in India have been volatile for a certain period of time. This has put the FIIs into a dilemma as to whether they should be investing in India or not. In recent times their investments have touched an unprecedented level and so if they pull out then the inflow will go down as well. As per a report in Business Today, the international investors in India have withdrawn to the tune of INR 44,162 crore during June 2013 and this is a record amount. This has also created a current account deficit (CAD) that is only increasing, thus contributing significantly to the depreciation of the INR.

REMEDIES TO PREVENT THE FURTHER DEPRECIATION OF RUPEE

1. Government should increase the limit of FDI in the existing sectors as well as encouraging in other sectors such as aviation, retail, telecommunication, radio & broadcasting etc.
2. Government should create a stable political and economic environment in order to make India an attractive destination for foreign investments.
3. Government should raise import duty on gold in order to decrease the domestic demand for gold import.
4. Government and both RBI should take measures to bring down high inflation rates.
5. Government should boost export-intensive sectors and develop import-substituting industries in order to make India less dependent on imports.
6. RBI should sell Forex reserves and buy rupees in an immediate action in order to arrest the further decline in the value of rupees.
7. RBI should hike the interest rates in order to reduce the money supply in the economy.

CONCLUSION

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.

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