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THE IMPACT OF CURRENCY DEPRECIATION ON LOGISTIC SECTOR IN INDIA

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ABSTRACT

The most concerning chapter for India during last two years is the Weakening of rupee against dollar. It is not only that rupee has lost its value in the Global context but also dollar has improved its performance in the global trading markets. Though weakening of rupee is beneficial to some sectors it is a real threat for the country's overall fiscal health and increases the Current Account Deficit heavily. Depreciation leads to imports more costly, and prices of various imported commodities like gold, oil etc rising thereby increasing overall inflation higher. The Logistic sector in India plays an important role in the economic growth of the country. Rupee depreciation has a great impact on Indian logistic sector. The paper makes an attempt on factors contributing currency depreciation and its impact on Indian logistic sector.

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KEYWORDS

CAD, Currency depreciation, Inflation, logistic sector, LSPs.

INTRODUCTION

Indian economy has been going through a rough phase for the past few years. Declining exports, increasing inflation, falling GDP, poor manufacturing outlook, increasing NPA's of banks are some of the major problems that India is facing. Together with these problems, the depreciating currency made the matter worse. On Aug 28, 2013 rupee touched a record low of 68.79/ dollar. Currency depreciation means a fall in value one currency with respect to another. That is one US dollar can buy 45 INR today, can be 60 INR tomorrow. INR would have depreciated by 33%. The value of rupee had weakened 16% this financial year. Persistent rupee depreciation has adversely impacted the profitability of various industries, widened the current account deficit and has also fuelled inflation that has adversely impacted the common man. Rupee dollar exchange rate is standing 61.85 as on February 12, 2014.

CURRENCY FLUCTUATION

The record low rate of Rupee which reached 68.79 against Dollar on Aug 28 2014 was brought back to a steady level around 62 by strong measures taken by the government and RBI. Euro reached a record rate of 91.78 on Aug 28 2014 which is now moving in a steady rate of around 85.

GRAPH 1

The graph below shows historical exchange rates between the Indian Rupee (INR) and the US Dollar (USD) between 7/12/2013 and 1/8/2014



The graph above displays historical exchange rates between the Indian Rupee and the US Dollar.

GRAPH 2

The graph below shows historical exchange rates between the Indian Rupee (INR) and the Euro (EUR) between 7/14/2013 and 1/8/2014



The graph above displays historical exchange rates between the Indian Rupee and the Euro.

The rupee depreciation against US dollar has created a challenging environment for Indian logistic sector. This is because of the increased cost of operation for both international shipping companies and the domestic transportation companies, and this increased the cost of end users (manufacturing and shipping companies) within the country.

RBI and government of India is taking various measures to bring back the economic prospects of the country. If proper measures are not taken, currency depreciation will have some serious impact on the long term prospects of the country.

CAUSES OF INDIAN RUPEE DEPRECIATION

International investors describe one currency as strong or weak with respect to another currency. For example, the U.S. dollar may be weak against the Euro, but strong against the Indian Rupee. A stronger currency is said to appreciate, whereas a weaker currency depreciates. When currency depreciates, it loses value and purchasing power. Fluctuations in currency value are a common event. The minor daily increases and decreases in value are generally due to investor supply and demand. Changes in currency value become significant when the depreciation of currency is an ongoing trend. The reasons countries experience or cause a currency depreciation are numerous: In some instances, depreciation is intentional. In other cases, depreciation is an inevitable consequence of economic policy. Major causes for the depreciation of Indian Rupee can be listed as follows.

IMPROVING THE STRENGTH OF US ECONOMY

Improving the strength of the US economy or dollar gaining strength against other currencies is considered as one of the major reason for the crisis. That is Reserve Banks of Euro zone and Japan printing excessive money due to which their currency is being devalued. On the other hand, US Fed has shown signs to end their stimulus. (Stimulus is a plan by central bank to counter a weak economy, by taking various actions like lowering interest rates, increase govt. spending, and quantitative easing etc.) This side effect includes weakening currency. Hence helps to make US Dollar stronger against other currencies.

HIGH OIL PRICES

It is another factor that puts stress on the Indian Rupee. India is in the unhappy situation where it has to import a bulk of its oil requirements to satisfy local demand, which is rising year-on-year. The domestic demand for oil increases which causes the price of oil to increase in the international market. The demand for dollar also increases to pay our suppliers from whom we import oil. The effect is cumulative like an Avalanche breakdown. This increase in demand for dollar weakens the rupee further. 55% of India's oil imports are used for transportation of goods and people. And 50% of that or 27% of the total is used for transporting the 1.8% Indians who own cars. Indian crude oil imports during October, 2013 is valued at US\$415217.6million which was 1.7 percent higher than oil imports valued at US\$14957.7million in the corresponding period last year.

WIDENING CURRENT ACCOUNT DEFICIT

Wider current account deficit is one of the reasons for currency depreciation. A current account deficit occurs when a country is importing more goods and services than it is exporting. India's current account deficit has exploded 1125%. Since 2007 going from \$8billion to \$90billion. In other words India is importing more than it is exporting. RBI Governor Raguram Rajan has the opinion that India's large current account deficit which stood at \$56 billion or less than 3% of India's GDP and USD32 billion in the current financial year 2013-2014.

LOWER GROWTH

Lower growth is another reason for currency depreciation. Indian GDP growth rate fell down to a decade low of 5% in 2012-2013. Foreign Institutional Investors are pulling out money from the Indian markets due to the slow growth.

VOLATILE STOCK MARKET

Great volatility of stock market is another reason for currency depreciation.. Equity is the investments in Indian companies made by Foreign Institutional Investors (FIIs). The FIIs are in a dilemma whether to invest in India or not because of the lack of overall confidence in the Indian economy. Even though they have brought in record inflows of dollar to the country this year, chances are they may be thinking of taking their money out of the equity market, which might again results in less inflow of dollars in India. Therefore, decrease in supply and increase in demand of dollars results in the weakening of the rupee against the dollar. As per report from Business today, international investors are pulled their money to the extent of 44162 cores during June 2013 and touched an all time high.

LOW FOREX RESERVE

Low forex reserve is another reason for currency depreciation. India's forex reserves have declined in recent months. In the year 2007 India had \$300 billion in foreign exchange reserves. It could cover its current account deficit 37.5 times over. Currently India's foreign exchange reserves have gone down to \$275 billion; it can cover only its current account deficit 3 times. India's forex reserves are sufficient only to cover imports of 7 months. India's forex reserve down by \$ 17.23 billion y-o-y and as on Sept 6 it stood at \$274.81 billion. On a week on week basis the reserves show a dip of just \$685 million. Now the reserves had fallen by a massive \$2.2 billion. The main reason for this fall is due to heavy dollar sales by RBI to protect the rupee. On Nov 9th the forex reserve again dipped to \$ 1.65 billion due to the dip in value of gold in reserves.

HIGH DEMAND FOR GOLD

Increased demand for Gold or increased import of gold is considered as another reason for the crisis. In India there is more requirements for gold as the tradition exists to wear gold and diamond ornaments for the auspicious occasions. Since gold is not abundantly available in India, it has to import these at huge price. When the rupee value gets depreciating, the percentage for each dollar increases making the demand increase. In India, Gold import rose to 23.5 tons in October from 11.64 tons in September. Gold import in July and August stood at 47.75 tons and 3.38 tons respectively. In 2012-2013 fiscal, gold import stood at 845 tones.

HIGH FISCAL DEFICIT

High fiscal deficit can be regarded as another reason for the rupee devaluation. It is the difference between Govt. receipt and Govt. spending, touched to 4.12 lack cores in April-Sept 2013. The Government fiscal deficit in the first six month of the current fiscal reached 76% of the budget estimate of Rs. 5.42 lack crore. During the first seven months of this fiscal year, the deficit reached 84.4% of the full-year budgeted target compared with 71.6 last year. In the past five years the average was 67.5%. The higher fiscal deficit could lead to speculative attacks on currency. In case of high deficit Govt. may use foreign currency reserve to finance the deficit. This lead to lowering of reserves and if there is speculation of currency, the govt. may not have adequate reserve to protect the fixed value of currency. This prompts the govt. to devalue the currency.

CAPITAL ACCOUNT FLOWS

Deficit countries need capital flows and surplus countries generate capital outflows. India needs dollars to finance its current account deficit. Institutional investors investing in India are directly impacted by the global market uncertainty. In 2008 India had a net outflow of \$14 billion of FIIs and INR depreciated from 39 level to 52 against dollar. A volatile currency is never good for a foreign investor as it increases the transaction risk. Thus the relation becomes a vicious cycle, thereby further magnifying the volatility. Though RBI has intervened through open market operations to arrest the downfall of INR (managed float) but the reserves of \$290 billion don't provide enough room to make a significant impact.

DOLLAR GAINING STRENGTH AGAINST OTHER CURRENCIES

Dollar gaining strength against other currencies is considered as another reason. The US Federal Bank's Chairman Mr. Ben Bernanke introduced the unwinding bond purchase program in the US. The US had been printing money to bolster the economy. Now with the revival of the economy the Chairman plans to unwind the program. This statement led to unrest in the US economy and US investors started withdrawing money from the overseas markets. With the increase in demand for dollar, the prices of dollar in the global market rose and price of all currencies weakened against dollar, among which rupee also affected.

WITHDRAWAL BY INVESTORS

Withdrawal by investors affects the rupee to decline in value. The economic slowdown of many industries, in the Indian environment, the market's weakness for the government to implement public policies are increasingly disappointed. Global giants like Arcelor Mithal and Posco decided to withdraw their investments and Posco planned for a steel plant in Karnataka with an estimated investment of Rs. 30000 cores and Arcelor mithal intended a steel plant in Odisha worth around Rs. 52000 cores. The withdrawal by foreign investors in different sectors shows that policy changes made by India is too small and too late.

LACK OF CLARITY IN POLICY REFORMS

Lack of clarity in policy reforms is another reason for depreciation of currency. Perception of lack of clarity on the policy front is also fanning speculative demand wherein RBI on one day said it will tighten liquidity and on yet another said it will inject \$1 billion in the market. Then Key reforms like Direct Tax Code (DTC) and Goods and Service Tax (GST) have been in the pipeline for years. The government announced FDI in Retail, but had to hold back amidst huge furor from both opposition and allies.

INTEREST RATE DIFFERENCE

Interest rate difference is another factor, that is higher interest rate generally attract foreign investment but due to slowdown in growth there is increasing pressure on RBI to decrease policy rates. Under such conditions investors stay away from Indian market. This effects capital account flows to India and put a decreasing pressure on rupee.

HIGHER INFLATION

We are experiencing higher inflation which will decrease purchasing power of rupee against other currencies. This will lead to rupee depreciation. Over the last 24 calendar months India's money supply grew at around 29% while its GDP grew at a much lower pace. This essentially means that more rupees were printed than required which causes a rise in inflation. India is experiencing high inflation above 8% for all most years. If inflation becomes higher it leads to overall worsening of economic prospects and capital outflows and eventual depreciation of currency. The inflation rate is based on consumer price index (CPI) The index is a measure of the average price which consumers spend on a market-based basket of goods and the services. The inflation rate in India was recorded at 7 percent in October of 2013.

IMPORTANCE OF LOGISTIC INDUSTRY IN INDIA

It is now experienced by many countries that, lack of logistics slows down their development process. Every country is now trying hard to develop their logistics infrastructure; otherwise its inadequacy may create bottlenecks in their economic growth. Lately, the logistics industry in India too has received lot of attention from both industry and government. Logistics cost in India is higher than that in developed nations. So, the country is trying to bring down its logistics cost from the present 14 percent to 9 percent of the GDP. In the light of the above facts, impact of currency depreciation on Indian logistic sector is looked with high importance

Logistics costs vary from company to company and from industry to industry. However across the economy as a whole, the total cost of logistics is expressed as a percentage of gross domestic product (GDP). The annual logistics cost in India is estimated to be 14 percent of the GDP, which translates into USD 140 billion while the GDP of India is estimated to be USD 1.78 trillion. However, the industry is growing at a fast pace and if India can bring down its logistics cost from 14 percent to 9 percent of the GDP, savings to the tune of USD 50 billion will be realized at the current GDP level, making Indian goods more competitive in the global market. Moreover, growth in the logistics sector would imply improved service delivery and customer satisfaction. It would lead to growth of export of Indian goods and potential for creation of job opportunities. As per the some of the leading rating agency's report the logistics industry is expected to grow at

15-20% a year to reach around USD 3.5 trillion by 2015 from its current size. Industry experts and the statistics shows the need for a strong logistics industry in India, considering the expected upsurge in trade and commerce which is evident from the following industrial highlights. India's nominal GDP could grow from USD 1.8 trillion currently to USD 3.6 trillion by 2020 at an annual growth rate of 9 percent. By 2030, India's crude steel production is expected to increase by a factor of 4. The demand for cement in the country is expected to double by 2030. Agricultural output, although reduced in size as a percentage of the economy, is expected to increase from 207 million metric tonnes (MMT) to 295 MMT by 2020. The Indian textiles industry is expected to triple from USD 78 billion currently to US\$220 billion by 2020. The share of organized retail is expected to increase from 5 percent currently to 24 percent by 2020. India's industrial energy consumption is expected to double by 2020. In this scenario, the country will need to mine 2 billion tonnes of coal by 2030 and transport 75 percent of mined coal. Further, around 30 percent of total transported coal will have to be imported through ports. Overall export-import (EXIM) cargo at Indian ports is projected to increase to around 2,800 MMT by 2020 from approximately 890 MMT currently. Finished consumer goods, both imported and those produced in India, will have to be transported to the country's middle-class consumers, which, by 2030, are expected to increase fourfold from the current middle class population of 160 million. So it is inevitable to have a strong and stable logistic sector which can support the expected industrial and economical advancement of the country. India's logistic market is estimated at USD 92 billion. Over last 5 years increasing private sector participation, growing propensity to outsource transport and logistics services and overall mobilization have driven the growth of logistics sector in India at CAGR 9.5%.

CURRENCY DEPRECIATION AND ITS IMPACT ON INDIAN LOGISTIC SECTOR

The logistics sector in India has today become an area of priority. One prime reason for the same stems from the reason that years of high growth in the Indian economy have resulted in a significant rise in the volume of freight traffic moved. This large volume of traffic has provided for growth opportunities in all facets of logistics including transportation, warehousing, freight forwarding, express cargo delivery, container services, shipping services etc. The growth path has also meant that increased demand is being placed on the sector to provide the solutions required for supporting future growth. Going forward it will not be wrong to say that the strength of the logistics sector is likely to be one of the key determinants of the pace of future growth of the economy.

Various estimates put the market size of the logistics sector in India to be between USD 90-125 billion. With regards to cost of spends on logistics, India's logistics sector accounts for 13% of the GDP of India. This is much higher than that in the US (9%), Europe (10%) and Japan (11%) but lower than in China (18%). Major elements of logistics costs typically include transportation, warehousing, inventory management and other value added services such as packaging. The various challenges faced by the logistic industry lead to high logistic cost incurred by the Indian economy.

Depreciation of Indian rupee against the US dollar has both the direct and indirect effect on the Indian logistic sector. Due to the cascading effects, it has an impact, not only on logistic service providers and end users, but also to the end consumers of goods. The direct impact is in the form of higher costs incurred for international shipments for which payments have to be made in US dollars, in case of imports, this depreciation leads to higher landing costs of consignments, which importers may bear as own costs and pass it on to end consumers by raising prices. The rupee depreciation against US dollar has created a challenging environment, owing to the increased costs of production for both international shipping companies and increased costs of services for end users (Manufacturing and Distribution companies) within the country. The international shipment creates a challenging environment for the logistic end users because importers and exporters need to pay shipping charges in US Dollars and hence, additional amount has to be paid for the shipments, making international trade less profitable for the companies.

In case of exports, the rupee depreciation results in increased shipping charges for exporters, which results in lower profit margins. Since there is a risk of losing orders to competing exporters from other countries exporters may not be in a position to increase prices of their export goods in the targeted markets. Due to the risk of losing international customers to competing exporters from other international markets, the Indian exporters may be forced to absorb the increase in freight charges, and work with lower margins. In the event of failure to absorb such additional freight costs, the exporters and importers may abstain from international trade. This could lead to an overall decrease in international trade volumes from India that would prove to be challenging for the shipping and freight forwarding companies. In the case of shipping companies in Indian industries, a decline in international trade volumes from the country would result in idle capacity or shipments with not fully loaded ships resulting in lower revenues as well as higher operational costs per consumer consignment.

On the domestic front, rupee depreciation against US dollar would lead to increase in fuel costs which may result in higher operational costs for cargo transporters, which would always be passed by them to the end users. The end users are on the losing side due to the impact of depreciation. The logistic service providers (LSPs) and end users are bound in long term contracts with charge revisions permitted only once in a year or a half year. The service providers have to bear the increased costs of operations and hence are likely to incur erosion in profits or even losses in some cases. Fuel cost accounts for about half of operational costs for transportation companies in India. A 5% rise in fuel cost results in about 10% increase in transportation charges for logistic users. The effect of rise in fuel price is high in markets such as India where more than 60% of domestic cargo transportation is still via-road. The impact of rise in fuel costs is low in markets where rail has a significant – dominant share of domestic cargo transportation volumes. As the shipping and port related services are charged in US dollars, the LSPs in port terminals are benefited to some extent, but that gains could also be negated by the decreased trade volumes. The increase in price of aviation logistic turbine has already resulted in a proportional rise in airfare. Air freight services are premium logistic services and will now be even costlier owing to increased fuel cost. The impact is not only on LSPs and end users, but also on the end consumers due to the cascading effect. In majority of cases, however, the depreciating rupee largely affects end consumers of imported goods.

LOGISTICS IN INDIA: MODE OF TRANSPORT AND ITS SHARE

TABLE 1

Mode of transport	Percentage (%)
Road	60
Rail	31
Water	8
Air	1

Source: www.kpmg.com

The Indian transportation and logistics industry is poised at a crossroads along its growth trajectory. This is particularly important at this juncture in light of the ongoing global economic uncertainty that has been impacting the Indian market to an extent. However, driven by strong fundamentals and consistent demand, the resilient Indian economy in general and, the logistics sector in particular, are seemingly well-positioned to sail through turbulent global waters.

Indian Railways have carried 1,009.73 million tonnes (mt) of revenue earning freight traffic during 2012-13, which is 15 mt less than the budget estimates.

The freight carried, however, shows an increase of 39.95 mt over the freight traffic of 969.78 mt carried during the corresponding period last year, an increase of 4%.

During March 2013, the revenue earning freight traffic carried by Indian Railways was 98.20 mt. Railways carried 93.85 mt during the same period last year, showing an increase of 4.64%.

TABLE 2: INDICATIVE BREAK UP OF FREIGHT HANDLED IN INDIA

Mn tones	FY06	FY07	FY08	FY09	FY10	FY11
Rail freight	667	728	794	850	910	969.78
Road freight	1353	1478	1612	1726	1875	2046
Water freight	424	464	519	530	561	570
Air freight	1.4	1.55	1.71	1.7	1.9	2.1

Source: <http://www.Indiabiznews.com/?q=node/2283>

Freight handled through railway during fy2012 was 1009.73 mt. which was 15mt less than the estimated.

Freight handled through air during fy2012 was 2.19 mt.

The upward trend in freight suggests an increase in freight handled in future. But the weakening rupee may not support this trend. The LSPs and end-users can choose to work on less margins for keeping their existing customers; however, this will not be sustainable in the long term. Eventually, the increase cost of logistics services will be passed down to the end consumer. On the whole, the depreciation of the Indian Rupee against the US Dollar will impact all the key stakeholders of the logistics sector in India. The primary impact of this will be borne by the LSPs, particularly the transporters and the freight forwarders, and the end-users.

CONCLUSION

The rupee has depreciated about 50% in the past 3 years and 15% this year. The situation is extremely worrying us because of the devastating impact it will have on the India's fundamentals that have been pushed to the brink by global factors. In India, there is a sense of dejection in the wake of policy announcements that haven't really been executed. There is a sense of loss of credibility. The fall in rupee is a mere manifestation of the deeper malaise - higher inflation, low interest rates combined with low growth. Logistics system in India plays a vital role in economic systems and everyday life. Logistics and warehousing industry continued to witness growth during the first half of 2013 despite weak economic scenario. The demand for logistics and warehousing services is expected to increase on the back of relaxation in the FDI regulation in the retail sector."Despite weak economic sentiments, the logistics and warehousing industry continued to witness growth largely due to growth in retail, ecommerce and manufacturing sectors. The recent relaxation of FDI regulations in the retail sector is also expected to create substantial demand for logistics and warehousing services across the country. Currency depreciation of Indian Rupee against US dollar has created a challenging environment for the Indian logistic sector, owing to the increased cost of operation for both international shipping companies and the domestic transportation companies and increased cost of services for end users within the country. On the whole, depreciation of Indian rupee against US dollar negatively affects LSPs to a considerable extend, also severely affects logistics end users and end consumers of goods. Currency depreciation creates challenging environment not only for logistics sectors but also to various other linked or dependent sectors. So Government and RBI should make a timely intervention to tackle the crisis. They should contribute to the most to make the Indian economy capable to achieve highest growth prospects in the world in the coming decades.

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