DEVALUATION OF INDIAN RUPEE AGAINST US $: A HISTORICAL PERSPECTIVE

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ABSTRACT

The Indian Rupee decreased to 59.93 in April from 59.97 in March of 2014. Indian Rupee averaged 32.55 from 1973 until 2014, reaching an all time high of 68.61 in September of 2013 and a record low of 7.19 in March of 1973.India may face its worst financial crisis in decades if it fails to stem a slide in the rupee, leaving the central bank with a difficult choice over how to make the best use of its limited reserves to maintain the confidence of foreign investors. The fall in the value of Indian rupee has several consequences which could have mixed effects on Indian economy. This paper tries to study the reasons for devaluation of pre liberalization era and post liberalization. It also attempts to study the real implications of the depreciation of the rupee on the Indian economy and shows that in the long run, the Indian economy has more to lose and less to gain with weaker rupee. In this paper effort has been made to highlight on the importance of central bank intervention to control this situation.

KEYWORDS: Devaluation, Revaluation, FII, ECB's, FCCBs, Depreciation, Forex reserves.

I. OBJECTIVES OF THE STUDY

1) To know about the trend of Indian Rupee and it exchange rate against us $ historically.

2) To understand the concept of devaluation

3) To understand the causes and the steps taken by government on the major devaluations that took place in India.

4) To study the real implications of the depreciation of the rupee on the Indian economy

II. INTRODUCTION

Devaluation means a fall in the value of domestic currency in terms of foreign currency/currencies. For example, suppose the exchange rate between rupee and dollar is Rs 35= 1 $. If this exchange rate is fixed at Rs. 40 = 1$ then it is called devaluation of rupee. Earlier Rs. 35 could purchase a dollar and now more rupees (rs.40) are required to get a dollar. So the value of rupee in terms of dollar has declined Real Implications of Devaluation:

a) It helps to boost exports.

b) It will lead to higher cost of imported goods and make some of the capital extensive projects more expensive to execute.

c) It will increase cost of dollar loans taken by companies and increase foreign debt.

d) It will slow down the overall economic growth by increasing the interest rates and dissuade flow of FII's.

III. HISTORY ABOUT INDIAN RUPEE AND ITS EXCHANGE RATE WITH US $

From 1950 to 1973 Indian rupee was linked to British pound. In 1966 and 1973 devaluation happened. On 24th September 1975, the connection between Indian rupee and pound was broken. In 1975, the rupee ties to the pound sterling were disengaged. India established a float exchange regime. With the rupee's effective rate placed on a controlled, floating basis and linked to a "basket of currencies" of India's major trading partners. In 1993 Liberalized exchange rate system (LERMS) was replaced by the unified exchange rate system and hence the system of market determined exchange rate was adopted. However, the RBI did not relinquish its right to intervene in the market to enable and control the Indian currency. Indian rupee and its exchange rate historically.

1950 – 4.79 Indian rupee to 1 American dollar

1955 – 4.79 Indian rupee to 1 American dollar

1960 – 4.77 Indian rupee to 1 American dollar

1965 – 4.78 Indian rupee to 1 American dollar

1970 – 7.56 Indian rupee to 1 American dollar

1975 – 8.39 Indian rupee to 1 American dollar

1980 – 7.86 Indian rupee to 1 American dollar

1985 – 12.36 Indian rupee to 1 American dollar

1990 – 17.50 Indian rupee to 1 American dollar

1995 – 32.42 Indian rupee to 1 American dollar

2000 – 44.94 Indian rupee to 1 American dollar

2005 – 44.09 Indian rupee to 1 American dollar

2010 – 44 to 50 Indian rupees to 1 American dollar

2014 – 59.70 Indian rupees to 1 American dollar

Before 2014 India had faced two major devaluation that is in the year 1966 and 1991. So let's understand the reasons and the measures adopted by government for the major devaluations that took place in India.

IV. THE 1966 DEVALUATION

As a developing economy, it is to be expected that India would import more than it exports. Despite government attempts to obtain a positive trade balance, India has had consistent balance of payments deficits since the 1950s. The 1966 devaluation was the result of the first major financial crisis the government faced.

4.1 Causes

a) Increasing trade deficit Despite government attempts to obtain a positive trade balance, India suffered a severe balance of payments deficits since the 1950s. Inflation had caused Indian prices to become much higher than world prices at the pre-devaluation exchange rate.
When the exchange rate is fixed and a country experiences high inflation relative to other countries, that country's goods become more expensive and foreign goods become cheaper. Therefore, inflation tends to increase imports and decrease exports. Since 1950, India ran continued trade deficits that increased in magnitude in the 1960s.

b) India's war with Pakistan in late 1965 The US and other countries friendly towards Pakistan, withdrew foreign aid to India, which further necessitated devaluation. Because of all these reasons, Government of India devalued Rupee by 36.5% against Dollar.

c) Defence spending in 1965/1966 was 24.06% of total expenditure, the highest it has been in the period from 1965 to 1989.

d) Drought of 1965/1966 also resulted in a sharp rise in prices.

4.2 Steps taken by government

a) **Imposed Quantitative Restrictions-** The government used the method of QRs with varying levels of severity until the Import- Export Policy of 1985-1988. Periodically, when import prices reached a premium, the government would impose import tariffs in order to absorb the gains accruing to foreign exporters as a result of India's import

b) **Provided export Subsidies-** Government began to subsidize exports in an effort to further narrow its consistent current account.

V. THE 1991 DEVALUATION

1991 is often cited as the year of economic reform in India. Surely, the government's economic policies changed drastically in that year. Then the Import-Export Policy of 1985-1988 replaced import quotas with tariffs. This

represented a major overhaul of Indian trade policy as previously, India's trade barriers mostly took the form of quantitative restrictions. After 1991, the Government of India further reduced trade barriers by lowering tariffs on imports. In the post-liberalization era, quantitative restrictions have not been significant **Causes**

a) The trade deficit in 1991 was US $9.44 billion

b) The current account deficit was US $9.7 billion

c) The gulf war led to much higher imports due to rise in oil prices.

d) Cost pull inflation

e) Political and economical instability

VI. Revaluation

In the period 2000–2007, the Rupee stopped declining and stabilized ranging between 1 USD = INR 44–48. In late 2007, the Indian Rupee reached a record high of Rs.39 per USD, on account of sustained foreign investment flows into the country. This posed problems for major exporters, IT and BPO firms located in the country who were incurring losses in their earnings given the appreciation in rupee. The trend has reversed lately with the 2008 world financial crisis as foreign investors transferred huge sums out to their own countries. Such appreciations were reflected in many currencies, e.g. the British Pound, which had gained value against the dollar and then has lost value again with the recession of 2008.

VII. THE 2011 DEVALUATION

Foreign Institutional investor's withdrawal from domestic economy is the one big reason for this depreciation:

a) Strengthening of Dollars- The Euro-Zone crisis has weakened the Euro significantly against the US Dollar. In other words dollar is getting stronger in the world markets. Obviously the investors are considering US a safe place to invest in.

b) Other capital flows- On month by month basis, FDI, ECB's and Foreign Currency Convertible Bonds (FCCBs) recorded a slowdown in Financial Year 2011.

c) Indian Politics- Number of Indian scams distracted government's concentration away from economy. All these scams make the bad image of India in the global market.

VIII. THE 2013 Depreciation

Due to stagnant reforms, and declining foreign investment, rupee started depreciating in the early 2013. As a result, the Indian Rupee dropped to 68.80 per dollar. Measures were announced by the government before this drop to

prevent it from dropping further. But, none managed to slow down the depreciation. After continued depreciation, and high inflation, the Prime Minister of India, Manmohan Singh, made a statement in the Parliament of India on the issue. He was of the view that, the present depreciation is partly led by global factors as well as domestic factors. He also asked the political parties to help his Government, tide over the crisis that the country was facing with rupee losing its value.

8.1 Policy options with RBI to control devaluation of rupee

a. **Raising Policy rates:** The rationale was to prevent sudden capital outflows and prevent meltdown of the currencies. In India's case, this cannot be done as RBI has already tightened policy rates significantly since Mar-10 to tame inflationary expectations. Higher interest rates along with domestic and global factors have pushed growth levels much lower than expectations. In its Dec-11 monetary policy review, RBI mentioned that future monetary policy actions are likely to reverse the cycle responding to the risks to growth. India's interest rates are already higher than most countries anyways but this has not led to higher capital inflows. On the other hand, lower policy rates in future could lead to further capital outflows.
b. **Using FOREX Reserves**: RBI can sell forex reserves and buy Indian Rupees leading to demand for rupee.
c. **Easing Capital Controls:** Dr Gokarn Deputy Governor of RBI said in his speech capital controls could be eased to allow more capital inflows. He added that "resisting currency depreciation is best done by increasing the supply of foreign currency by expanding market participation.

8.2 Steps taken by Government

a) Increased the FII limit on investment in government and corporate debt instruments.

b) First, it raised the ceilings on interest rates payable on non-resident deposits. This was later deregulated allowing banks to determine their own deposit rates.

c) The all-in-cost ceiling for External Commercial Borrowings was enhanced to allow more ECB borrowings.

8.3 Administrative measures: Apart from easing capital controls, administrative measures have been taken to curb market speculation:

a) Earlier, entities that borrow abroad were liberally allowed to retain those funds overseas. They are now required to bring the proportion of those funds to be used for domestic expenditure into the country immediately.

b) Earlier people could rebook forward contracts after cancellation. This facility has been withdrawn which will ensure only hedgers book forward contracts and volatility is curbed.

c) Net Overnight Open Position Limit (NOOPL) of forex dealers has been reduced across the board and revised limits in respect of individual banks are being advised to the forex dealers separately.

IX. CONCLUSION

Thus we can see that since 1950 besides few appreciation rupee is depreciating against US dollar and the causes of depreciation are invariable different. Even government took various steps to curb depreciation of rupee but still it remains under pressure. Both domestic and global conditions are indicating that the downward pressure on Rupee to remain in future. Thus, RBI should likely to continue its policy mix of controlled intervention in forex markets and administrative measures to curb volatility in Rupee. Apart from RBI, government should take some measures to bring FDI and create a healthy environment for economic growth. Some analysts have even suggested that Government should float overseas bonds to raise capital inflows.

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