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Rupee Depreciation: Its Impact on Indian Economy

Lt. Rajender Singh[a] and Dr. Krishan Lal Grover[b]

[a]Assistant Professor, Department of Commerce, Sri Guru Hari Singh College, Sri Jiwan Nagar (Sirsa), Haryana
[b]Associate Professor, Department of Commerce, Sri Guru Hari Singh College, Sri Jiwan Nagar (Sirsa), Haryana

Abstract:

The consequences of recent rupee depreciation against the dollar on the Indian economy have been investigated in this paper. This study's data is derived from secondary sources. The analysis spans the years 2021 to 2022. Here, we attempt to explore the benefits and drawbacks of fluctuations in the value of the rupee against the dollar to the Indian economy, as well as the opinions of experts on the subject. India's economy is reliant on crude oil imports from other countries. India is suffering as a result of its reliance on the petroleum economy. The reasons and consequences of the rupee's devaluation are also addressed. It discusses how issues such as large gold imports, increases in petroleum prices, and so on affect Indians.currency value against the dollar. As a result of currency devaluation, domestic goods and services became more affordable than previously. Imports fall as exports rise. Developing nations often strive to improve their export industry in order to grow their GDP level.

Key Words: Depreciation Of Money, Domestic Currency, Foreign Exchange, Imports, Exports, Exchange Rate.

1.Introduction

Depreciation of moneyis defined as "a decrease in the value of the local currency in relation to foreign currencies as a result of demand for foreign currency outstripping supply in the market" (Saravanan, 2015). Domestic buyers are now paying more for one unit of the foreign currency than they were previously. The world's economy has grown more intertwined. No economy can function in a vacuum; developments in one sector undoubtedly impact other economies. Nations purchase foreign commodities because they cannot create them in-house or because other countries can provide goods and services at a lower cost than they can. India buys products and services from other nations and distributes them across the world. When citizens of one nation sell or purchase products and services from citizens of other countries, a currency exchange must take place. Each country in international trade is dependent on exchange rates, which are the worth of one country's currency in terms of another country's currency.

In theory, the volume of imports and exports is determined by the exchange rate. For example, if the Indian currency falls by 10% against the dollar, the rupee will purchase fewer dollars while dollars will buy more rupee. Indian goods and services are becoming more appealing to both Indians and Americans. This raises India's exports while decreasing imports from the United States. When exports rise, so does GDP. More GDP indicates increased wealth or a better economic situation in the country. When exports rise, the country produces more goods and services. This phenomenon generates additional job opportunities and encourages investment. On the other hand, if the US dollar falls by 10% against the Indian rupee, imports will rise.As a result, more products and services will be produced outside of India. India's GDP is now lower under such a condition. Exchange rate swings have a significant influence on imports, exports, and capital flows between countries.

Exchange rates relate the prices of one nation to the prices of another. Imports and exports are increasing as a result of liberalisation and globalisation policies. This has a direct influence on the country's GDP, which reflects the country's economic status. International commerce and its relevance extend beyond the sale and purchase of commodities and services to play a significant influence in the country's strategic policies. International trade and its relevance extend beyond the buying and selling of commodities and services to play a significant influence in the country's strategic plans. As a result, it is critical for India to assess the effects of recent changes in the currency rate. The rupee has depreciated significantly against the US currency in India.

2.Review of literature

In recent times several research works on the exchange rate, its impact on India’s GDP are conducted. Several analyses were also made by the experts from Newspapers, Journals and Magazines. According to Dr G. Jayachandran (2013), India’s economic growth is caused by its fiscal and monetary policies. Economic growth is especially caused by the growth of government revenue. He further describes that he didn’t find any pieces of evidence which can show a strong relationship between exchange tare and GDP.

According to R. Sirohi (2013), individuals suffer with rising commodity costs as a result of currency devaluation, which impacts students intending to travel or who are presently studying abroad. When it comes to the impact of the rupee devaluation on the Indian economy, Divakaran, N Deepa, and Dr. G.S. Gireeshkumar (2014) have a mixed perspective. They cited that the Indian export-oriented sector will get benefits from this. Sectors like the IT sector, Textile, Pharmaceuticals, Gems and Jewellers, Power and Fertilizers are the major ones. The weak rupee will make Indian producers more competitive in the international market and make them able to fetch more money. On the other hand, it can bring inflation and widen the current account deficit.

Another online Magazine "Energy world" from The Economic Times, has stated that rupee depreciation is creating pressure on the Current Account Deficit (CAD), fiscal deficit and inflation.According to Dr. Singh (2018), India's reliance on imports, as well as its high current account and budget deficits, had a negative impact on the economy.

3.Objectives of the study

The paper is aimed to achieve the following objectives:

1.To examine the relationship between the price of rupee in exchange market and state of Indian economy.

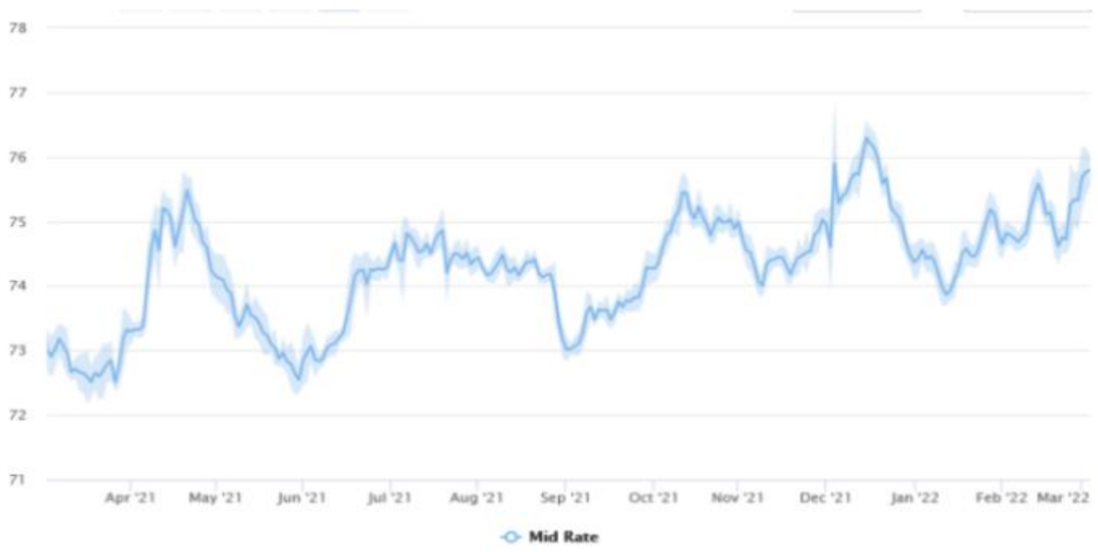
2.To examine the factors which influence the currency depreciation against the Dollar.

4.Methodology

For this study, the datais mostly gathered from the RBI and the Ministry of Commerce and Industry's website. All statistics on the exchange rate, trade, and GDP are obtained in US Dollars to preserve consistency in analysis. The data on imports, imports, and exports comes from https:/tradingeconomics.com/India, while the trade imbalance data comes from the Hindustan Times' website. No statistical software is employed to assess the data. However, economic ideas were used to assess the situation. The data is presented via graphs and tables.

I. Data on Indian economy

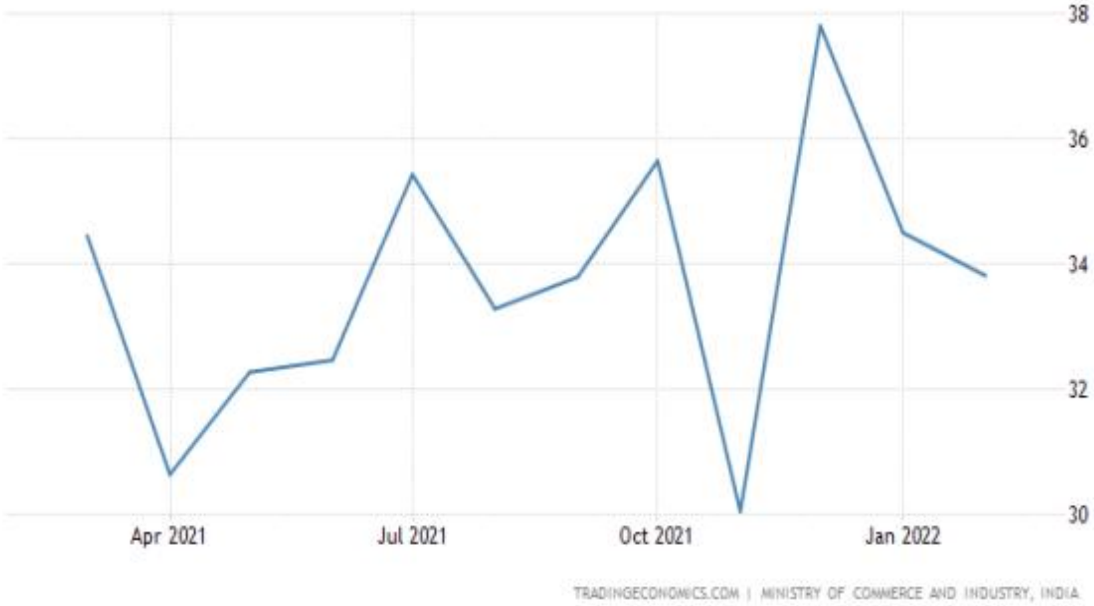
Chart 1: Exchange Rate Fluctuation – Rupee Vs US Dollar



X axis- Time, Y axis- Rate of the Dollar in terms of rupee

(Source:www.poundsterlinglive.com)

Chart 2: Amount of Indian Export

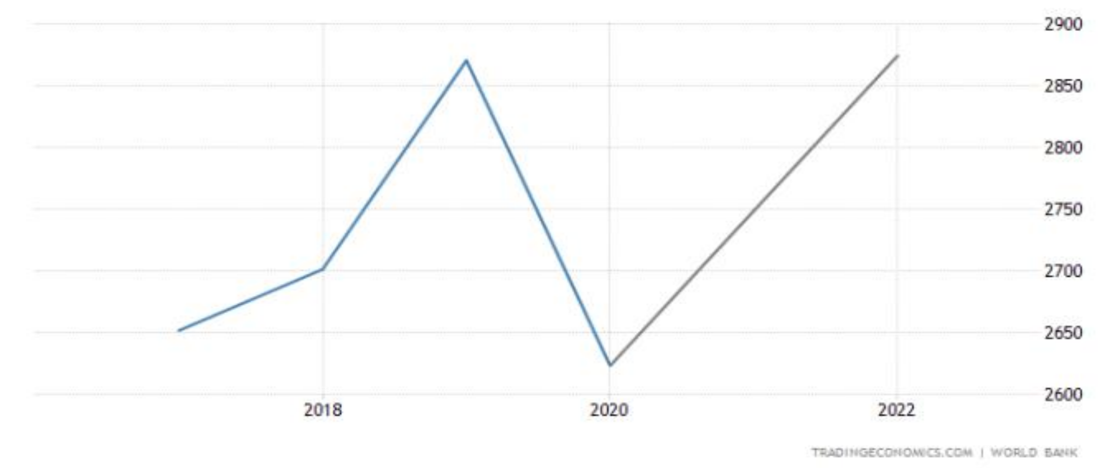


X-axis-Time period, Y-axis- Amount (USD billion)
(Source: https:/tradingeconomics.com/India/exports)

Chart 3: Volume of Imports to India

X-axis- time period, Y-axis- amount (USD billion)
(Source: https:/ tradingeconomics.com/India/imports)

Chart 4: India's GDP



X-axis-timeperiod, Y-axis-amount(USDbillion)
(Source: https:/tradingeconomics.com/India/gdp)

5.Data Analysis

India is importing more than 80 per cent of the net consumption of crude oil. During the first 08 months of the financial year (April 2021 to November 2021), the country imported crude oil for USD 73.3 billion. India's economy is highly dependent on crude oil. The transport and energy requirement of India is the chief consumer of oil. As described earlier, India imports more than 80 per cent of petroleum consumption, which means India's two most important sectors are dependent on its imports.

India's demand for crude oil and petroleum is less elastic. It refers that India cannot shift the demand for crude oil in the short run. India's energy needs depend upon petroleum products. India is experiencing a lack of technological advancement in the energy generation sector. It is still using conventional energy sources and will have to shift to a new one to reduce its dependency on petroleum. According to the Economic Survey of India, the crude oil import bill increased from 31.3 USD billion (April-November 2020-21) to 73.3 USD billion (April-November 2021-22).

Table: India crude oil import bill (Quantity and Value)

Year	Quantity(MMT)	Value (in $ Million)	Value (in ₹ Crores)
2019-20	227.0	1,01,375	7,17,001
2020-2021	196.5	62,248	4.59,779
April 21- Jan. 22	175.9	94,267	7,01,078

Source: www.ppac.gov.in

India has been facing financial losses due to the rise in the prices of crude oil and rupee depreciation. Both are creating pressure on the Current Account Deficit (CAD), fiscal deficit and inflation. The retail prices of petrol and diesel in India are linked to international fuel prices. An increase in the prices of petroleum and crude oil resulted in a high domestic fuel price.

India is still running its coal plants to produce electricity. Strategically it is important to the economy. We completely can't depend on foreign players to fulfill over energy needs. In case, India is not able or does not get petroleum from the outside, it can generate electricity from its coal stocks and run economic activity. Today the computer generation cannot imagine running its economy without electricity.

Causes of the currency depreciation

A. Demand and Supply rule:

It is the basic concept of economics. In the foreign exchange market, if there is an excess demand for the dollar, other things remaining equal, the rupee price of the dollar will go up or the rupee will depreciate. And if there is an excess supply for the dollar, other things remaining equal, the rupee price of the dollar will go down. People take part in the foreign exchange market for their different reasons. Their activities and decisions left an impact on the current exchange rate.

Those who supply rupees are the holder of the rupee seeking to exchange them for dollars. Those who demand the rupee are the holders of the dollar seeking to exchange them for the rupee. Private Citizens, banks, government, and corporate parties exchange rupees for dollars and dollars for rupees every day. The supply of the dollars in the foreign exchange market is the number of dollars that holders want to exchange for the rupee in a specific period. Just like this demand for the dollar is the number of dollars that is desired in exchange for the rupee by the holder of the rupee. Parties demand and supply their currencies due to different reasons. Some parties may intend to settle their international transactions. While some parties thought that if the rupee is depreciating against the dollar, it is more profitable to hold their wealth in terms of the dollar. For that purpose they demand dollars (Karl E. Case, R. C.).

B. Improving the strength of US economy:

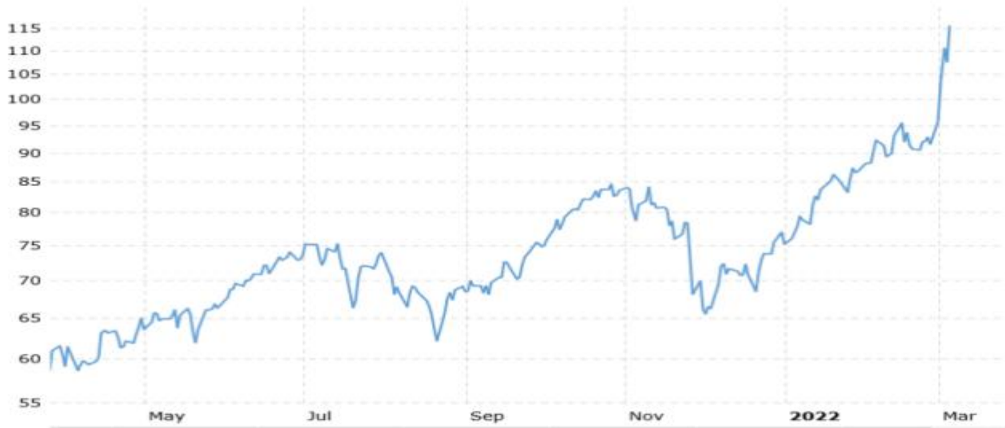
Despite some domestic challenges the US economy is still the largest and the most important economy at the world level. The US economy has 20 per cent of the global output and is greater than that of China, India. Large US-based corporations play a significant role in the world economy. The financial conditions of such large players can affect World Economic Operations.

The service sector is the engine of the US economy but had about 15 per cent of the World's manufacturing output of goods also. Major manufacturing units in the US are high-value industries such as Machinery, Telecommunications, Chemicals, Automobiles and Aerospace. All these industries are the base for the other industries. That is the way they had comparatively more important for the economic growth of the nation.

C. Increased price of oil:

Changes in crude oil prices always give tensions to the Indian economy. Because of its high dependency on crude oil. India has to pay in terms of the dollar for bulk demand of crude oil. When prices of crude go up, India has to demand more dollars to pay for the same quantity of crude. Badly quantity demanded the crude is also increasing every year.

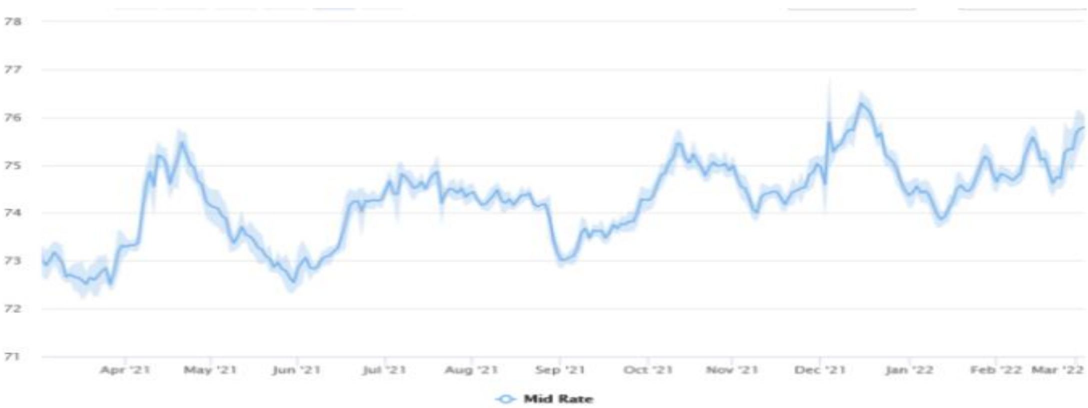
Chart 5: Changes in crude oil prices



X axis- Time Period, Y axis- USD

(Source:www.macrotrends.net/1369/crude-oil-price-history-chart)

Chart 6: Exchange rate: Rupee Vs Dollar



X-axis- Time period, Y-axis- Rate of Dollar (rupees)

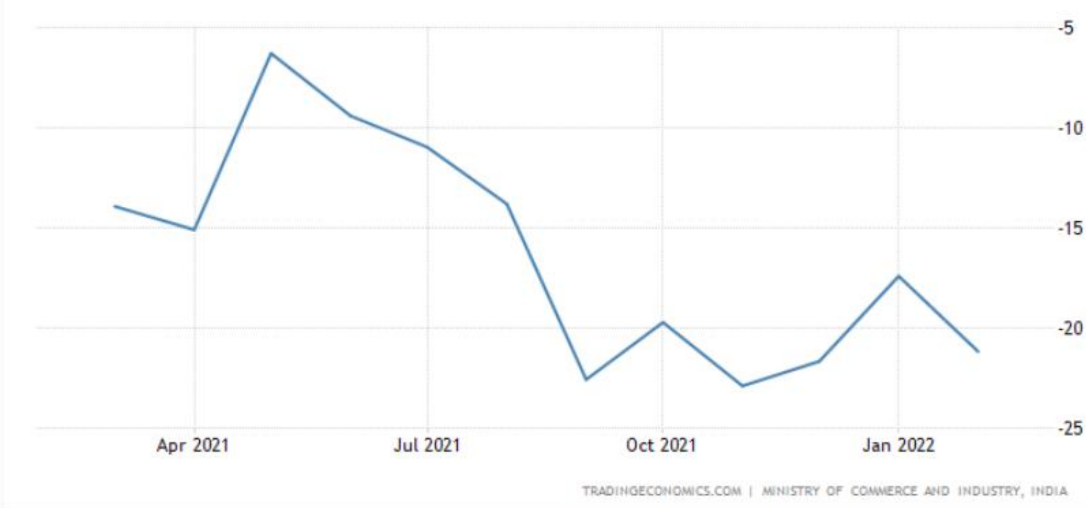
(Source:www.poundsterlinglive.com)

The above charts for the crude oil prices and exchange rate are with the same slopes. It means that crude oil and the dollar is becoming costlier at the same time. Expert is continuously arguing that the increase in crude oil is causing the depreciation of the rupee.
There are several reasons for the increment in the prices of crude oil. Such as sanctions on the Venezuelan oil industry, tensions between Saudi Arabia and Iran, global oil producers limiting supply, US Oil Production.

D. Wider Current Account Deficit:

Higher oil prices, foreign portfolio outflows and a weaker rupee have increased the nation’s current account deficit. A current account deficit mainly occurs when a country is importing more than what is exporting. India is also among those countries. When the excess is imported, more the dollar is demanded to pay against net imports. It leads to the rupee depreciation.

Chart 7: India’s trade balance



X-axis- Time period, Y-axis-USD (millions)
Source: https://tradingeconomics.com/india/balance-of trade

The above chart indicates the increasing trade deficit which further causes the current account deficit. India is among the leading gold, petroleum, heavy machinery, and electronic item importer. When these items are import, Indian buyers of these goods have to pay back in terms of the dollar. They demand more dollars to settle the transactions. Finally, this causes the depreciation of the domestic currency in India, it is the rupee. Trade deficit also causes the drainage of the foreign exchange reserves of the nation. The main items that cause India’s current account to deficit are the excessive imports of crude oil, gold, electronic items.

E. High demand for Gold

In India people used to wear gold and diamond ornaments for auspicious occasions like weddings, religious festivals etc. India is one of the world’s largest importers of gold. In India, it is considered a “safe haven” asset. India didn’t have the gold reserves to fulfill its demand. So we have to import these goods from the international market to meet the domestic demand. When the rupee depreciated Indians has to pay more. “The 2021 gold import bill easily doubled the $22 billion spent in 2020 and surpassed the previous high, set in 2011, of $53.9 billion, according to the official. India splurged a record $55.7 billion on gold imports in 2021” (economictimes.indiatimes.com). A decrease in gold imports helps contain India’s current account deficit (CAD). Due to depreciation in the rupee value, imports of gold declined and as a result price of gold also decreased.

Effects of change in exchange rate on imports, exports and GDP

As we have already discussed, when a currency depreciates, imports became costlier and the use of domestic products became cheaper than earlier. Exactly reverse impact takes place when a currency appreciates. When the domestic product became cheaper for the domestic and international demand, the demand for the domestic product rises. It happens due to the depreciation of the currency. On the other hand, when a currency appreciates, domestic products became costlier, hence the demand for that decreases. The level of import/export has a direct connection with the level of GDP. When export increases, the level of GDP increases. When imports increase, there is an adverse effect on the growth of the GDP. Crude oil, electronic items and gold are the major imports items.US currency’s strong demand from importers and banks, continuous capital outflows, increasing current account deficit.Export-oriented sectors such as gems and jewelers, IT sector, pharmaceuticals, textile will be benefited from the depreciation of the currency. Because in global market Indian produce became more competitive. Exporters will be able to fetch more money from the international market. Even if the exporter exports the same quantity abroad, he is getting more money than what he is earning earlier.In the case of imports, the same goods and services became costlier to the domestic market. Petroleum, gold, electronics are the major import of India. Due to the weak rupee petroleum prices rise. Ultimately the pressure passed on the consumers. Foreign tours will be more expensive because now it has to pay more.Continuous depreciation of money increases inflation. To control the level of inflation, the RBI has to take some measures for the same.

6.Conclusion

This research paper helps to find out the relationship among the various macroeconomic variables-exchange rate, balance of payment and analysis of the current scenario and currency depreciation against the dollar value in India. As discussed earlier, India is a special case which is why the situation is different from the theories of economics. Here the main import item (crude oil basket) is less elastic. That is why there is an adverse effect on India's balance of payment. The currency depreciation is extremely worrying all because of the devastating impact it will have on India's economic fundamentals that have been pushed to the brink by global factors. Government should make available the bonds to the nonresidential investors which will also increase the inflow of Dollars into the country. To overcome this crisis, govt. has to improve export intensive sectors and also try to develop import-substituting industry which helps India to less dependent on imports.

In case of continuous depreciation RBI or the government has to take necessary steps to check the situation. In such a situation government releases its dollar reserve to supply dollars in the market. Government can do this by providing dollars to state-run oil companies because they are the major player in demanding dollars. Government can also reduce the import of some goods like gold by hiking the duties. To counter the outflow or foreign portfolio, the Government attracts NRIs by launching different schemes. Currency depreciation is not the only factor affecting a country's import, exports, foreign portfolio etc. But it plays a specific role. Agencies should also consider the other factor while policymaking. RBI Should sell foreign exchange reserves and buy rupees immediately to check continuous rupee depreciation. Expert suggests that an exchange rate around 40 to 60 is good for developing India. India should maintain the situation. Extreme fluctuation is not so good for the health of the nation's economy. Import substitution and export substitution measures in such a situation can be adopted. The central bank can cut the SLR to ease liquidity to rescue the rupee.

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