LOK SABHA SECRETARIAT
Research and Information Division

# INFORMATION BULLETIN

LARRDIS No. 3/2013/EF AUGUST 2013

# INDIAN RUPEE (₹) *VS.* US DOLLAR ($): THE CURRENT SCENARIO

The Indian Rupee plunged to a record low of 61.05 against US $ on 8 July 2013. At present, due to the sharp depreciation, the Indian Rupee is being seen as one of the poor-performing currencies of the emerging market economies. The reasons for depreciation in the value of Indian Rupee *vis-à-vis* US Dollar have been both domestic as well as global.

Quotation of Rupee value follows the simple economic rule of demand and supply. If there is more demand for US Dollar in India than the supply for it, Rupee would depreciate and *vice-versa.* While the demand for US Dollar is created by importers requiring more Dollars to pay for their imports, its supply is reduced by the Foreign Institutional Investors (FIIs), particularly those who withdraw their investments for various reasons and take the Dollars outside India. Similarly, supply of Dollar is created by exporters bringing Dollars from their revenues, by NRIs remitting more funds and by FIIs bringing more Dollars to India to spur their investments. Currently, some of the demand and supply side factors are at work unfavourably, thereby causing depreciation in the value of Rupee. The exchange rate of Indian Rupee *vis-à-vis* US Dollar in the last 20 years is given in the table below:

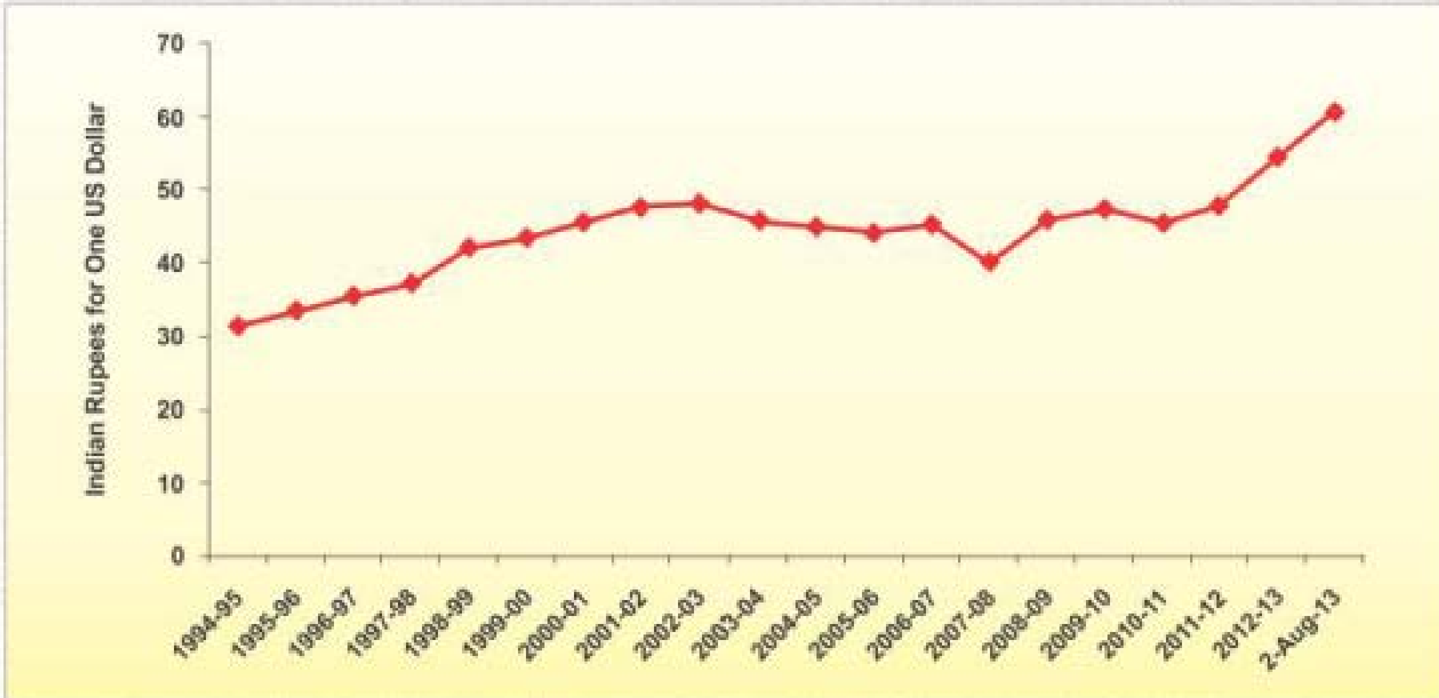
**Table-1: Exchange Rate of Rupee *vs.* US Dollar (Annual Average)**

| Year | Market Exchange Rate |
|---|---|
| 1994-95 | 31.39 |
| 1995-96 | 33.44 |
| 1996-97 | 35.49 |
| 1997-98 | 37.16 |
| 1998-99 | 42.07 |
| 1999-2000 | 43.33 |
| 2000-01 | 45.68 |
| 2001-02 | 47.69 |
| 2002-03 | 48.40 |
| 2003-04 | 45.95 |

| Year | Market Exchange Rate |
|---|---|
| 2004-05 | 44.93 |
| 2005-06 | 44.27 |
| 2006-07 | 45.28 |
| 2007-08 | 40.24 |
| 2008-09 | 45.92 |
| 2009-10 | 47.41 |
| 2010-11 | 45.57 |
| 2011-12 | 47.92 |
| 2012-13 | 54.41 |
| 02 Aug. 2013 | 60.80 |

**Source:** Reserve Bank of India

## Graph A: Exchange Rate of Rupee *vs.* US Dollar since 1994-95




A comparative position of depreciation in the value of currencies of the emerging market economies, including India, is given in Table-2.

**Table-2: Depreciation in the Value of Currencies of Emerging Market Economies (in Percentage)**

| | (30 Mar. 2012-29 Mar. 2013) | (29 Mar. 2013-02 Aug. 2013) |
|---|---|---|
| Argentina Peso | 14.5 | 7.2 |
| Brazilian Real | 8.9 | 12.1 |
| South African Rand | 16.6 | 7.9 |
| Indian Rupee | 5.9 | 10.5 |
| Indonesian Rupiah | 5.5 | 5.5 |
| Russian Rouble | 5.6 | 6.1 |

**Source:** Reserve Bank of India

## REASONS FOR DEPRECIATION IN THE VALUE OF RUPEE

Some of the main reasons which are currently troubling Rupee are as follows:

### *Increasing Fiscal Deficit*

In simple words, the excess of expenditure over total income is called fiscal deficit. India is currently spending more than it earns through taxes resulting in a mounting fiscal deficit. The major part of this spending is going into subsidies further pushing up the fiscal deficit. With mounting fiscal deficit, foreign investors have been feeling, to some extent, uncomfortable and trying to pull their money out of India, thereby increasing the possibility of Rupee depreciation. Table-3 shows the trends in India's fiscal deficit since the year 2003-04.

**Table-3: Trends in Fiscal Deficit since 2003-04 (As percent of GDP)**

| Year | Fiscal Deficit |
|---|---|
| 2003-04 | 4.3 |
| 2004-05 | 3.9 |
| 2005-06 | 4.0 |
| 2006-07 | 3.3 |
| 2007-08 | 2.5 |
| 2008-09 | 6.0 |
| 2009-10 | 6.5 |
| 2010-11 | 4.8 |
| 2011-12 | 5.8 |
| 2012-13 (P) | 4.9 |
| 2013-14 (BE) | 4.8 |

P: Provisional
BE: Budget Estimates
**Source:** Ministry of Finance

**Graph B: Trends in India's Fiscal Deficit since 2003-04 (Percentage of GDP)**


### *Widening Current Account Deficit*

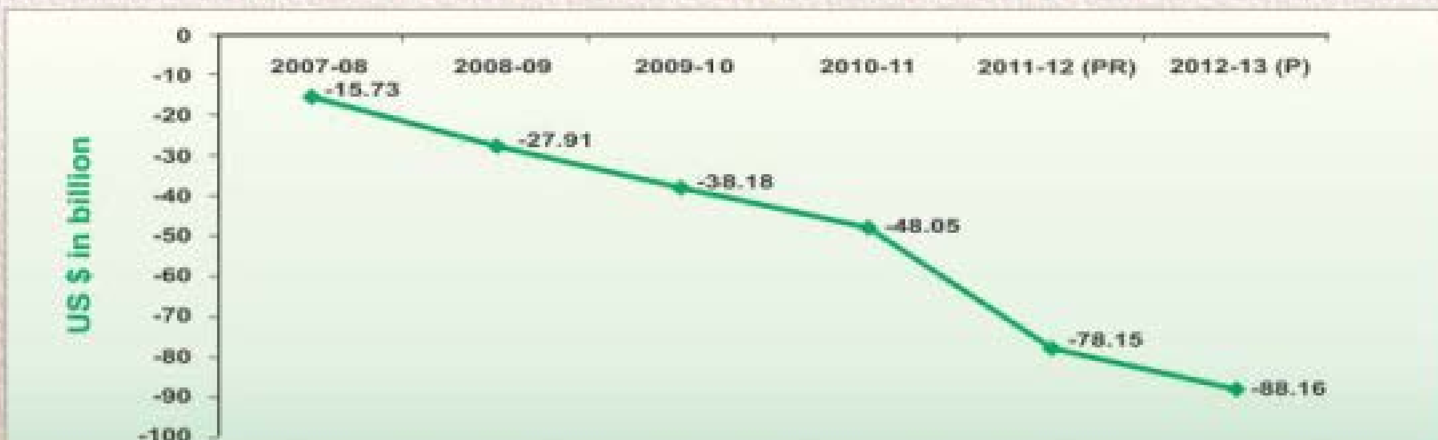
India is structurally an import-intensive country mainly because of the increasing demand of oil which constitutes a major portion of India's import basket. The Current Account Deficit (CAD) arises when a country's total imports of goods, services and transfers exceed exports. In recent times, India's CAD has been significantly high. In the coming months, as some analysts expect, the Current Account Deficit may be higher than that of the last quarter of the financial year 2012-2013 (which was 3.6 per cent of the GDP) on account of a weak Rupee and a comparatively slower pick-up of the exports. With a CAD of this magnitude, a country like India relies heavily on foreign institutional investors to finance the deficit of the Current Account with increased inflow of foreign capital. Since Institutional Investors investing in India are directly impacted by the global market uncertainties, this is risky because such foreign capital is prone to sudden stoppages. These apart, the Euro Zone is one of the major trading partners of India which is presently under severe economic crisis. This has significantly impacted India's exports because of the reduced demand from the Euro Zone. Exports to China have also declined significantly. As a result, India continues to see Current Account Deficit, depleting forex reserves and, resultantly, depreciating Rupee. Table- 4 (a) and Table- 4(b) show the recent trends in India's widening Current Account Deficit and Table-5 shows quarterly position of the Current Account Deficit during the years 2011-12 and 2012-13.

**Table-4 (a): Current Accounts Balance (2007-08 to 2012-13)**

| Year | (US $ billion) |
|---|---|
| 2007-08 | -15.73 |
| 2008-09 | -27.91 |
| 2009-10 | -38.18 |
| 2010-11 | -48.05 |
| 2011-12 (PR) | -78.15 |
| 2012-13 (P) | -88.16 |

PR: Partially Revised
P: Preliminary
**Source:** Ministry of Finance

**Graph C: Current Accounts Balance since 2007-08 (US $ in billion)**

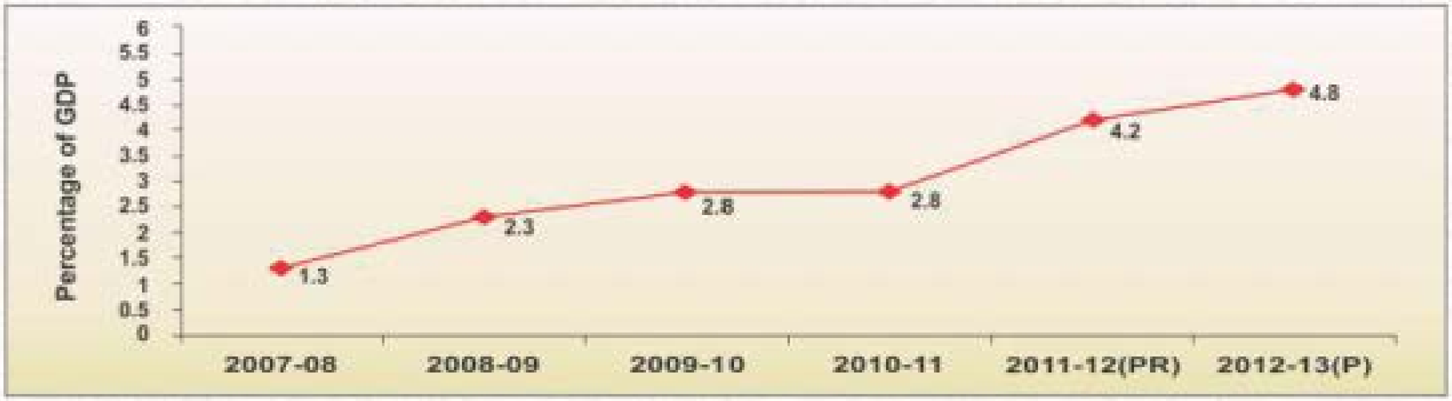


### Table-4 (b): Current Account Deficit (2007-08 to 2012-13) (Percentage of GDP)

| Year | Deficit |
|---|---|
| 2007-08 | 1.3 |
| 2008-09 | 2.3 |
| 2009-10 | 2.8 |
| 2010-11 | 2.8 |
| 2011-12 (PR) | 4.2 |
| 2012-13 (P) | 4.8 |

PR: Partially Revised
P: Preliminary
**Source:** Ministry of Finance

### Graph D: Current Account Deficit since 2007-08 (Percentage of GDP)




### Table-5: Current Account Deficit (US $ billion): Quarterly for 2011-12 and 2012-13

| 2011-12 | | | | 2012-13 | | | |
|---|---|---|---|---|---|---|---|
| Q1 | Q2 | Q3 | Q4 | Q1 | Q2 | Q3 | Q4 (P) |
| 17.4 | 18.9 | 20.2 | 21.7 | 16.9 | 21.0 | 31.9 | 18.1 |

P: Preliminary
**Source:** Reserve Bank of India

### Graph E: Current Account Deficit in US $ billion (Quarterly) for 2011-12 and 2012-13

## Oil Prices

Oil import constitutes the biggest portion of India's total imports and by quantity, the oil demand has been increasing year after year. The oil prices are quoted in international markets in terms of US Dollar. Thus, oil prices are another significant factor in putting pressure on the Indian Rupee. With the increasing price of oil in international market and increase in the quantity of oil imported into India, a further pressure is imposed on the demand for Dollars to pay to the suppliers from whom India imports oil. This increase in the demand for Dollars causes further depreciation in the value of Rupee.

## Weaker Capital Markets

If the capital markets (share markets) are on a boom, there is a continuous flow of Dollar into India which adds to the overall supply of Dollars in the country. Unfortunately, the current situation is opposite. Though the net FII flows in 2012-13 were higher than in 2011-12, since the last week of May 2013, the capital market has been adversely impacted by the US Federal Reserve's forward guidance on exit from Quantitative Easing (QE) Programme*. Resultantly, weaker supply of and excessive demand for Dollar have been causing depreciation in the value of Rupee.

## Speculations of Improvement in the US Economy and Federal Reserve's Possibility of Scaling Down of its Quantitative Easing

Currencies react to both the fundamentals of demand and supply as well as sentiments in the international market. The international market remained volatile since May 2013 when the Chairman of the US Federal Reserve, Mr. Ben Bernanke announced that the Federal Reserve might gradually stop its Quantitative Easing (QE) Programme if the American economy continues its journey along the path of recovery. As part of the QE Programme, the Federal Reserve has been purchasing huge quantities of bonds and, in the process, increasing money supply and keeping interest rates at the historically low levels. Due to all these factors, the US Dollar has gained against most of the emerging-market currencies. The currencies of the emerging-market economies (including India) are depreciating primarily due to increasing strength of the US Dollar supported by improving economic data of the US economy and also on account of high levels of Current Account Deficit.

## Volatile International Market

Volatility in all currencies, capital flows and stock markets across the world also had a considerable spill-over effect on the Indian Rupee. For quite some time, there have been fluctuations in the exchange rate of the Indian Rupee. Since Independence, India's exchange rate policy has transited from a par-value system to a basket-peg and then to a managed floating exchange system. Under the float regime operative since March 1993, the objective has been to contain volatility through orderly market conditions without any explicit or implicit target for the exchange rate. The RBI does not target the exchange rate, nor has a fixed band for nominal or real exchange rates to guide interventions. However, in excessive volatile market conditions, 'smoothing' interventions are carried out to keep markets orderly and prevent large jumps that can induce further spirals of fluctuations in the value of the currency.

*QE, as it has come to be called, refers to the monetary stimulus programme that was initiated by the Federal Reserve in order to revive the US economy.

## Capital Outflows

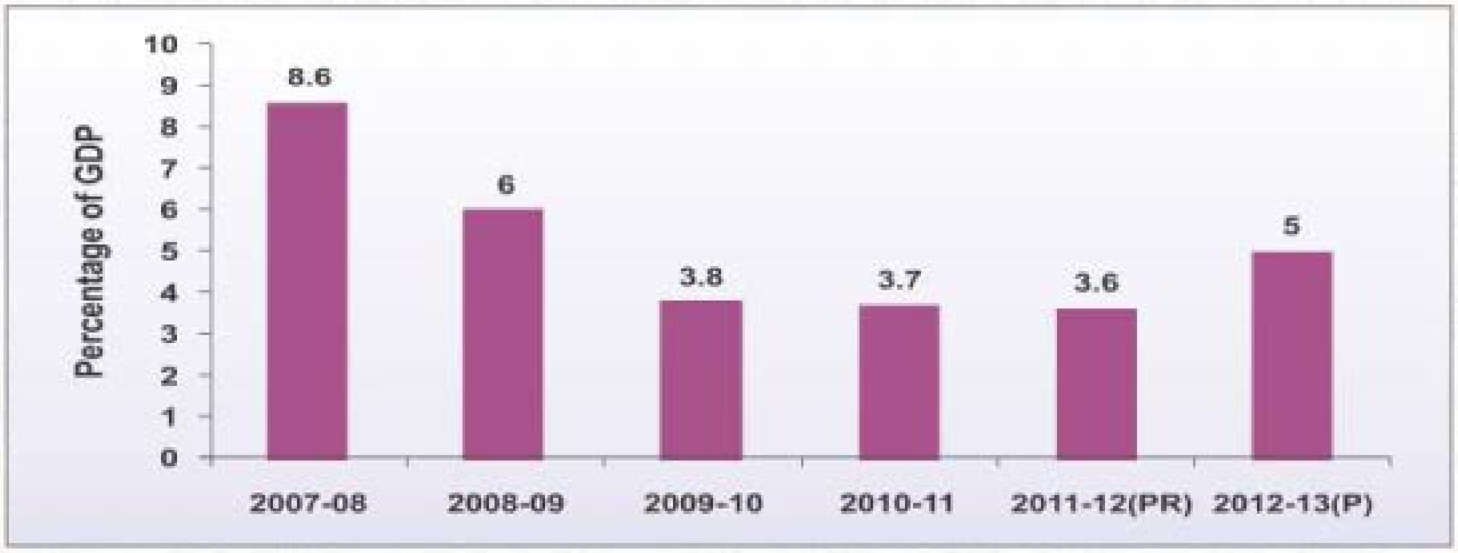
In the light of uncertainty and fall in global stock market, foreign institutional investors are supposed to be pulling out their money from various emerging market economies. When the economy performs well and its stock market performs better than those of other countries, overseas investors become heavy investors. It is well known that Indian stock market is dominated by overseas investors. Given the very low rates of interest in the US and lack of other investment options in the domestic economy, the Foreign Financial Investors have sought greener pastures abroad, particularly the stock exchanges of emerging markets like India and some African countries. With the warning bells from Federal Reserve and volatile Indian Rupee and stock market, the American Financial Institutions particularly have started withdrawing funds invested abroad (in emerging markets including India). Selling Rupee and buying US Dollars by these overseas investors in bad performing markets further add to the Rupee depreciation. Since the original inflows propped up many of the currencies of the emerging economies, the sudden outflow has caused precipitous fall in the external value of these currencies. India and Turkey have been the hardest hit, with the Rupee and Lira touching their historical lows. Though we have enough foreign exchange reserves, it will be drawn down low if the Current Account Deficit persists to be high and foreign institutional investors refrain from investing in Indian equity and debt market. The trends in Net Capital Inflow since 2007-08 are shows in Table-6. Table-7 shows the quarterly trends in foreign institutional investment during the years 2011-12 and 2012-13.

**Table-6: Net Capital Inflows (2007-08 to 2012-13) (Percentage of GDP)**

| Year | Capital Inflow |
|---|---|
| 2007-08 | 8.6 |
| 2008-09 | 6.0 |
| 2009-10 | 3.8 |
| 2010-11 | 3.7 |
| 2011-12 (PR) | 3.6 |
| 2012-13 (P) | 5.0 |

PR: Partially Revised
P: Preliminary
**Source:** Ministry of Finance

### Graph F: Net Capital Inflow since 2007-08 (Percentage of GDP)




### Table-7: Disaggregated Items of Capital Flows (US $ billion)

| | 2011-12 | | | | 2012-13 | | | |
|---|---|---|---|---|---|---|---|---|
| | Q1 | Q2 | Q3 | Q4 | Q1 | Q2 | Q3 | Q4 (P) |
| Net Direct Investment | 9.3 | 6.5 | 5.0 | 1.4 | 3.8 | 8.2 | 2.1 | 5.7 |
| Portfolio Investment | 2.3 | –1.4 | 1.8 | 13.9 | –2.0 | 7.6 | 9.8 | 11.3 |
| Other Investment | 12.6 | 14.2 | 1.0 | 1.4 | 15.4 | 5.6 | 20.0 | 4.2 |

P: Preliminary

Source: Reserve Bank of India

### *Continued Global Uncertainty*

Owing to uncertainty prevailing in Europe and slump in international market, investors prefer to stay away from risky investments. This has significantly affected the portfolio investment in India. This global uncertainty has adversely impacted the current and capital accounts of India's Balance of Payments and caused depreciation of the Indian Rupee. The International Monetary Fund (IMF) in its recent forecast (on 09 July 2013 in its *July 2013 World Economic Outlook*) has stated that the global growth is projected to remain subdued at slightly above 3 per cent in 2013, the same as in 2012. This is less than forecast in the *April 2013 World Economic Outlook*, driven, to a large extent, by appreciably weaker domestic demand and slower growth in several key emerging market economies, as well as a more protracted recession in the Euro area. The IMF expects Indian economy to grow at 5.6 per cent in 2013, below its April 2013 estimate of 5.8 per cent. The IMF has warned the emerging economies stating that they may face a longer growth slowdown. The IMF has also warned the Euro Zone for a protracted recession which may create more policy difficulties for the slowing emerging economies. All these factors have adverse impact on the value of the currencies of the countries which suffer slowdown.

### *Persistent Inflation*

India has experienced high inflation in the recent past. High inflation worsens economic prospects and capital outflows. Under normal circumstances, inflation is tamed by increasing interest rates, but since India already has high interest rates, it does not leave that option open, as it may lead to further slowdown in growth.

### *Lack of Reforms*

Key policy reforms like Direct Tax Code (DTC) and Goods and Services Tax (GST) have been in the pipeline for years. A retrospective tax law — General Anti-Avoidance Rules (GAAR) — has already earned a lot of flak from the business community. The Government has announced FDI in retail sector but much more needs to be done as the Indian Rupee has been sliding to its lowest and there has been criticisms of policy paralysis from certain quarters.

## IMPACT OF FALLING RUPEE ON DIFFERENT SECTORS OF THE ECONOMY

Depreciation leads to imports becoming costlier which is a worry for India as it meets most of its oil demand *via* imports. Apart from oil, prices of other imported commodities like metals, gold, etc., will also rise pushing overall inflation higher. Even if prices of global oil and commodities decline, the Indian consumers might not benefit as depreciation will negate the impact. The depreciating Rupee will add further pressure on the overall domestic inflation. The depreciating Rupee has serious effects on the external debt figures of the nation also.

### *Impact on Oil Imports*

Oil imports consume the largest part of the country's forex reserves. A depreciating Rupee is bound to offset the decrease in the international prices of commodities such as oil. Though the oil price per barrel has not gone up sharply in the last few months, the depreciating rupee has not given any respite to the importers as they actually have to shell out more money in order to purchase the same quantity of oil.

### *Impact on Debt*

A depreciating Rupee is not only impacting the import bill, it has also severely affected the cost of borrowings for the corporate sector. Indian companies heavily rely on the borrowings through ECBs (External Commercial Borrowings) and FCCBs (Foreign Currency Convertible Bonds). The corporate sector had been increasingly tapping overseas loans, mostly in the US Dollar, till a few months ago to save costs arising out of higher interest rates and liquidity constraints within the country, but the subsequent fall in the Rupee value has partially offset the benefits.

### *Impact on Exports*

With a depreciating Rupee, the value of exports would naturally increase. Hence export-oriented industries would post gains in forex earnings. Exporters are perhaps the biggest beneficiaries of the Rupee depreciation as every Dollar of their sale fetches them more Rupees. Hence, if they don't reduce their prices, with the same quantity of sales, they earn more in terms of Indian Rupees. If they intend to capture market share, depreciating rupee gives them an opportunity to reduce the price of their products in terms of Dollar and still making the same amount of profits in terms of Rupee. This makes their products more competitive in international markets and helps in selling more volume of products due to cheaper prices in terms of Dollar.

*IT Sector:* The sharp depreciation in rupee is expected to boost software exports and forex gains.

*Pharmaceuticals:* Companies in this industry are net exporters and stand to gains through higher export realisations enhanced by a depreciating rupee. Losses on External Commercial Borrowings (ECBs) and limited feasibility of conversion on Foreign Currency Convertible Bonds (FCCBs) pose a concern to these companies, but are not expected to be huge.

*Gems and Jewellery:* Since the sector is export-oriented and is expected to gain from the Rupee depreciation trend.

These apart, the tourism industry in India will become cheaper. This will promote foreigners to visit India as India becomes an attractive tourism spot owing to the sector's enhanced competitiveness.

### *Higher Inflation*

Imports becoming expensive with a depreciating Rupee a direct consequence of it is that the inflation in the economy shoots up. Higher inflation results in commodities becoming more expensive. As India is a major importer of oil which tends to hit the cost structure of the economy, it will fuel inflation scenario in the economy if the Rupee depreciates.

### *Repayment of Loans*

A couple of years ago, the option of borrowing cheap money from overseas was the preferred option which every capable company was exploring. But the impact of currency depreciation meant that the borrowing companies had to pay more Rupees to repay their Dollar-denominated loans. This adversely impacted up their financial computations, whereby some companies even ended up defaulting on their loan payments.

### *Foreign Education*

There are more and more Indian students taking admission in foreign universities. However, foreign education doesn't come cheap. With the depreciation of Rupee, the students studying abroad have to shell out more Indian Rupees.

## RECENT INITIATIVES TO CURB THE RUPEE DEPRICIATION

### *Restriction on Gold Imports*

India is the world's biggest gold buyer. The import of gold has also a strong bearing on the position of country's Current Account Deficit and accordingly, on the value of Rupee. As a corrective measure to curb the Rupee depreciation, the Government imposed restrictions on banks to import gold. As a measure to rationalize the import of gold, the Reserve Bank of India advised nominated banks/nominated agencies to ensure that at least one-fifth of every lot of gold import is exclusively made available for the purpose of exports. The RBI also restricted the facility of loans against gold coins. Further, to curb the import of gold, import duty on gold has been increased from 6 to 8 per cent. These measures have started showing results as gold import has shown contraction in June 2013.

### *Intervention by RBI & SEBI*

As per present practice, oil firms seek quotes from several banks for their Dollar needs in discovering better rates, which adds to the speculation demand for Dollar. To contain this speculation, the RBI asked the State-run oil firms to source all of their Dollar requirement every month for import of oil, from a single public sector bank. This apart, the Non-Banking Financial Companies (NBFCs) involved in asset financing are now allowed to tap External Commercial Borrowings (ECBs) under the automatic route to attract Dollar inflow. Securities and Exchange Board of India (SEBI) has also cut the exposure that brokers and their clients take on currency derivatives (financial instruments) and doubled their margins on Dollar-Rupee contracts so as to reduce volatility in foreign exchange market. The tightening of derivatives-trading, coupled with potential measures to curtail the impact of oil-related Dollar demand could provide a reprive to the falling Rupee.

At times, controlling the Rupee depreciation is difficult. But Government needs to intervene and take conscientious measures to come up with policy reforms to control the currency movements. Hopefully, Rupee would back trace its steps and come down to more comfortable range in the coming days.

Prepared by the Research and Information Division in consultation with the Ministry of Finance and the Reserve Bank of India for the use of Members of Parliament in support of their parliamentary work. Officers associated in the preparation of the Bulletin: Shri P.K. Misra, Additional Secretary; Shri C.N. Sathyanathan, Director; Dr.B.C. Joshi, Additional Director and Shri Jayanta Kumar Samal, Research Officer.