Imapct of Rupee Depreciation on Indian Economy

Let us first understand what is "Exchange Rate". Exchange rate is the conversion rate between two currencies. In other words, Exchange rate is the price of one currency in terms of another currency. The conversion could be quoted in two ways - one is direct quote where the price of a unit of Foreign currency is expressed in terms of the domestic currency (Eg US 1 $ = INR 66.11) whereas, under indirect quote, the price of a unit of domestic currency is expressed in terms of foreign currency (Eg INR 1 = US $ .015).

It would make sense to comprehend Appreciation and Depreciation terms. When foreign currency inflows into India is greater than the outflows then Indian Currency is likely to appreciate i.e. say US 1 $ will be equal to INR 65 whereas Foreign Currency outflows from India outnumber inflows then Indian Currency would depreciate. Another question that would come to mind "Who determines the Exchange Rate?", It is not the RBI nor the Government that decides the Exchange rate rather market forces i.e. demand and supply of the foreign currency would determine the exchange rate. Rarely does RBI intervenes in the volatile currency markets to prevent INR from steep

DEPRECIATION OF MAJOR CURRENCIES AS WELL AS EMERGING MARKET CURRENCIES

Exchange Rate	31st March 2018	30th June 2018	30th September 2018	31st October 2018	%age depreciation
USD – INR	65.08	68.44	72.51	74.08	13.83
EUR – USD	1.2323	1.1702	1.1604	1.1318	8.15
GBP – USD	1.4018	1.3209	1.3039	1.2766	8.93
USD – JPY	106.28	110.74	113.74	112.86	6.19
USD – YUAN	6.2753	6.6210	6.8689	6.9756	11.16
USD – BRL	3.3051	3.8771	4.0542	3.7220	12.61

appreciation or depreciation.

The hardening of interest rates in US led to an outflow of funds from Equity markets. The bond yield in US had touched a high of 3.23% in the recent past when we witnessed Foreign Portfolio Investors (FPIs) taking out funds from Indian Equity markets. In other words, global cues also played a catalyst in funds outflow.

On the day USD-INR exchange rate breached 74 mark for the first time, RBI Governor reiterated that domestic currency is still better than its emerging market peers and that the apex bank doesn't have a target for it. The Indian bond market yield rose to 8.10% before settling down at 7.80%. October month witnessed debt investors selling US $ 1.25 billion (INR 7,729 crore) worth of securities in bond markets.

Post PNB fiasco on Letter of undertaking (LoU) front, RBI abruptly banned the instrument (Buyer's credit), which led to buying of dollars by importers directly from the currency markets, thereby adding a few billions to US dollar demand. On perusal of the table furnished, it is observed that developed as well as emerging market currencies have depreciated against dollar during last 8 months. In other words, US dollar has gained strength against other currencies.

IMPACT ON ECONOMIC PARAMETERS:

Consider the FOREX Reserve, which has fallen from a high of around US$ 425 billion by FPIs from Capital Markets was one of the reasons for reduction in FOREX Reserves. GDP growth for the Q1FY18-19 reached at 8.2%, signalling restoration of economic growth post demonetisation when it had dipped to 5.7%. Retail Inflation has dipped to 3.31% for the month of October 2018, which is well under control. Wholesale Inflation has reached a level of 5.13% for September 2018 where weight of petroleum products is higher. Index of Industrial Production (IIP) for the September month stood at 4.5%, indicating silver lining in the industrial growth.

IMPACT ON OIL IMPORTS:

The domestic currency breached the level of INR 74 against US dollar in the recent past, to close at all time low of INR 74.47. The fall in domestic currency could be attributed to US-China Trade War, rising US Bond yields, rising crude oil prices, petroleum and petroleum products, which had touched US $ 86 a barrel. India's reliance on crude oil import is almost 80% of its requirement. The oil import bill is likely to be around US $ 88 billion in the total import bill of US $ 460 billion in 2018-19. Every US dollar change in the price of Crude oil impacts the country's import bill by US $ 0.13 billion (INR 823 crore). Oil Marketing companies IOC, BPCL & HPCL share prices crashed by almost 50% on account of double whammy i.e. rising crude prices and falling rupee.

IMPACT ON STOCK MARKETS & BOND MARKETS:

Post announcement of 10% Long Term Capital Gain Tax (LTCG) on Equities & Equity-linked MF schemes in the budget applicable for the current financial year, we have seen outflow of funds from Indian Equity Markets as it dampened the investor sentiments.

FPI outflows have been consistent from equity as well as debt markets. Tightening of interest rates, due to hike in Repo rate, led to falling bond values, resulting in FPI outflows. 10 year GSec YTM rose to 8.10%, which has now settled around 7.80% as oil prices eased further. Equity indices has corrected by almost 15% when it breached 10k on the lower side. The crash in the stock markets could be largely attributed to the falling rupee as well as rising bond yield in US markets where FPI have moved a portion of funds due to higher bond yields.

IMPACT ON SOFTWARE & OTHER EXPORT ORIENTED SECTORS:

Falling rupee led to windfall for listed IT companies where we have seen improvement in margins, profitability and turnover. Overall Export Oriented companies have benefitted with the depreciated rupee. A weaker rupee would benefit Agriculture, Leather, Textile and Transport Equipment sectors where turnover and profitability would be on rise. These are the sectors where net exports are positive where exports are higher than imports.

IMPACT ON CHEMICALS, ELECTRONICS, ENGINEERING & MINERALS SECTORS:

While these sectors stand to lose on margins, profitability as well as turnover, there is a silver lining in these sectors that a stable rupee exchange rate may prompt fresh investments, which will reduce dependence on imports. These sectors are net importers where imports are higher than exports.

BALANCE OF PAYMENT:

India's Current Account deficit has widened to US$ 15.8 billion in the Q1 FY18-19. Silver lining is 10 basis points reduction in current account deficit to 2.4% of the GDP. India has been unable to grow exports despite global growth has been decent. Global financial conditions led to reduction in funds inflow to the extent of US$ 5.8 billion in Q1, which stood at US$ 26.9 billion in the corresponding period previous year. If the Oil prices trend gets reversed to upwards and rupee continues its downward journey, it is going to put pressure on BoP position in FY18-19.

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