

Fluctuations In India's Rupee Rate And Its Impact

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After depreciating to a record low of 52.73 against the U.S. dollar on November 22, the Indian rupee (INR) rose in value to 51.206 per dollar on Friday to complete the currency's first weekly advance since October.

The Indian rupee is under great stress as overseas investors are paring their exposure to Asia's third-largest economy amid international uncertainty and mounting worries over the domestic economy.

On November 21 alone, overseas funds sold more than US\$500 million worth of Indian-listed shares over the five trading sessions, reducing net inflows for 2011 to under US\$300 million – a tiny sum compared to the more than US\$29 billion experienced in 2010. The rupee has lost more than 10 percent of its value this year, making it one of the worst performing currencies in Asia.

The rupee's modest 2.1 percent advance against the dollar last week occurred as six monetary authorities, led by the U.S. Federal Reserve, coordinated a move to lower the interest rate on dollar-liquidity swap lines.

The premium banks pay to borrow dollars overnight from central banks will fall by half a percentage point to 50 basis points. The move was coordinated with the European Central Bank and monetary authorities in Canada, Switzerland, Japan and the United Kingdom.

"Sentiment has improved slightly after the central banks' actions," Vikas Babu, a Mumbai-based currency trader at Citigroup, told Bloomberg News. "This is unlikely to last long as only the symptoms of the crisis are being tackled, and I expect dollar strength to persist."

The exchange rate of the Indian rupee is dependent upon the market conditions. Though, in order to sustain effective monetary policy, the Bank of India (RBI) actively trades in the US\$/INR currency market. The RBI also intervenes in the currency markets to stabilize exchange rates and remove excess liquidity from the economy. The rupee is pegged by the Bhutanese ngultrum at a rate of INR1 to NPR1.6.

India has a managed floating exchange rate system. This means that the Indian government intervenes only if the exchange rate is increasing or reducing the money supply as the circumstances demand.

Impact on economy

Rupee appreciation makes imports cheaper and exports more expensive. According to intelligence reports by the Asian Development Bank, sectors like petroleum and petroleum products, drugs and pharmaceuticals and engineering goods – will gain if the rupee appreciates. The imported raw materials which would increase their profit margins.

Likewise, a depreciating rupee makes exports cheaper and imports expensive. So, it is good news for industries such as tourism which generate income mainly from exporting their products or services. Rupee depreciation makes Indian goods more competitive in the international market.



overseas buyers, thus leading to increases in demand and higher revenue generation. The foreign tourists would find India, therefore increasing the business of hotel, tours and travel companies.

India's IT sector is dependent on foreign clients, especially the United States, for more than 70 percent of its revenue. When a project is awarded from a client, it pre-decides on the length of the contract and the cost of the project. The contracts are in U.S. dollar terms. So, the fluctuation in the exchange rate can bring about a considerable difference in the performance of

Some companies undertake a range of measures like hedging exchange risks using forwards and futures contracts. However, to avoid the losses due to exchange rate fluctuations, but none-the-less the impact is substantial.

The exchange rate is a significant tool that can be used to examine many key industries; with fluctuations potentially affecting the economy, industries, companies, and foreign investors. Rupee appreciation is generally helpful for industries which rely on imports while depreciation of the rupee is welcome news for industries which are exporting a majority of their products.

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