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"RUPEE-DOLLAR FLUCTUATION: CAUSES AND IMPACT"

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ABSTRACT

Exchange rates are expressed as a comparison of two currencies. It is always relative and can be measured between two countries. It is regarded as the value of one country's currency in terms of another currency. It is also known as a foreign exchange rate or forex rate. According to the new system Liberalized Exchange Rate System (LERMS) the Forex rates are determined by market forces and are based on demand & supply of these currencies.

The US dollar is the most predominant currency in the world. As USA is India's biggest trading partner fluctuations in dollar and rupee exchange rate have huge impacts on both the countries' trade and economy. In the past few years the rupee dollar exchange rate is fluctuating frequently.

How is Exchange Rate determined?

Exchange Rate is determined as a combination of currencies. Exchange rate is determined by the market forces and are based on demand and supply of the currency. If Supply exceeds the demand the value of currency depreciates and vice versa.

. For E.g. 1 $= 60 Rs. After some period there can be two cases
Case 1: 1$=55Rs. This means rupee has appreciated or become stronger and one would pay less for a dollar.
Case 2: 1$=65Rs. This means rupee has depreciated or got weak and one would pay more for a dollar.

Rupee's appreciation or depreciation against the dollar depends on the change in demand and supply for both the currencies. The demand of rupees is comparatively is high rupee appreciates if demand goes down it depreciates.

Causes of the Rupee Dollar Fluctuation:-

1. Demand for Foreign exchange: The demand for foreign exchange for the purpose of business, payments, tourism etc. cause an increase in the exchange rate of the currency. For e.g.:- If a person goes to USA for higher studies he needs dollars. Hence the demand for dollar is rises.

2. Interest Rate: The demand for a currency is reliant on the interest rate differential between two countries. For. E.g. If in India rate of interest is high, greater capital inflow will be there in India as investors get better return. This results into rupee appreciation.

3. Inflation: If a country is going through a high inflationary phase, it leads to worsening of the overall economy. This leads to capital outflows, which leads to depreciation of a currency.

4. Import Export Proportion: The imports of India are more than exports. India primarily imports high value products like petroleum products and crude oil and exports low value products like garments, textiles, leather products, handicrafts etc. This leads to a high demand of US Dollars. So this results in dollar appreciation and rupee depreciation.

5. Capital Market: Foreign investors invest in the Indian Capital markets in the form of Foreign Institutional Investments. When the markets are doing well they put in dollars in the Indian Markets. During the past few months Indian markets have not been performing well. Thus investors are withdrawing their capital. This leads to depreciation of rupee.

Impact of Rupee Dollar Fluctuation:

1. On Economy: The high fluctuation in Dollar and Rupee will result into a Current Account Deficit. It is expresses as a percentage. It is the excess of imports over exports. India has a current account deficit of 1.4% of GDP. India's major trading partner, the European Union is under crisis. This has impacted Indian exports. Because of this Indian economy is facing pressure.

2. On Imports and Exports: An appreciating rupee is good for imports. The imports become cheaper. A depreciating rupee is good for exports. The present situation is that the rupee is depreciating. This scenario is especially beneficial for exports. The IT industry is benefiting because of this.

3. On Commodity Prices: India is a major importer of goods like Gold, crude oil, fertilizers and pharmaceutical products. Because of the depreciating rupee these commodities have become costly. This has lead to a further pressure on inflation and economy.

4. On investors: India used to be a very attractive investment avenue. The stock market was flooded with foreign investments. This earlier had led to a meteoric rise in the Sensex. But the depreciating rupee brought the trend down. Due to uncertainty in Indian markets, investors are pulling out the money from Indian markets and are investing in safe investments like Gold and US Bonds.

Conclusion

The fall in the value of currency not only affects the pride of a nation, but also affects a lot of economic growth indicators. Depreciation of rupee reduces the inflow of foreign capital, rise in the external debt pressure, and also grow India's oil and fertilizer bills. The most positive impact of depreciation of rupee is the stimulation of exports and discouraging imports and thus improving the current account deficit. For a country such as India, imports are unavoidable. Hence the Reserve Bank of India and the ruling government should take steps to improve capital inflow in the form of Foreign Direct Investment (FDI) and Foreign Institutional Investments (FII). Along with the above, overall improvement in the economy may also help Indian Rupee to appreciate.

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