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Variations in exchange rate of Indian rupee and impending general elections

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Abstract

Indicators of economic development were progressed well in the last ten years (2004-2014). The last two years were a setback as GDP growth rate was below five percent. Indian rupee's exchange rate is the indicator of its external value. Exchange rate fluctuations alarm about monitoring parameters of foreign trade, balance of payments, FDI flows, FII flows etc. India witnessed general elections in 2009 and 2014. Rupee's bilateral exchange rate against U.S. dollar varied wildly in preceding years of both the elections. The exchange rate variation was studied. It influenced the sentiments of the voters in relation to government's capacity to manage the financial issues. As a result of it political parties in opposition took an extra advantage by default. Nominal effective exchange rate and real effective exchange rate are the phenomenon of rupee's external competitive value. RBI and central government's data has been presented together to draw a rational picture of related economic scenario of the country in the last ten years. Forecasting model of exchange rate was also discussed. Bilateral exchange rate of rupee against some key currencies has been compared for a balanced analysis. Trade pattern in 2004-05 and 2013-14 has been compared for six major trade partners. India's GDP growth rate, external debt, forex reserves, current account deficit, capital account balance and their percentile data has been shown for a rational look on economic stability. Trade pattern of I has been studied by (Banerjee and Roy, 2014) [3] also made some clarity on the issue. India International monetary fund data has been collected for showing growth pattern of some countries for comparative view. The objective of the paper is to present the balanced view on rupee's external value rather than pin pointing some sudden jerks.

Keywords: election, exchange rate, foreign trade, economic growth

1. Introduction

It is one of the most difficult tasks to determine the factors which bring about variations in the value of a currency. A few of them are as follows: gross domestic product (GDP), trade volume, FDI flows, FII flows, inflation, interest rates, budget deficits and general elections in a democratic country like INDIA. Looking to the 2009 and 2014 general elections in INDIA, I found general election to be one of the important phenomenon causing wild variations in the value of Indian rupee.

In a globalized world international trade and movement of liquid assets is increasing day by day. The monetary transactions for business and many other purposes take place through currencies of different countries. Some currencies are 'Key currencies' like U.S. Dollar, Euro, Pound sterling, Japanese yen etc. and are accepted by almost all the countries while some other currencies are not considered that important. Every country keeps a close watch on the value of their currency for purposes of international transactions. Nations take necessary steps to get their currency's value at desired level. Indian rupee is national currency of India and its central bank viz. RBI is authorised to keep surveillance over its external value.

The value of a currency depends on the factors that affect the economy. For example exports, imports, inflation, interest rate, growth rate, trade deficit, foreign exchange reserves, foreign investment inflows etc. with geopolitical conditions affect the value of a national currency. "The price of one currency in terms of another is called exchange rate. The market exchange rate is the actual price of currency in foreign exchange market. Market prices of currencies are liable to fluctuate between narrow margins in fixed exchange rate system and much more widely under a floating exchange rate system." [4]

The variation in exchange rate of rupee takes high level of concern of central government and RBI.

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When domestic currency’s value is decreased in terms of other currencies it is called depreciation of domestic currency. The currency appreciation happens when it become stronger to buy more foreign currency units with same quantity. We can include differentials in inflation, differentials in interest rate, current account deficit, public debt, terms of trade and political stability and economic performance of a country as some of factors that influence exchange rate variations. Some of possible reasons for a currency’s depreciation may be export falling, current account deficit rise, foreign flows, fiscal deficit and slower growth. “In current scenario nation cannot measure their currency’s price in terms of U.S. Dollar or Pound sterling because diversified trends has been shown in different bilateral exchange rates. For example: Indian rupee, U.S. Dollar and Pound sterling are available for consideration as three currencies. When Rupee gets 10 percent depreciation against Pound sterling and 15 percent appreciation against U.S. Dollar then value of Rupee will be weighted average of both bilateral exchange rates. In real world value of Rupee can vary at different degrees in terms of various independently floating currencies. Thus to determine the change in Rupee’s value it is necessary to measure the

weighted average of all bilateral variations. Nominal effective exchange rate (NEER) is determined by measuring the weighted average of several bilateral exchange rates. NEER does not take into account the price changes that have taken place in the countries under consideration. Therefore it is imperative to incorporate the price changes that have taken place in the countries concern in order to make the proper assessment of the changes in the value of a currency. Thus REER is calculated by incorporating the corresponding changes in the relative price indices in the NEER by induction of corresponding relative price indices in NEER data.”^[5]

Pattern of rupee depreciation before election year

General elections were held in April-May 2009 and April-May 2014. In the preceding year Indian rupee was depreciated at higher amount both the times. (Table-1) This impacted the sentiments of public about the financial management of government. Assembly elections were held in 5 states (Rajasthan, Madhya Pradesh, Chhattisgarh, Delhi and Mizoram) in December 2008 and December 2013. Political parties in opposition targeted the central government of that time for this phenomenon.

Table 1: In the preceding year Indian rupee was depreciated at higher amount both the times

S. No.	Exchange rate of Indian rupee vis-a-vis U.S. Dollar in the year preceding general elections				
1	Reference date	17, April 2013	28, August 2013	21, April 2008	13, July 2008
2	Exchange rate	53.94	68.36	39.89	49.4
3	Duration of general elections	07, April 2014 TO 12, May 2014		16, April 2009 TO 13, May 2009	
4	Percentage change exchange rate between reference date	26.73		23.84	

Source: RBI

Comparison of exchange value of rupee and real value of rupee

The real value of rupee was not depreciated at that much extent as compared to bilateral exchange rate against U.S. dollar in April 2013 to August 2013. (Table-2)

Table 2: Bilateral exchange rate of rupee against U.S. dollar and NEER, REER indices

S. No.	Month	Ex. Rate*	Neer	Reer
1	APRIL 13	54.38	75.97	120.87
2	MAY 13	55.01	75.29	121.20
3	JUNE 13	58.40	70.51	114.22
4	JULY 13	59.78	68.89	112.99
5.	AUGUST 13	63.21	64.61	107.56

Note: for NEER and REER indices of Indian rupee (6-currency trade based weights) source: economic survey 2013-14 GOI, *month average

Comparison of exchange value of rupee and real value of rupee

The real value of rupee was not depreciated at that much

extent as compared to bilateral exchange against U.S. dollar in April 2008 to July 2008. (Table-3)

Table 3: Bilateral exchange rate of rupee against U.S. dollar and NEER, REER indices

S. No.	Month	Ex. Rate*	Neer	Reer
1	APRIL 2008	40.02	70.63	112.16
2	MAY 2008	42.13	67.48	108.23
3	JUNE 2008	42.82	66.38	108.20
4	JULY 2008	42.84	65.83	107.94

Note: for NEER and REER indices of Indian rupee (6- currency trade based weights) Source: economic survey 2008-09 GOI, *month average

Recent variation in rupee value with some key currencies

As we see bilateral exchange rate of rupee against some key currencies, rupee’s value have a depreciating trend but in a smoother way. (Table-4) In 2010-11 rupee was appreciated against U.S. dollar, pound sterling and euro. Depreciation of rupee was much steeper after 2011.

Table 4: Bilateral exchange rates of rupee per foreign currency (annual average)

S. No.	Year	U.S. Dollar	Pound Sterling	Euro	Japanese Yen*
1	2007-08	41.34	82.72	56.6	35.13
2	2008-09	43.54	80.13	63.74	42.30
3	2009-10	48.40	75.72	67.39	51.81
4	2010-11	45.72	70.87	60.21	53.27
5	2011-12	47.91	76.38	65.87	60.72
6	2012-13	54.41	85.98	70.07	65.85
7	2013-14	60.50	96.30	81.17	60.40

Source: economic survey 2013-14 GOI, *per hundred yen

Variation in foreign trade pattern

Table 5: Percentage Change in normalised weights for 6 currencies NEER and REER indices

S. No.	Year	China	Hong Cong	Euro	Japan	UK	USA
1	2004-05	11.96	7.45	35.12	7.15	10.13	28.19
2	2013-14	26.56	8.35	31.09	6.65	5.79	21.56

Source: RBI

India's foreign trade pattern has changed in the last decade. Thus bilateral exchange rate variation needed concern. China has become a stronger trade partner while the share of the United Kingdom and the United States of America become lower. The euro area is representative of five

countries namely Belgium, France, Germany, Italy and Netherlands. (Table-5)

A few economic indicators

The growth rate of the Indian economy was in good position in consecutive two years before 2008-09 but in the same interval GDP growth rate was quite below before 2013-14. (Table-6). Still we have seen almost same pattern of rupee depreciation after five years interval preceding election year. GDP growth rate and percentile data of external debt, foreign exchange reserves, current account deficit and balance of payment show that economic stability was in good position on long term parameters ^[6]. (Table-1)

Table 6: Data in Percentage

S. No.	Year	GDP Growth Rate	External debt to GDP	Forex Reserve To EX. Debt	CAD To GDP	Capital Account Balance To GDP
1	2006-07	9.6	17.5	115.6	1.0	4.7
2	2007-08	9.3	18.0	138.0	1.3	8.6
3	2008-09	6.7	20.3	112.2	2.3	0.6
4	2009-10	8.6	18.2	106.9	2.8	3.8
5	2010-11	8.9	18.2	95.9	4.2	3.7
6	2011-12	6.7	20.5	81.6	4.7	3.6
7	2012-13	4.5	21.8	72.1	1.7	4.5

Table 7: Key economic indicators for rupee's value determination (U.S. dollar in billion)

S. No.	Year	CAD	Capital account balance	FDI inflow (net)	Forex reserves *	External reserves
1	2006-07	10	45	8	199	172
2	2007-08	16	107	16	310	224
3	2008-09	28	07	20	252	224
4	2009-10	38	52	19	279	261
5	2010-11	48	61	12	305	318
6	2011-12	78	65	22	294	361
7	2012-13	88	92	20	292	405
8	2013-14	32	49	22	304	426#

Source: economic survey 2010-11, 2013-14 GOI

* financial year end # December 2013

Economic growth of some developed countries and India

World economies including India were at the lower level of growth in 2012 and 2013. As India's share in world trade increasing the external shocks can effect at larger extent.

RBI governor Dr. Raghuram Rajan expressed his views about the world economic scenario "Everybody is in their own boat and they sink or swim, we are in it together". (8)

Table 8: Percent change year over year in GDP

S. No.	Country	2011	2012	2013	2014 (*)	2015 (*)
1	World	3.9	3.2	3	3.6	3.9
2	USA	1.8	2.8	1.9	2.8	3
3	China	9.3	7.7	7.7	7.5	7.3
4	Japan	-0.6	1.4	1.5	1.4	1
5	India	7.9	4.7	4.4	5.4	6.4
6	Euro Area	1.4	-0.7	-0.5	1.2	1.5

Source: world economic outlook (IMF January 2013, April 2014) *projections

Conclusion

A similar pattern of rupee's depreciation has been shown in preceding year of last two general elections while the key economic indicators about economic growth and rupee's value determination were at long term sustainable level. The real value of rupee should be considered in a rational manner and bilateral exchange rate phenomenon should be least used. The short term fluctuations should not affect the five year long tenure of any government in a wrong manner or some sudden alarms may not be falsely converted in a big-bang.

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