OKONOMIST

Institute of Management Technology Nagpur

The Forum of Aspiring Business Leaders

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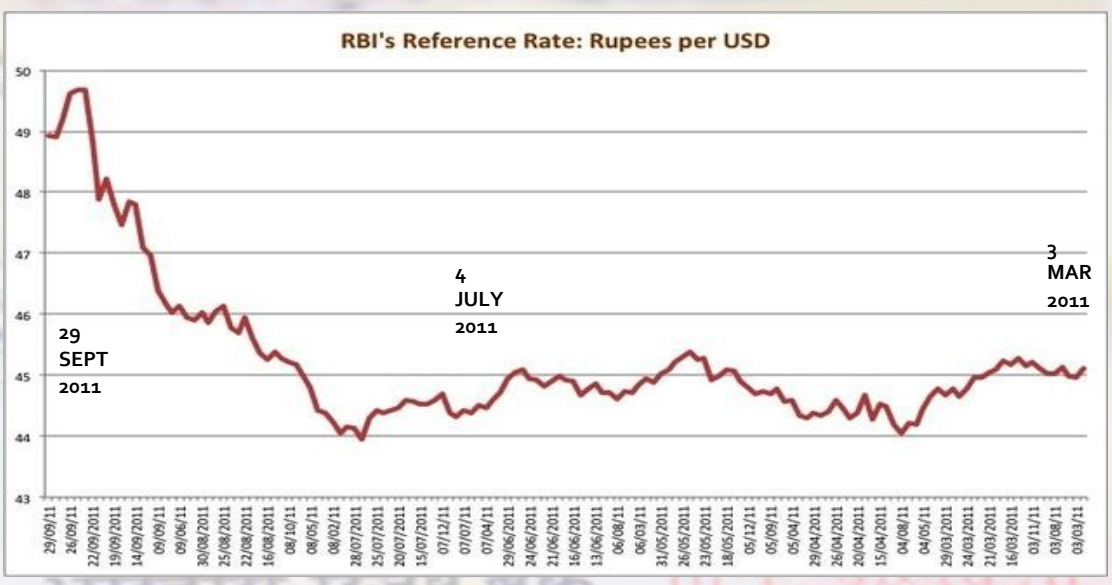
FOCUS ₹UPEE DEPRECIATION

Prevailing News of Previous Month

- *"Rupee falls to 28-month low at 49.54 per dollar, RBI moves watched"* - Economics Times - 22 Sep 2011
- *"Re rises after almost hitting 50 vs dollar; RBI hand seen"*- Hindu Business Line - 23 Sep 2011
- *"Pranab discusses rupee depreciation with RBI chief "* - PTI - 24 Sep 2011
- *"Rupee fall may inflate India Inc's foreign loan bill by $2 billion"* - PTI -Sep 25, 2011
- *"Sensex nosedives on Europe woes Rupee 16-month low"*- Moneycontrol.com - 13 Sep 2011
- *"R tumbles to year's low as safe haven $ lures wary investors"*- Financial Express - 9 Sep 2011

EDITORIAL



In an industry it is very important for the managers to have a clear understanding of not only the organization to which he serves but also of all those external factors which can have a huge impact on the organization's future profitability and sustainability in order to enable him to take the right decisions at the right time.

One of the most important factor which can play a pivotal role in making decisions is the study of macroeconomics .Considering the current Indian economic scenario we decided to come up with an important part of macroeconomics which is DEPRICIATION OF CURRENCY which can have huge implications on the economy as well as on the organization. We all know the formal definition of currency depreciation which means a loss in value of a country's currency with respect to some other foreign currency.

In this 1st edition of volume 2 of OKONOMIST let us see how and why currency depreciates, why Indian currency is depreciating, who are the gainers and losers because of this currency depreciation and what measures government take to control such scenario.

WHAT CAUSES DEPRECIATION?

Swings in the rupee is much like swings in prices of rice or wheat are caused by changing equations between demand and supply of currency. The upsurge in demand for US dollars, for instance impel people to sell more rupees to receive dollars: this leads to a cheaper rupee. This causes depreciation.

Demand for dollar by Indians arises due to the following:

- The Indian individuals, firms or government who import goods from USA into India, as they need to pay for goods and services imported.
- The Indian individuals travelling and studying in USA would require to meet their travel expenses and education expenses.
- The Indians who want to invest in equity shares and bonds of the US companies and other financial instruments.
- The Indian firms who want to invest directly in building factories, sales facilities, shops in USA.

Supply of dollars in exchange market is affected by:

- The individual firms and government which export Indian goods to USA will earn dollar from American residents who would buy Indian goods imported into USA and pay their price in dollar.
- Americans who travel to India and use the services of Indian transport, hotels etc .will also supply dollars to be converted into rupees for meeting these expenses.
- American firms and individuals who want to buy assests in India , such as bonds and equity shares of Indian companies or wish to make loans to Indian individual and firms will also supply dollars.

WHY SO MUCH FUSS?

Major Factors Influencing the Currency Value

- *Inflation:*

Higher inflation rate reduces currency value, as its purchasing power decreases relative to other currencies.

- *Interest Rates:*

Lower interest rates decrease the currency value.

- *Current Account Deficits:*

The country needs to buy more foreign currency to fulfill its need inside the country which decreases the currency value.

- *FDI (Foreign Direct Investment):*

Reduction in investment results in reduction of Dollars supplied.

- *ECB :*

External Commercial Borrowings include commercial loans and borrowings from private sector windows of multilateral Financial Institutions such as International Finance Corporation. Decrease in ECB reduces supply of dollars in Indian Economy

- *Foreign portfolio inflows (FII-Foreign Institutional Investors) :*

There is a relation between stock market and currency. Stock market in India moves down when there is a large reduction in FII inflows. This moves dollars out of Indian Economy and make the rupee depreciate.

- *Foreign Funds Outflow:*

Because of the global uncertainty and various economy crisis like Europe sovereign debt problem, US economy problem, etc leads to search for the safe heaven among the investors. They are quickly pulling out the money from Indian market and investing in any other safe investments like Gold or US dollar.

In the past 2 months Indian currency was continuously depreciating against dollar. The question here is what happened suddenly which made our currency to depreciate continuously for 2 months?

Well it all depends on the current economic conditions of a nation and what is happening round the world. The rupee fell to almost 50 against dollar on September 23 from 44.4 in July 2011. The fall is almost as steep as that during the peak of Lehman crisis in 2008. The rupee depreciation during the Lehman Episode was characterized by a global recession and the consequent credit freeze. The current slide of the rupee is due to two factors- first , rising demand for dollars by Indian companies in conjunction with reducing supply of dollars due to weak FII inflows.

According to Crisil report on rupee depreciation , this time repayment pressures on corporate India , rather than capital outflows seems more responsible for the weakening of rupee. Overall, the supply of dollars into India has not weakened substantially in recent weeks. The downward pressure on rupee, therefore, appears to be much as the result of increase in demand for dollars from corporate India. This time the demand for dollars has increased because of two reasons , first is the usual one when corporate have to pay back their debt in dollars and the other one is because of Corporate expectations regarding the credit freeze in advanced nations, which could impair their ability to raise debt and/or roll it over. The need to ensure smooth repayment of debt has led to the rush for dollars and hastened the fall of the rupee.

TOUGH TIME FOR GOVERNMENT AND RBI

A depreciating rupee may compound the macroeconomic problems as the prices of imported goods will surge and worsen the current account deficit. India wont be able to take advantage even if commodity price ease due to global slowdown. One more concern for the government is the inflationary pressure which is already near a two digit number and the government policies till now has been ineffective in curbing inflation. A depreciation of rupee will add fuel to this . It might lead to high inflation as India imports almost 70 % of its crude oil requirement and the government will have to pay more for it in terms of rupees. Further this higher import bill will lead to rise in fiscal deficit for the government and will push the inflation.

Following this steep fall in value of India Currency , RBI acted to stop the erosion of rupee value against the dollar currency. RBI has sold more dollars from its forex reserves which will result in the higher supply of dollars to meet the demand of dollars. When the demand of dollars is met by increased supply of dollars, it will not lead rupee to depreciate further. The other benefit by using this policy is that when people or corporate buy more of dollars by paying in rupees , it will actually reduce the supply of rupee in the economy, which is generally been accepted as a tool to counter inflation .

With the rupee continuing to depreciate, importers are feeling the pinch and have started delaying payments. While bigger companies said they were still protected , smaller players said they are under severe pressure and they want government to help them out.

This is a challenging period for RBI. If they increase the key rates, it will affect our growth rate and there will be stock market crash. If it is not, inflation will kill the economy. If the rupee depreciation continues, it will increase our trade deficit.

THE EFFECT: IT Industry

When a currency depreciates the first group of people who smiles is exporters because now they receive more in terms of their domestic currency . Let us take an example for this . Suppose, an Indian, exports some commodity to US for $10 at that time the exchange rate was say Rs45/dollar, the amount he will receive in rupees would be Rs450 .Now when rupee depreciates say to Rs50/ dollar this person will receive Rs 500.

Since Indian IT sector earns revenues mostly from outside , rupee depreciation is positive for IT sector at least in the given circumstances. According to an article in business standard published on sep 23, 2011 every one per cent change in rupee-dollar has a 40 basis points impact on the margins and, at least, 2 to 3.5 per cent on the net profit numbers of IT services firm. The impact of the depreciating rupee on the bottom line will vary for each company as it would largely also depend on the hedging positions taken by these firms. Analysts were of the opinion that companies like HCL Technologies and Infosys that hedge for a shorter duration and also have lesser hedged amount will see substantial gains. Whereas, Tata Consultancy Services and Wipro, which do that for a longer duration and have over $1 billion in hedges, might see a marginal negative impact. Though unlike 2008, IT firms might not see any forex losses this time.

THE EFFECT: Mutual Funds

Let us now move to a different but interesting fact , if you are an investor in mutual funds, do you know changes in exchange rate can have an impact on your fund net asset values (NAV)?

We will see how it works , If you invest in mutual funds (MFs) having exposure to international equities, chances are that a portion of their NAVs are being affected by the currency movement. This happens because you buy fund units in Indian rupees, but the international stocks that form part of the fund are bought in the local currency of the country. When you invest, your rupee is first converted to dollars and subsequently to the requisite currency of the country where the stock or fund units are bought. The opposite happens if you redeem.

For example if you invest in a fund wherein most of the stocks are of US , according to the above process first your money would be invested in rupees and then converted in dollars and the NAV is calculated in rupees . Now suppose rupee depreciates means you will receive more rupees per dollar . This will automatically get reflected in the NAV by an increase.

THE ADVERSE EFFECT

Now we will have a look at the sectors which are hit hard by rupee depreciation.

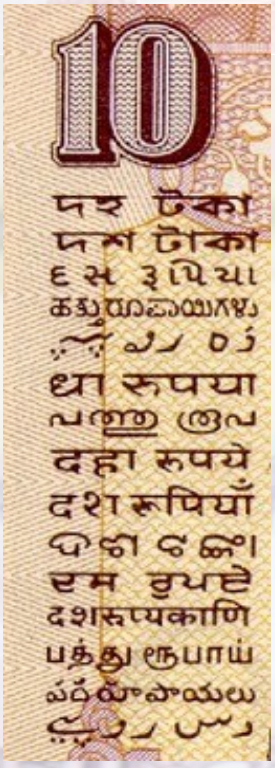
Major hit sectors are oil refineries, Power and steel which are dependent on import of coal. Because coal cost is the major input cost and any increase in cost would lead these companies to face tough times to maintain profitability. According to an article, among the worst hit are thermal power producers including JSW energy and state-run NTPC. A typical 1,000mw coal-fired plant presently requires about 6.2 million tonnes of domestic coal for operating at 85 per cent plant load factor or about 3.1 million tonne of imported coal. India is heavily depend on the import of raw materials and oil for its industrial development. In the decreasing rupee scenario, the outgo of money will be much higher. This would affect the expenses for the companies who imports raw materials for their factory and all the Oil Marketing Companies (OMC) will incur heavy payment to import the Oil. Now you would have understood why the Petrol prices have been increase in previous months.

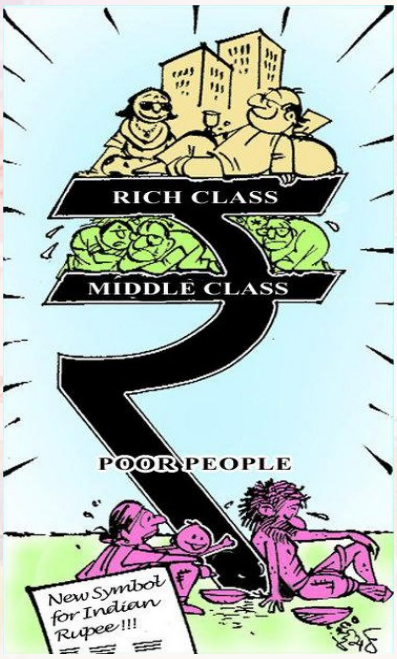
Similarly other imports will also be negatively affected by rupee depreciation.

WHO IS AFFECTED?

- Exporters
- BPO
- NRI
- Foreign Investors
- Common Man
- Indians Aspiring to Study in US
- Importers

FUN & INFO ZONE



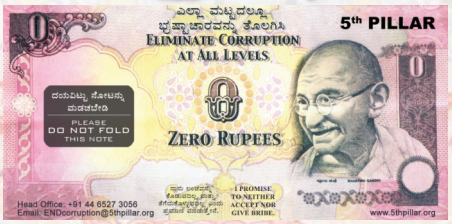


We all are familiar with out Rupee note , lets see how Indian Rupee Note looked in pre-independent India.

In French Territory Like Pondicherry

Under British

Some Interesting & Informative Facts

- Indian Currency notes are printed at the Currency Note Press, Nashik, Bank Note Press, Dewas, Bharatiya Note Mudra Nigam (P) Limited presses at Salboni and Mysore and at the Watermark Paper Manufacturing Mill, Hoshangabad.
- In September 2009, the Reserve Bank of India introduced polymer notes (polymer banknote) on a trial basis. Initially, 100 crore (1 billion) pieces of 10 denomination notes were introduced. The polymer notes have an average lifespan of 5 years (4 times the regular Indian bank notes) and are difficult to counterfeit. They are also cleaner than the regular notes.
- During 2010-11, as many as 13.9 billion pieces of soiled banknotes (21.4 per cent of banknotes in circulation) were processed and removed from circulation .
- India's Foreign Exchanges reserves was Rs. 13,61.013 Crores at the end of March 2011.
- At the end of March 2011, Total Values of Bank Notes in circulation was Rs. 9,35,856 Crores and total value of coins in circulation was Rs. 12,628 Crores.
- The Zero rupee note is not an official government issue but a symbol of protest and it is printed and distributed by an NGO (rtiindia) in India.
- 

QUIZ TIME

1 List five differences between a 10,50,100,500,1000 Rs note .

2 What is PIP? For which country PIP is measured differently ? How is it different?

Post correct entries and send us mail.

The winner's picture will be posted in the next edition.

Do you find any Economics concept difficult to understand?

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