Rupee Depreciation

Why in news?

The Indian rupee's exchange rate against the US dollar has breached the 85 mark.

What is exchange rate?

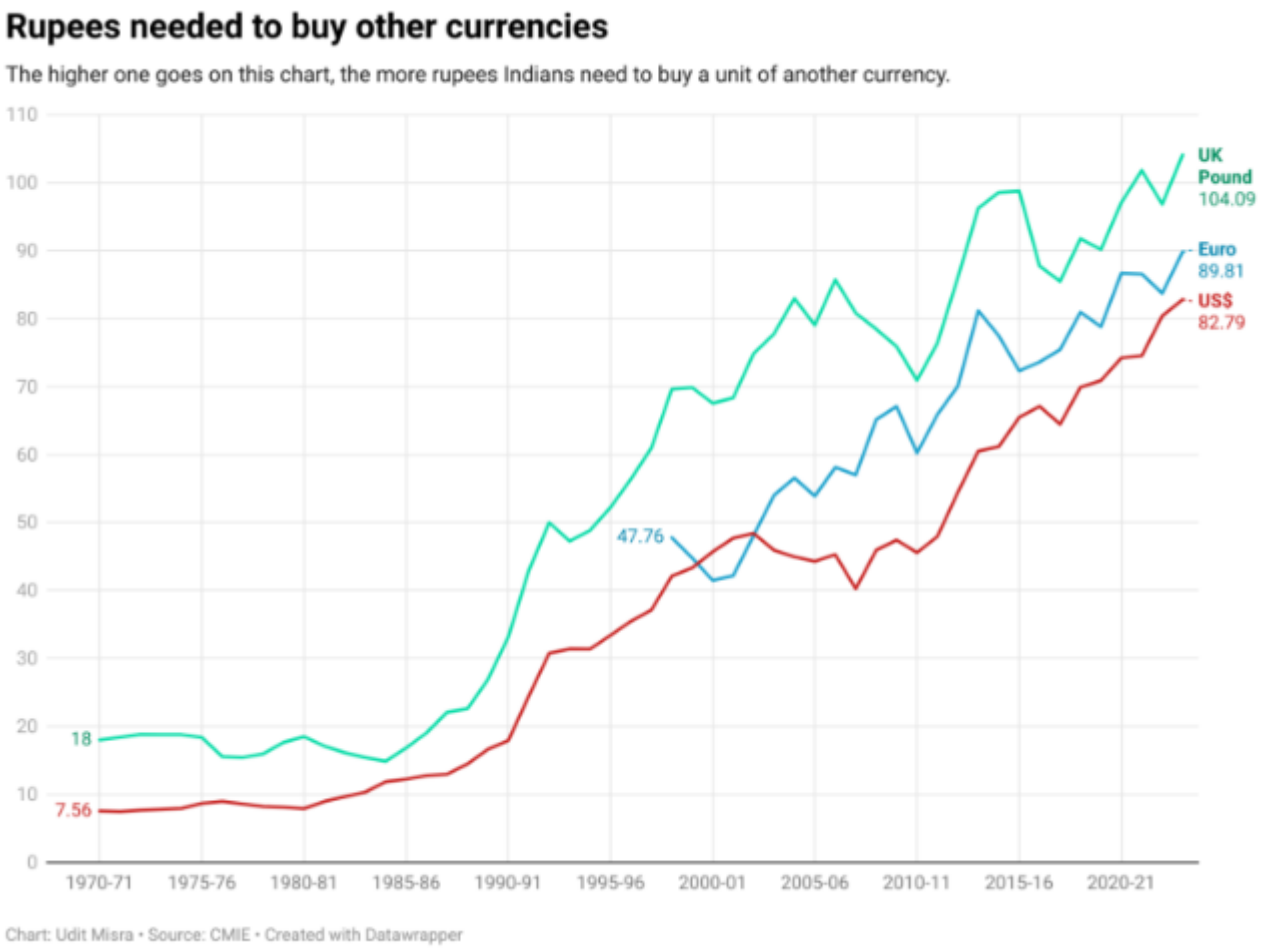
- **Exchange rate** - The value of currency relative to another currency and the number of units of one currency that exchanges for a unit of another.
- **Forex market** - A foreign exchange market is a market in which different currencies are bought and sold.
- Foreign exchange markets arise because various countries have different monetary systems and require different currencies to buy goods, services and financial assets.
- In this market, each currency is treated like a commodity itself.
- **Not a physical place**- Forex market is an electronically linked network of big banks, dealers and foreign exchange brokers who are all the time bringing buyers and sellers together.

The biggest FEM centre is London.

Society of Worldwide International Financial Telecommunications (SWIFT) is a satellite-based communications network to facilitate forex market messaging services.

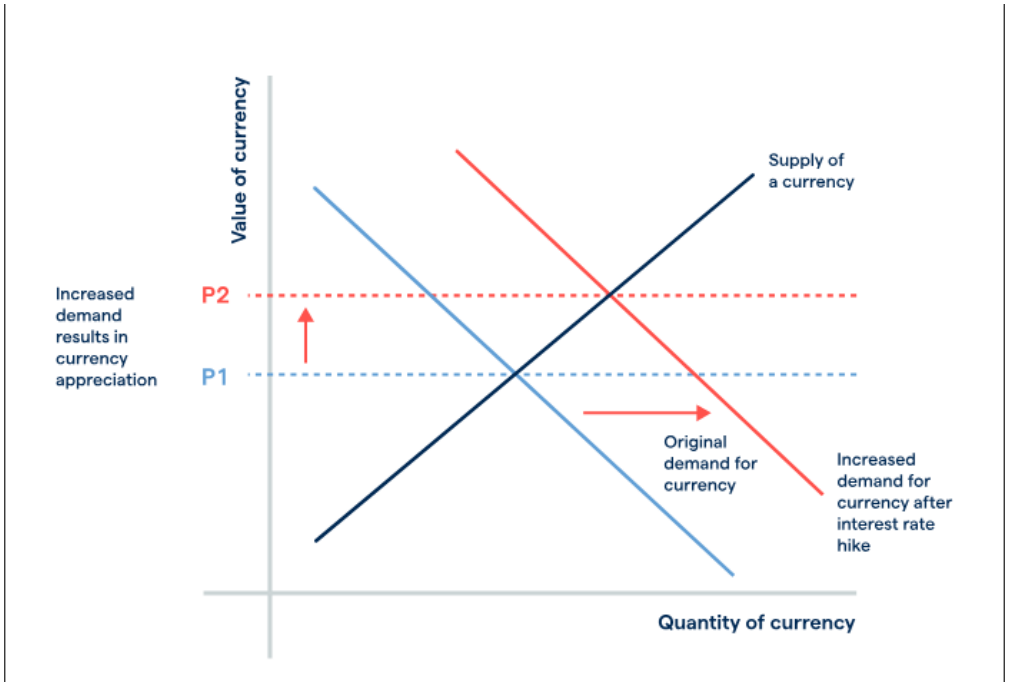
- **Appreciation -** A currency appreciates with respect to another when its value rises in terms of the other.
- **Depreciation** - A currency depreciates with respect to another when its value falls in terms of the other.
- **Exchange rate determinant** - The relative value of one currency against another depends on which is demanded more.
    - If Indians demand more US dollar than Americans demand the Indian rupee, the exchange rate will tilt in favour of the US dollar.

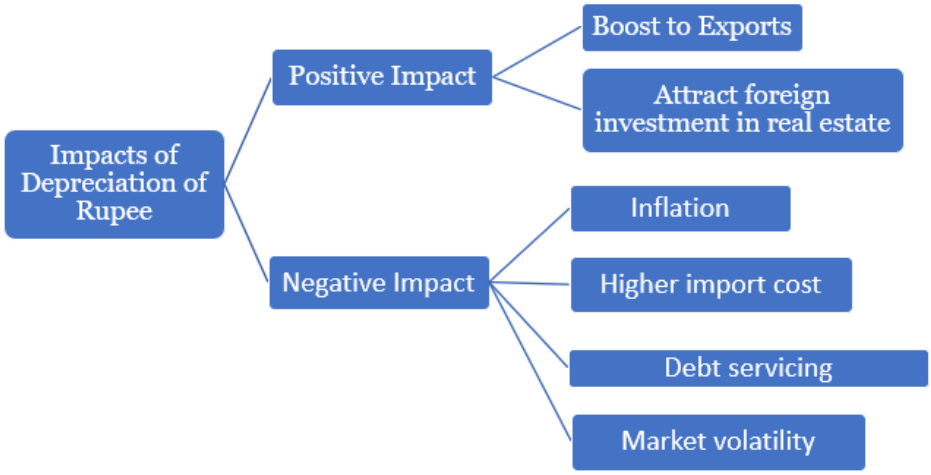
Foreign Exchange Dealers Association of India (FEDAI) was set up in 1958 as an Association of banks dealing in foreign exchange in India (typically called Authorised Dealers - ADs) as a self-regulatory body.



What factors determine the demand for rupee vis a vis dollar?

- **Trade of goods** - If India imports more goods from the US than what it exports to the US, then the demand for US dollar will outstrip the demand for Indian rupee.
- This, in turn, will make the US dollar gain strength against the rupee and its exchange rate versus the rupee will appreciate.
- **Trade in services** - If Indians buy more US services like tourism than Americans buy Indian services, then again, demand for dollar will outstrip the demand for rupee, and rupee will weaken.
- **Investments** - If Americans invest in India more than Indians invest in the US, then the demand for rupee will outstrip the dollar and rupee will appreciate against the dollar.
- **Global developments** – Conservative trade and protectionist measures of countries also affect trade and consequent currency demand.
- **Interest rate differences** - Higher interest rates tend to attract foreign investment, increasing the demand for and value of the home country's currency.
- **Inflation differences** – Higher inflation affects the real return value of investments made in domestic markets, thus discouraging investments.





What can be done to improve the Rupee value?

- Actively intervention by the RBI to curb the rupee's depreciation by selling dollars and conducting dollar/rupee swaps.
- Adjusting interest rates to control inflation and stabilize the currency.
- While the RBI's actions may provide short-term relief, it is vital that the government actively consider all measures, both fiscal and monetary, to bolster economic growth and stabilise the currency.
- Creating Policies to attract foreign direct investment (FDI) and portfolio investment.
- Long-term currency stability will depend on structural economic reforms and a return of favourable sentiment in the global markets.

Reference

[The Indian Express | Fall of Rupee]



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