THE VALUE DECEND OF INDIAN RUPEE

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Abstract: In the past, governments used to back their currencies with gold reserves or a foreign currency such as the US dollar that could be converted into gold on demand. The gold standard currency system was abandoned as there was not enough gold to issue money and currency valuations fluctuated with the supply and demand of gold. In the modern economy, governments print money based on their assessment of future economic growth and demand. The purchasing power of the currency remains constant if the increase in money supply is equal to the rise in gross domestic product and other factors influencing the currency remain unchanged.

A fantasy world where trees have banknotes and bear coins instead of fruits might sound like a dream come true. Economists will be the devil's messenger in that world when they break the news that your money is as good as dry leaves. If you are looking for a machine that can print money, just meet someone who actually owns one-the government. Money is printed by governments, but they cannot print all the money they need. When a government prints money to meet its needs without the economy growing at the same pace, the result can be catastrophic. Zimbabwe is a recent example.

The recent consistent drop in the value of rupee relative to dollar, has hit the vast middle class society and the B.P.L(Below poverty line) people with brute force. The buying power of consumer together with the consumer spending has declined highly when in comparison with the past years. (Oil hits 9-month high, above $115 a barrel on Iraq conflict, Indian today 6/20/14) With Oil prices going up, foreign reserves depleting, the balance of trade staged at a huge deficit, and with the euro crisis further adding more oil into the fire, our rupee value is steadily declining through the years.

The question is, are we aware of this fact and the consequences of further drop of our currency? If we are aware, what exactly is our central bank doing to prevent this and efficiently put a check to this dropping value.

Introduction: What is Money?: If you were all alone in the world or on an island by yourself, you wouldn't need money. You'd have to make do with what you could catch or grow for yourself. If there were others around, you could do what the Mayans did: barter. You could be a fisherman and trade some fish for shoes from a shoemaker. But what if that shoemaker hated fish and was a vegan? You'd have to find a grower of vegetables who wanted your fish and then trade those for the shoes.

Barter is simple, but it is not very efficient. It's far better to have something that everyone wants, something that all people can trade with. But what would that something be? Anthropologists, archeologists and historians have discovered that for most every group of people that have ever existed, what was chosen as money had at least five properties to it.

1. It had accepted value to everyone. That's obvious. But what is less obvious is that in all societies, what emerged as money was some commodity that was valued by people for itself first, before it became money.
2. It was durable. What's the use of money if it falls apart in a short time? It had to hold its value as long as possible. That's why lettuce has never been money, though in America during the 1930s, this word was used as slang for money since dollars were green, thin and "leafy".
3. It was easily divisible. It could be broken down into small pieces or amounts for small purchases.
4. Even when it was broken down into small pieces, however, it still had to be consistent in value and quality. One unit of it, gram, ounce or whatever, had to be the exact same as any other unit of the same weight or appearance. Otherwise, there would be chaos.
5. Finally, money had to be convenient to use.

Gold and Silver: Hundreds of commodities have been used as money, from seashells to paper. But time and time again, in civilizations far and wide, two things stand out: You rarely find a time or place where either gold or silver, or both, were not regarded as best having what it took to be money. In this way, the Mayans were the exception that proves the rule.

Take the above five attributes of money and both of these metals fit the bill. The paper we now use as money only developed as a convenient substitute for having to carry around lots of gold or silver. When they were first issued, it was clearly written on them that they entitled the bearer to be paid metals on demand. Paper money used in this way can indeed be valuable, but only as long as people have confidence in it, or in the ones who print it. On the other hand, no one today has confidence that the Byzantine Empire has any power at all, yet the gold coins minted by it so long ago still have real and increasing value.

Archeologists are almost monthly increasing our knowledge of past civilizations, but as of now it appears that the Greeks, about 800 years before Christ, developed the first money that has truly lasted. To be sure, the Babylonians came up with the idea of stamping bars of gold and silver with their weights and fineness, but as far as we know these were just the markings of the particular metals dealer or trader. Outside of the immediate community, these markings could not be trusted and certainly no government stood behind them.

A History of International Currencies: We owe the Greeks much. They have been called the clearest thinking of all people in history, and where money is concerned it is hard to argue with this. All of a sudden, they started minting coins that quickly became the first "international currency". Not only did they meet all the five attributes of money, but the money they made was often stunningly beautiful. Many coin experts concur that the most beautiful coin ever made was minted by Greeks in Syracuse (modern Sicily) in about 350 BC. The front, or obverse, is the head of Persephone surrounded by dolphins, and the reverse is a charioteer with Nike -- Winged Victory--- crowning his win. The very objects on this coin give an idea of the universality and timelessness of appeal of Greek money, and for the first time in recorded history money began to exert its fascination over the minds of men. Non-Greeks thousands of miles away treasured this money and Greek coins have been found in China, India and northern Europe. In fact, even though Rome soon rose to eclipse Greece, most Asians kept using Greek money for centuries. The main currency of Greece was the Athenian drachma. It was a silver coin, and its weight and quality stayed amazingly consistent through the centuries. From Solon, around 600 BC, to Alexander the Great, around 300 years later, it stayed exactly 67 grains of fine silver (there are 480 grains to one troy ounce, so the silver drachma was about .1375 of an ounce). This was the money Alexander brought to India, and from there it traded yet further east becoming the monetary standard of all Asia. And even as Greece declined and was finally absorbed into Rome, its value did not fall much. By the end of the 3 drachma's life, it had only declined to 65 grains of fine silver. This is an extraordinary achievement. No other civilization has ever had an international currency that stayed the same value ---or pretty much so, since a fall from 67 to 65 grains of silver is a loss of less than 3%. And this was not only during the period of its greatest influence, but even as it declined in power over a period of six centuries. Whatever the secret of the Greeks was, no international currency since then has ever been able to keep its value, even as the government issuing it started on its seemingly inevitable decline.

Certainly the conquering Romans were astounded at how the Greeks had mastered money. They paid Greece the ultimate monetary compliment by fashioning their own money, the Roman denarius, as an exact copy of the drachma right down to the size and weight.

Rupee vs. Dollar

The rupee was around 19 against the US dollar in 1991. Now, 20 years later, the rupee is around 53 against the dollar. This means the Indian currency has fallen, or depreciated, by 179 per cent over the years against the dollar. However, the rupee has not fared badly if its value against all major global currencies is taken. The real effective exchange rate (REER) — or the

REER Index of the rupee — calculated by the Reserve Bank of India (RBI) based on a basket of 36 global currencies (36-REER) was 94.2 on March 31, 2012. It was around 75.5 in 1991. This means, in real terms, the rupee has remained strong over the years. The 36-REER — with 2004-05 base as 100 — even rose by 4.7 per cent during the fourth quarter of 2011-12. However, for the full year it declined by 3.3 per cent after a rise of 8 per cent in 2010-11, the RBI says.

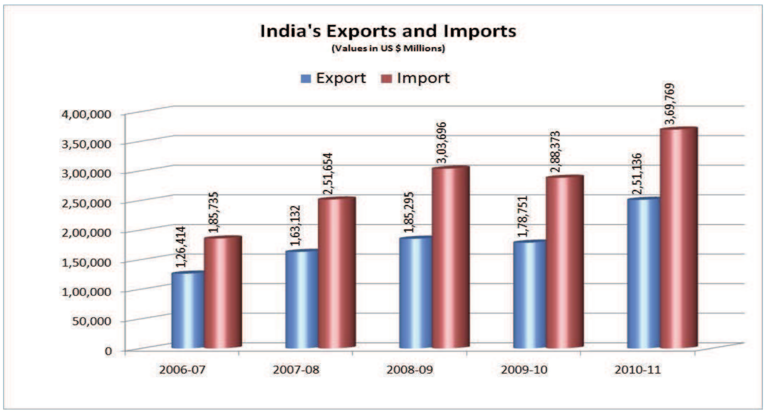
The 6- currency REER Index, which is at 105.5 has showed a rise of 4.2 per cent in the last quarter of 2011-12. It rose 13 per cent in 2010-11 but fell marginally by 2.9 per cent in last fiscal. The central bank has kept the 6-REER Index close to the 100 level to keep the exports competitive amidst huge capital flows and dollar purchases by the RBI.

The RBI takes the REER Index — adjusted for relative inflation in India and her trading partners — seriously while formulating its exchange rate policies. The rupee's value against the dollar alone is not the deciding factor. The rupee-dollar value is not considered as the real measure of export competitiveness as India exports goods and services to several countries — not just the US alone — and the economic indicators, including inflation and currency value in these countries, are different.

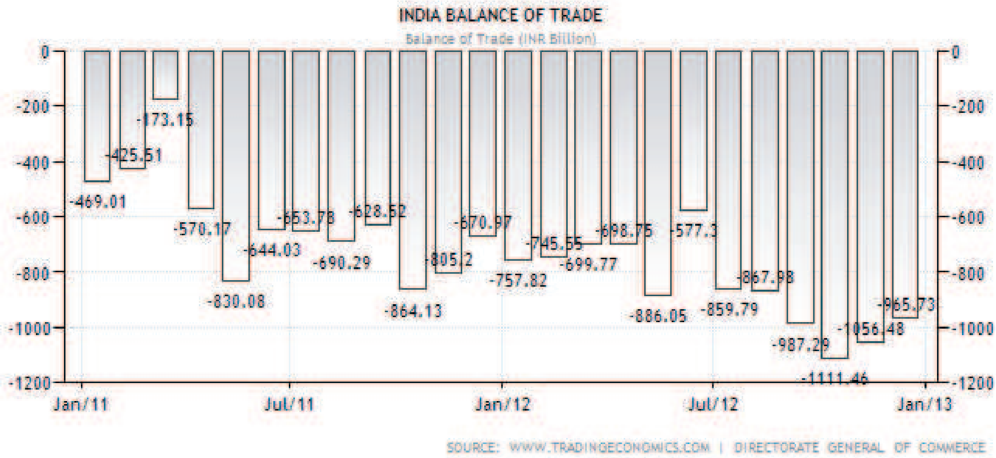
The Indian rupee is the best-performing Asian currency so far in 2013, up 3.1 per cent in January, posting its first monthly gain in the last four months. The strength has been on the back of the government's resolve for reforms and the recent interest rate cuts. The Indian government recently announced a slew of fiscal and economic reforms, like allowing the diesel price hike and imposing import duty on gold imports, to curb the increasing twin deficits. The Reserve Bank of India followed by lowering the repo rate by 25 bps, the first cut in the last nine months. The rate cut came along with accompanying statements that it would want to provide an appropriate interest rate environment to support growth. The market is also looking for the volume in dollar inflows from stake sales in Oil India and NTPC. Support for the rupee is also coming from the heavy dollar inflows in domestic equity and debt markets.FIIs' buying reached above $4 billion;Jan13

The threat from S&P last year of a cut in investment grade credit rating also seems distant as of now, increasing both domestic and foreign investors' confidence. The strength in euro, trading at 14 month highs, has also been providing strength to the Indian rupee. Euro ended the month of January up 3 per cent against the US dollar, while the JPY has declined 5 per cent in Jan vs the USD. However, economists are of the view that the most of the above-mentioned positives have been factored in the recent rupee rise for the near term. There still are a lot of concerns which would continue to weigh on the currency. While there is a jump in capital inflows with the current steps undertaken by the government, the issues of the trade and fiscal deficit are still far from sorted. Also, the diesel price hikes will mean a constantly increasing inflation which will restrict much of interest rate cuts needed currently to boost economic growth. The food price is another area adding to inflation.

Even as the euro is around 14-month high vs USD and the eurozone crisis seems to have stabilised, it is still a long time from getting into a positive recovery mode. The Q4 US GDP figures show a decline, pointing to uneven recovery and keeping gaps open for more such surprises. The over-dependency on foreign inflows is also seen as weighing on the rupee. Going ahead, the noises from the street indicate that the rupee may strengthen up to 53 per dollar and in a best case scenario, to 51.50 per dollar. A break of 55 per dollar on the higher side can take it to the record lows hit in 2012.



There is a relationship between a nation's imports and exports. A positive balance is known as a **trade surplus** if it consists of exporting more than is imported; a negative balance is referred to as a **trade deficit** or, informally, a trade gap. The Graph above represents that India has been going through serious trade deficits through the years 2006-11.



Balance of Trade

Balace of trade is the difference between monetaryvalue of exports and imports of output in an economy over a certain period.. The balance of trade is sometimes divided into a goods and a services balance.

The balance of trade forms part of the current account, which includes other transactions such as income from thenet international investment position as well as international aid. If the current account is in surplus, the country's net international asset position increases correspondingly. Equally, a deficit decreases the net international asset position.

The trade balance is identical to the difference between a country's output and its domestic demand (the difference between what goods a country produces and how many goods it buys from abroad; this does not include money re-spent on foreign stock, nor does it factor in the concept of importing goods to produce for the domestic market).

Factors that can affect the balance of trade include:

- The cost of production (land, labor, capital, taxes, incentives, etc.) in the exporting economy vis-à-vis those in the importing economy;
- The cost and availability of raw materials, intermediate goods and other inputs;
- Exchange rate movements;
- Multilateral, bilateral and unilateral taxes or restrictions on trade;
- Non-tariff barriers such as environmental, health or safety standards;
- The availability of adequate foreign exchange with which to pay for imports; and
- Prices of goods manufactured at home (influenced by the responsiveness of supply)

Indian exports cover a wide range of agricultural and industrial products as also various handicrafts, ready-made garments and leather manufacturers etc. Project exports which include consultancy, civil construction and turn-key projects have also made a significant progress in recent years. Recently electronic hardware and software exports have increased in a significant way mainly to the advanced countries. Imports have also increased substantially, bulk of which comprise items like petroleum products, fertilizers etc., precious stones for export production and capital goods, raw materials, consumables and intermediates for industrial and capital goods, raw materials, consumables and intermediates for industrial production and technological up gradation. Export-led growth is the current strategy of India's economic policy. Indian exports should acquire a high degree of competitiveness in the world markets. For this adequate supplies of exportable goods need to be assured besides the pursuance of sound fiscal and monetary policies. To push up exports, India needs a further diversification of foreign trade. Over 40% India's export have been concentrated among a few countries such as USA, Japan, UK and West Germany, while, over 60% of our imports are from 10 countries, including France, Hongkong, Singapore, Iraq, Iran and Saudi Arabia, which continue to be the largest market for our export accounting for over 30%. Trade statistics reveal that India depends more on developed countries for its major portion of exports as well as imports, and imports from developing countries do not grow at a significant rate. Further, while trading with developed countries, India's terms of trade are mostly unfavorable. Hence, India is rather a losing partner in its trade with developed countries. As such, larger trade with developed countries would mean more exploitation or resource drain and this cannot be an engine of growth.

Foreign Direct Investment (FDI): Foreign direct investment (FDI) is a direct investment into production or business in a country by a company in another country, either by buying a company in the target country or by expanding operations of an existing business in that country. Foreign direct investment is in contrast to portfolio investment which is a passive investment in the securities of another country such as stocks and bonds. Foreign direct investment has many forms. Broadly, foreign direct investment includes "mergers and acquisitions, building new facilities, reinvesting profits earned from overseas operations and intra company loans. In a narrow sense, foreign direct investment refers just to building new facilities. The numerical FDI figures based on varied definitions are not easily comparable.

As a part of the national accounts of a country, and in regard to the national income equation Y=C+I+G+(X-M), I is investment plus foreign investment, FDI is defined as the net inflows of investment (inflow minus outflow) to acquire a lasting management interest (10 percent or more of voting stock) in an enterprise operating in an economy other than that of the investor. FDI is the sum of equity capital, other long-term capital, and short-term capital as shown the balance of payments. FDI usually involves participation in management,joint-venture, transfer of technology and expertise. There are two types of FDI: inward and outward, resulting in a net FDI inflow (positive or negative) and "stock of foreign direct investment", which is the cumulative number for a given period. Direct investment excludes investment through purchase of shares. FDI is one example of international factor movements.

Types:

1. **Horizon FDI** arises when a firm duplicates its home country-based activities at the same value chain stage in a host country through FDI.
2. **Vertical FDI** takes place when a firm through FDI moves upstream or downstream in different value chains i.e., when firms perform value-adding activities stage by stage in a vertical fashion in a host country Horizontal FDI decreases international trade as the product of them is usually aimed at host country; the two other types generally act as a stimulus for it.

Methods: The foreign direct investor may acquire voting power of an enterprise in an economy through any of the following methods:

- by incorporating a wholly owned subsidiary or company anywhere
- by acquiring shares in an associated enterprise
- through a merger or an acquisition of an unrelated enterprise
- participating in an equity joint venture with another investor or enterprise

Foreign direct investment incentives may take the following forms:

- low corporate tax and individual income tax rates
- tax holidays
- other types of tax concessions
- preferential tariffs
- special economic zones
- EPZ – Export Processing Zones
- Bonded Warehouses
- Maquiladoras
- investment financial subsidies
- soft loan or loan guarantees
- free land or land subsidies
- relocation & expatriation
- infrastructure subsidies
- R&D support
- derogation from regulations (usually for very large projects)

Foreign direct investment in India: Foreign investment was introduced in 1991 as Foreign Exchange Management Act (FEMA), driven by minister Manmohan Singh. As Singh subsequently became a prime minister, this has been one of his top political problems, even in the current (2012) election. India disallowed overseas corporate bodies (OCB) to invest in India.

Starting from a baseline of less than $1 billion in 1990, a recent UNCTAD survey projected India as the second most important FDI destination (after China) for transnational corporations during 2010–2012. As per the data, the sectors that attracted higher inflows were services, telecommunication, construction activities and computer software and hardware. Mauritius, Singapore, US and UK were among the leading sources of FDI. Based on UNCTAD data FDI flows were $10.4 billion, a drop of 43% from the first half of the last year.

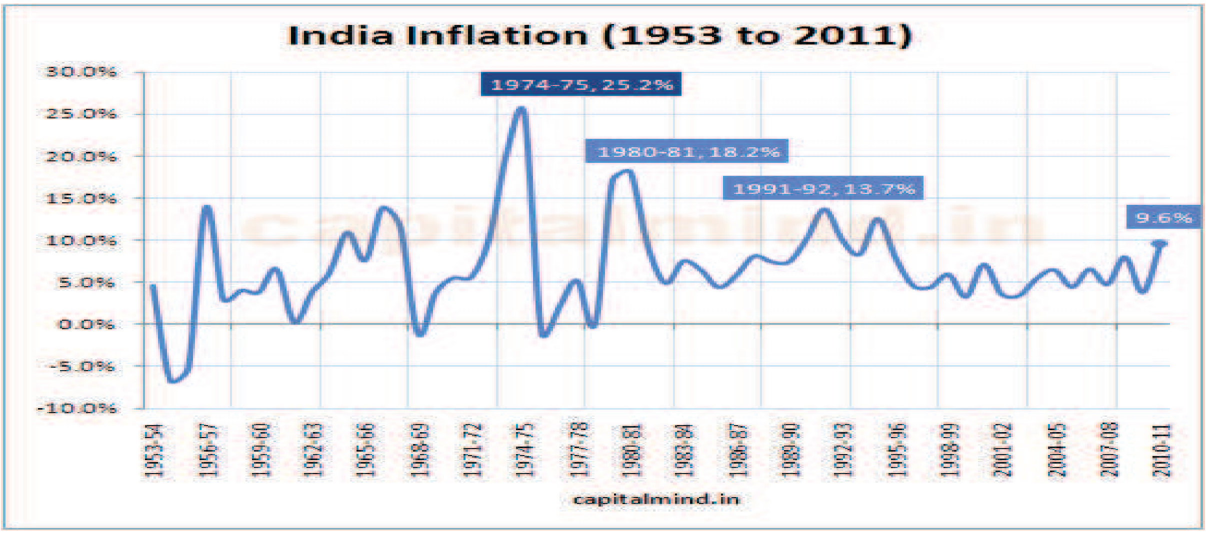
Foreign Institutional Investor: Institutional investors are organizations which pool large sums of money and invest those sums in securities, real property and other investment assets. They can also include operating companies which decide to invest their profits to some degree in these types of assets.

Types of typical investors include banks, insurance companies, retirement or pension funds, hedge funds, investment advisors and mutual funds. Their role in the economy is to act as highly specialized investors on behalf of others. For instance, an ordinary person will have a pension from his employer. The employer gives that person's pension contributions to a fund. The fund will buy shares in a company, or some other financial product.

Funds are useful because they will hold a broad portfolio of investments in many companies. This spreads risk, so if one company fails, it will be only a small part of the whole fund's investment.

Institutional investors will have a lot of influence in the management of corporations because they will be entitled to exercise the voting rights in a company. They can actively engage in corporate governance. Furthermore, because institutional investors have the freedom to buy and sell shares, they can play a large part in which companies stay solvent, and which go under. Influencing the conduct of listed companies, and providing them with capital are all part of the job of investment management.

Inflation: In economics, **inflation** is a rise in the general level of prices of goods and services in an economy over a period of time. When the general price level rises, each unit of currency buys fewer goods and services. Consequently, inflation also reflects an erosion in the purchasing power of money – a loss of real value in the internal medium of exchange and unit of account within the economy. A chief measure of price inflation is the inflation rate, the annualized percentage change in price.



Inflation's effect on an economy can be simultaneously positive and negative.Negative effects of inflation include an increase in the opportunity cost of holding money, uncertainty over future inflation which may discourage investment and savings, and if inflation is rapid enough, shortages of goods as consumers begin hoarding out of concern that prices will increase in the future. Positive effects include ensuring that central banks can adjust real interest rates (intended to mitigate recessions), and encouraging investment in non-monetary capital projects.

Inflationary-Pressure: Every generation complains about price rise. Prices shoot up when goods and services are scarce or money is in excess supply. If prices increase, it means the value of the currency has eroded and its purchasing power has fallen.

Let us say the central bank of a country increases money flow in the economy by 4 per cent while economic growth is 3 per cent. The difference causes inflation. If the growth in money supply is 10 per cent, inflation will surge because of the mismatch between economic growth and money supply. In such a scenario, loan repayments will be a lesser burden if interest rates are fixed, as you will pay the same amount but with a lower valuation.

A fall in purchasing power due to inflation reduces consumption, hurting industries. Imports also become costlier. Exporters, of course, earn more in terms of local currency.

However, if the increase in money supply lags economic growth, the economy will face deflation, or negative inflation. The purchasing power of money will increase when the economy enters the deflationary state. If you think deflation will help you consume more and enjoy life more, wrong.

Unless the fall in prices of goods is because of improved production efficiencies, you will have less money to spend. If you have a fixed-interest loan to repay, your debt will have a higher valuation. Yields from fixed-income investments made before deflation set in will, of course, increase in value.

Monetary Policy: Monetary policy is the process by which the monetary authority of a country controls the supply of money, often targeting a rate of interest for the purpose of promoting economic growth and stability. The official goals usually include relatively stable prices and low unemployment. Monetary theory provides insight into how to craft optimal monetary policy. It is referred to as either being expansionary or contractionary, where an expansionary policy increases the total supply of money in the economy more rapidly than usual, and contractionary policy expands the money supply more slowly than usual or even shrinks it. Expansionary policy is traditionally used to try to combat unemployment in a recession by lowering interest rates in the hope that easy credit will entice businesses into expanding. Contractionary policy is intended to slow inflation in order to avoid the resulting distortions and deterioration of asset values.

Fiscal Policy: Fiscal policy is the use of government revenue collection (taxation) and expenditure (spending) to influence the economy. The two main instruments of fiscal policy are government taxation and changes in the level and composition of taxation and government spending can affect the following variables in the economy:

- Aggregate demand and the level of economic activity;
- The pattern of resource allocation;
- The distribution of income.

Fiscal policy refers to the use of the government budget to influence economic activity.

Forex demand: Though international trade and movement of people is increasing rapidly, there is no currency that is acceptable across the globe. Whether you go for higher studies to the US or fly to Rio for a vacation, you have to pay for services and goods in the currency that is accepted in the country. Even while shopping online on stores run by foreign companies, you have to pay in foreign exchange. The foreign exchange rate for conversion of currencies depends on the market scenario and the exchange rate being followed by the countries. Floating exchange rates, or flexible exchange rates, are determined by market forces without active intervention of central governments. For instance, due to heavy imports, the supply of the rupee may go up and its value fall. In contrast, when exports increase and dollar inflow increases;rupee strengthens.

Earlier, most countries had fixed exchange rates. This system has been abandoned by most countries due to risk of devaluation of currencies owing to active government intervention. Most countries now adopt a mixed system of exchange rates where central banks intervene in the market to buy or sell the different currencies to control the movement of their own currencies.

Not everyone loses in a weak currency scenario. Exporters across the 17-country euro zone, for instance, are benefiting from a weak local currency. Sometimes countries use various ways to keep their currencies undervalued to promote exports. Chinese Renminbi is one such currency that several economists say is undervalued.

Behind the fall: Now that we know the factors that determine the value of a currency, how does the rupee in your bank account and purse stand at present? Over the past few months, since August, the rupee has been weakening against the dollar.

"The recent fall in the rupee was mainly due to conditions in the euro zone, plunging stock markets, falling foreign investment inflows and strengthening of the dollar," says Brahmbhatt of Alpari. "Rising fiscal deficit and untamable inflation were behind the fall in the rupee. As India runs a large current account deficit, it needs a constant inflow of dollars, which was not there. High oil prices inflated the import bill and resulted in further widening of the current account deficit, which accelerated the rupee fall," says Narne of AnandRathi. "The decision by the government to allow foreign investors to directly invest in Indian equity could bring some capital flows and have a positive impact on the economy and the rupee," adds Narne.

Impact of rupee's depreciation:

Primarily the consequences of weak rupee are to be felt through:

A. Increase in the Import Bill

A depreciation of the local currency results in higher import costs for the country. Failure of a similar rise being experienced in the prices of exportable commodities is going to result in a widening of current account deficit of the country.

B. Higher Inflation

Increase in import prices of essential commodities such as crude oil, fertilizer, pulses, edible oils, coal and other industrial raw materials are bound to increase the prices of the final goods. Thereby making it costlier for the consumers and hence inflation might be pushed up further.

C. Fiscal Slippage

The central government fiscal burden might increase as the hike in the prices of imported crude oil and fertilizer might warrant for a higher subsidy provision to be made for these commodities.

D. Increase in Cost of Borrowings

Interest rate differentials in domestic and global markets encourage the industry to
raise money through foreign markets however a fall in the rupee value would negate the benefits of doing so.

- Import Bill of the Country
- Import of Key Commodities
- Crude Oil
- Thermal Coal
- Fertilizer
- Vegetable Oil

Benefits of Rupee Depreciation:

For Exporters: Exporters are perhaps the biggest beneficiaries of the Rupee depreciation as every dollar of their sale fetches them more Rupees. Hence if they don't reduce their prices, with the same quantity of sales, they earn more in terms of Indian Rupees.

If they intend to capture market share, depreciating rupee gives them an opportunity to reduce the price of their products in dollar terms and still making the same amount of profits in Rupee terms. This makes their products more competitive in international markets and helps in selling more volume of products due to cheaper prices in dollar terms. For example, the cost of producing a product is Rs. 5000. When the Dollar was quoting 45 Rs., the dollar cost of producing this item was $111. The exporter wanted to make 50% margin and hence he priced his products at $166 or Rs. 7666 (at 45 level). At this level he is making a margin of Rs. 2666. When Dollar is now quoting at 56 Rs, the exporter is now getting Rs. 9296 for the same product which is priced at $166. If the exporter wants, he can now reduce his product prices in international markets to $136 without loosing his margin of Rs. 2666. With the reduced product prices, he would become more competitive in international markets and gain more customers / buyers.

NRIs become richer: Believe it or not, where ever NRIs are, most of them count their net worth in Rupee terms and find depreciating Rupee to their advantage. For example, a NRI earning 100,000 dollars, when converts his earning in Indian Rupees would be earning equivalent of Rs. 56,00,000 (when USD is Rs. 56) compared to Rs. 45,00,000 (when USD was Rs. 46). This adds additional Rs. 11, 00,000 to their kitty due to currency movements. Depreciating Rupee hence gives NRIs a big incentive to remit more funds into India for investment purposes, adding to India's forex reserves.

Tourism industry: With a depreciating rupee, holidays in India become cheaper. Take for example, a holiday package in Kerala backwaters costs around Rs. 200,000 for 10 days stay. When Dollar was quoting Rs. 45, this holiday would cost around $4400. With Dollar quoting at Rs. 56, the same holiday package would cost $3500, a whopping $900 cheaper ! This promotes foreigners to visit India as India becomes an attractive Tourism spot owing to its financial competitiveness.

The Changing face: Money is not an organic creature but its value keeps changing with the society and its economic conditions. One rupee in 1947 is not the same as one rupee today, both in terms of appearance and purchasing power.
The value of a country's currency is linked with its economic conditions and policies. "The value of a currency depends on factors that affect the economy such as imports and exports, inflation, employment, interest rates, growth rate, trade deficit, performance of equity markets, foreign exchange reserves, macroeconomic policies, foreign investment inflows, banking capital, commodity prices and geopolitical conditions," says Pramit Brahmbhatt, chief executive officer, Alpari Financial Services (India), a foreign exchange brokerage.Income levels influence currencies through consumer spending. When incomes increase, people spend more. Higher demand for imported goods increases demand for foreign currencies and, thus, weakens the local currency.

"A country that sells more goods and services in overseas markets than it buys from them has a trade surplus. This means more foreign currency comes into the country than what is paid for imports. This strengthens the local currency," says Kishore Narne, head, commodity and currency research, AnandRathi Commodities, a brokerage house. Another factor is the difference in interest rates between countries. Let us consider the recent RBI move to deregulate interest rates on savings deposits and fixed deposits held by non-resident Indians (NRIs). The move was part of a series of steps to stem the fall in the rupee. By allowing banks to increase rates on NRI rupee accounts and bring them on a par with domestic term deposit rates, the RBI expects fund inflows from NRIs, triggering a rise in demand for rupees and an increase in the value of the local currency.

The RBI manages the value of the rupee with several tools, which involve controlling its supply in the market and, thus, making it cheap or expensive.

"Some ways through which the RBI controls the movement of the rupee are changes in interest rates, relaxation or tightening of rules for fund flows, tweaking the cash reserve ratio (the proportion of money banks have to keep with the central bank) and selling or buying dollars in the open market," says Brahm bhatt of Alpari.

The RBI also fixes the statutory liquidity ratio, that is, the proportion of money banks have to invest in government bonds, and the repo rate, at which it lends to banks.

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