Inflation Impact on Indian Rupees

GEETHA GOPALKRISHNA

Guest Faculty, Department of Commerce, Krishna Tunga Campus, Raichur University, Raichur, Karnataka, India

***Abstract*— Stability in the external value of the national currency is essential for the undisruptive international transactions as volatility in it affect the cost, profit and return on international financial investment drastically which may jeopardize the overall performance of the economy. The paper tries to explain the developments in some of the variables of the Indian economy and their possible linkage with the movements in the exchange rate of Indian rupee. The study concludes that as the growth in GDP, inflation, money supply, current account balance may influence the long-term movements in the exchange rate, India must have strong macroeconomic fundamentals to sustain the growth momentum.**

***Index Terms*- Inflation and Currency Value, Devaluing Indian Rupee**

I. INTRODUCTION

Inflation is a universal phenomenon in present day times. There is hardly any country in the world which has not been severely affected by the scope of inflation. *Crowther* has defined inflation as a "state in which the value of money is falling i.e, the prices are rising. *Brooman* defines inflation as a "continuing increase in the general price level".

Stability in the exchange rate is required for the risk-free international transactions and smooth functioning of an economy. Exchange rate volatility can drastically affect the cost, profit and return on international financial investment that may jeopardize the performance of the economy as whole. Indian rupee has been witnessing a downward pressure against the major currencies of the world over the years. In the current system of floating exchange rate the demand and supply forces have caused depreciation of the rupee significantly over the years. The depreciation has become of alarming proportion in the recent past. Explanations on the rupee turmoil have been given from different angles. Some arguments are made considering the economic activities and policies of the foreign countries like USA. Problems, however, are noticed in the domestic sector of India as well. This study tries to explain the developments in some of the macroeconomic variables of the Indian economy and their possible linkage with the movements in the exchange rate of Indian rupee.

- External Value of The Indian Rupee

External value of the Indian currency, i.e. the exchange rate, against the major currencies of the world like US dollar, pound sterling, Japanese Yen has registered an increase over the years. The Table-1 shows that the exchange rate has increased, that is rupee has depreciated, during the period 1965-66 to 2013 dramatically. In 1965-66 Indians could purchase one US dollar paying 4.76 of their home currency. But in the beginning of the last month of 2013 it required 62.33 one can be obtained only by paying 102.18. Similar is the case with Japanese Yen. During the period 1965-66 to 2013 rupee has depreciated by more than 13 times against dollar, 7.66 times against pound sterling and 46 times against yen. Just as no individual is self-sufficient, no country in the world is self-sufficient either. Differences in the climatic and geographic conditions, presence of natural resources, presence of human skills, etc. make mutual dependence an inevitable condition for all the countries in the world. Therefore, countries import (buy) what they lack and export (sell) what they have in excess. The dominance of export over import—usually referred to as a favourable balance of trade—is regarded as the hallmark of the strength of an economy. Export of goods and services is not as simple as selling them in the domestic market. As export involves movement of goods and services across boundaries and use of foreign currencies, a number of formalities need to be taken into account before the goods and services can leave the border of a country.

- Causes of Inflation

Inflation refers to a rise in prices that causes the purchasing power of a nation to fall. Inflation is a normal economic development as long as the annual percentage remains low; once the percentage rises over a pre-determined level, it is considered an inflation crisis. There are many causes for inflation, depending on a number of factors.

- Excess printing of money

Inflation can happen when governments print an excess of money to deal with a crisis. As a result, prices end up rising at an extremely high speed to keep up with the currency surplus. This is called the demand-pull, in which prices are forced upwards because of a high demand.

- Rise in production costs

Another common cause of inflation is a rise in production costs, which leads to an increase in the price of the final product. For example, if raw materials increase in price, this leads to the cost of production increasing, this in turn leads to the company increasing prices to maintain steady profits. Rising labor costs can also lead to inflation. As workers demand wage increases, companies usually chose to pass on those costs to their customers.

- International lending and national debts

Inflation can also be caused by international lending and national debts. As nations borrow money, they have to deal with interests, which in the end cause prices to rise as a way of keeping up with their debts. A deep drop of the exchange rate can also result in inflation, as governments will have to deal with differences in import/export level.

- Rise in tax and duties

Finally, inflation can be caused by federal taxes put on consumer products such as cigarettes or fuel. As the taxes rise, suppliers often pass on the burden to the consumer; the catch, however, is that once prices have increased, they rarely go back, even if the taxes are later reduced. Wars are often cause for inflation, as governments must both recoup the money spent and repay the funds borrowed from the central bank. War often affects everything from international trading to labor costs to product demand, so in the end it always produces a rise in prices.

- Effect of Inflation

As we know Inflation is the increase in the price of general goods and service. Thus, food, commodities and other services become expensive for consumption. Inflation can cause both short-term and long-term damages to the economy; most importantly it causes slow down in the economy.

1. People start consuming or buying less of these goods and services as their income is limited. This leads to slowdown not only in consumption but also production. This is because manufactures will produce fewer goods due to high costs and anticipated lower demand.
2. Banks will increase interest rates as inflation increases otherwise real interest rate will be negative. (Real interest =Nominal interest rate – inflation). This makes borrowing costly for both consumers and corporate. Thus people will buy fewer automobiles, houses and other goods. Industries will not borrow money from banks to invest in capacity expansion because borrowing rates are high.
3. Higher interest rates lead to slowdown in the economy. This leads to increase in unemployment because companies start focusing on cost cutting and reduces hiring. Remember Jet Airways lay off over 1000 employees to save cost.
4. Rising inflation can prompt trade unions to demand higher wages, to keep up with consumer prices. Rising wages in turn can help fuel inflation.
5. Inflation affects the productivity of companies. They add inefficiencies in the market, and make it difficult for companies to budget or plan long-term. Inflation can act as a drag on productivity as companies are forced to shift resources away from products and services in order to focus on profit and losses from currency inflation.

II. OBJECTIVE OF THE STUDY

The main objective of the study is to analyse the impact of inflation in Indian economy with respect to growth rate from the year 1999 to 2011.

III. METHODOLOGY

The study is based on secondary data. Inflation and growth rate is collected from World Economic Outlook for the period of thirteen years.

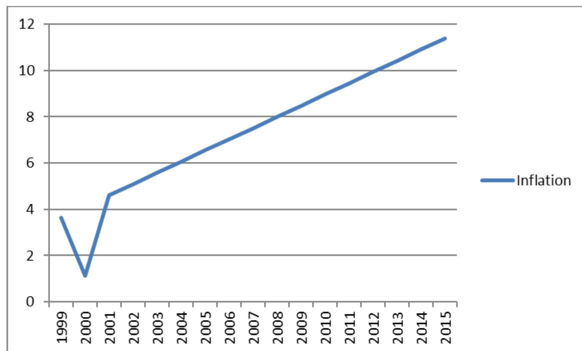
Tools Used
Karl Pearson's Correlation Coefficient is used to study the relationship between inflation and growth.

Table 1: Karl Pearson's Correlation

Year	Inflation	Growth
1999	6.7	7.24
2000	5.4	5.83
2001	3.77	3.89
2002	5.4	4.56
2003	3.8	6.85
2004	4.2	7.59
2005	4.2	9.03
2006	5.3	9.53
2007	6.4	9.99
2008	8.3	6.19
2009	10.9	6.77
2010	11.7	10.09
2011	8.9	7.8

r = 0.302

According to the table Correlation between Inflation and growth is 0.302. There are number of factors that affect the economic growth, inflation is one among them. A single factor affects the growth upto 0.3 shows a strong impact of inflation on economy.



The Graph shows that the inflation and growth is always fluctuating in India. There is no steady growth in Indian economy whereas trend value predicted for both inflation and growth is in straight lines showing a steady growth which could be accepted for growth but has to be curbed for inflation

CONCLUSION

Indeed, compared with a fragile world economy, India on autopilot could chug along quite happily, growing faster than most other countries. The government would carry on acting like a tinkering housekeeper with a habit of pinching loose change. Plenty of new firms would still triumph despite the red tape and most people would be better off. There would be fewer roads and more poor people than there might otherwise be, but the opportunity cost of the forfeited reforms would be a subject confined to scholarly debate. All that would still be a vast improvement on how things once were. Yet it would be a curious finale for the politicians and officials now in power who pushed through the reforms of 1991. Twenty years ago they said the yardstick against which India should be measured was its potential. On that measure, there is much to do.

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