Rupee touches 57 a dollar; FM steps in to calm nerves

Rupee hits record low, makes it difficult for RBI to cut rate

Rupee depreciation pushes Indian apparel exporters' margins by 5-7%

IT cos set to get a rupee depreciation boost in Q1

Newspapers were full of news, analysis and comments last week on the sliding rupee against USD, its impact on various sectors and possible moves by government and the RBI in this backdrop.

Few interesting questions that might have confronted you are:

- What makes a currency appreciate/depreciate against another currency?
- Why a particular movement is good/bad for different sectors?
- What is the role of the central bank in such a situation?

We’ll try to answer them one by one below:

What makes a currency appreciate/depreciate against another currency?

Currency movements in the short term are simply a function of demand and supply.

- If demand of rupee against USD increases, rupee appreciates.
- Similarly, if demand of USD against rupee increases, rupee depreciates.

For example a country with huge imports, will need more foreign currency to pay for the same, leading to appreciation in foreign currency (and depreciation in home currency). This is the situation in India today, given the gold imports resulting in a swelling current account deficit.

Analyst also attribute the recent fall in rupee to capital account outflows, with FIIs pulling money out of Indian debt markets. FIIs have withdrawn USD 2.7 billion from the Indian debt market since the end of May.

Why a particular movement is good/bad for different sectors?

Sectors having foreign exchange receivables (IT companies, exporters) will benefit with the appreciation in foreign currency/depreciation in home currency.
Sectors exposed to forex payables (oil & gas, gems & jewellery) will benefit from the depreciation in foreign currency/appreciation in home currency.

**What is the role of central bank in such a situation?**

RBI governor recently said, “RBI is not targeting any specific exchange rate or exchange band’. That’s true for all central banks across the world.

Central Banks don’t intervene till there is a threat to macro-economic stability via excessive volatility.

In such cases a central bank might stabilize exchange rate through:

- Buying/selling foreign currency
- Increase/decrease the foreign investment limits
- Staggering/expediting the import payments

Hope this helps.