

# Impact of Currency Devaluation on Indian Economy and Stock Markets

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## ABSTRACT

Fluctuations in currency of a particular nation are a natural outcome of the present system of economy because of existence of floating exchange rate system. The exchange rate of one currency versus the other is influenced by numerous fundamental and technical factors. These include relative supply and demand of the two currencies, economic performance, outlook for inflation, interest rate differentials, capital flows, technical support and resistance levels, and so on. But in recent days fluctuations are taking in the form of devaluation of currencies which may result in reducing the country's exports expenditure for foreigners, whereas, foreign products are relatively more expensive for domestic consumers as well as discourage the imports. Further the devaluation of currency will improve the trade competitiveness and decrease the trade deficit. Government may use this strategy to boost the aggregate demand in the economy and decrease the unemployment. An effective devaluation of currency may raise the world demand for its exports and reduce a nation's imports. It cause to increase in the inflow of foreign currency and it may help to become stronger on overall balance of payments account.

The present study assesses the impact of Yuan (CNY) depreciation on the various facets of the Indian economy like general commodity prices, exports of various essential commodities, impact on other major industries like steel, textile, cement, pharmaceuticals etc. The present paper highlights the impact of devaluation of Chinese currency on Indian stock market in specific. The article also focuses on the measures initiated by the government of India in this direction. Finally the researcher suggested some suggestions for overcoming the present burning problem.

**Key Words:** Devaluation of currency, Trade deficit, Global economy, Balance of Payments, Exports, Unemployment, Rupee Depreciation

## Introduction

Devaluation means decreasing the value of nation's currency relative to other countries currencies or gold. Many Eastern countries faced serious economic crises due devaluation of major countries currencies. It begins in Thailand when some foreign industries removed their funds. China is the second largest trading partner of India. While the devaluation encourages China boosting its exports, it can directly have an impact on the economics competing with it

(China). UN and UK also got affected, but they immediately started recovering. The Rupee sensitivity which was highly volatile forces the Reserve Bank to hold on high interest rates, which is the barrier for economic recovery. India runs on trade deficit, which increases in further days. This causes the pressure on exporting the Indian goods. There is also a fear of getting Chinese goods dumping in the Indian market. This shows impact on domestic manufactures.

Due to devaluation of Yuan the market participants' reaction was very strong and erratic. As well as linkage to the Dollar, Yuan had strengthened over the past year, including many of East Asian currencies like Korea, Taiwan and Thailand, which are China's most important export market. A 4 per cent depreciation of the Yuan Vs Dollar causes most declines and intervention is described as minimal effort on stabilizing exports. Slowing the Chinese economy means lowering the price of commodity globally which gives negative impact on domestic commodity producers. This effect causes overall inflation levels to come down

### **Impact on Indian economy**

China is the second largest economy in the World. It has been trading with most of the nations in the World. China's role in the global economy has increased significantly. According to World Development Indicators data base, World Bank, 17<sup>th</sup> February 2016 China stood first rank (2014) with 18,017,073 millions of international dollars where as India stood third rank (2014) with 7,384,099 millions of international dollars. China's share of world GDP was over 10 per cent in 2014. In exports, its share is over 15 per cent and in imports is over 11 per cent. China has accounts for close to half of the global consumption of copper, aluminum, steel and more than 10 per cent of crude oil. With this backdrop, if China devalued its currency significantly that shows the impact on world in general and especially on India. Europeans are not buying enough stuff form Chinese market. So to compensate this lose China is seeking for some other market, swallowing Indian profits.

Imports from China had rose to \$60 billion in 2014-15 compare with past year, and our exports with neighboring countries had plunged to \$12 billion leading to huge trade gap between India and China. The S&P BSE Dollex 30 had declined to 11.9 per cent which brings Rs 3 low.

Rising of the dollar demand including India will leads to down fall of Rupee. Indian rupee records 2 year low, this force RBI to hold higher interest rate for economic recovery. Exports are facing ground due to global slowdown. Industries like chemical, textile may badly effect due to low Chinese exports and metal industry, consumables, ecommerce industry got boosted due to domestic productivity and cheaper imported components from China. Industrial and commodity multinationals face the difficulty of lowering the prices due to the weaker consumption, to stem the profit slide.

### **Need for the Study**

Serious efforts of China central government and central bank economic slowdown was postponed from several years. Of late, China's steel factories have enormously decreased their production and its government spending has been increased. It results that there is a mismatch between revenue and expenditure. So it started borrowed spending. This led to public debt grew from 35 per cent of GDP to 45 per cent. To recoup the debt, it couldn't

raise its taxes. With this effect, it leads to decrease in China's economy growth. Due to this economy China had improved exports and investments and had devalued its currency value. But it is very difficult to gauge the consequences of devaluation of money on Indian economy.

### Objectives of the study

Keeping in view of above mentioned facts and figures, the following are the objectives of the study:

- To know the consequences of devaluation of currency
- To analyze impact of devaluation of currency on Indian economy.
- To study the impact of devaluation of currency on Indian commodity industries.
- To examine pressures on exports.
- To offer suitable suggestions.

### Methodology of the study

The study undertakes to recognize the objectives by employing a well-structured and more appropriate methodology.

### Data Collection:

The study is based on the secondary data available from various sources. The data are sourced from different text books, journals, news papers, and various websites.

### Impact of Yuan Devaluation on Indian Stock Markets

Table No.1 Changes in China currency, BSE and NSE

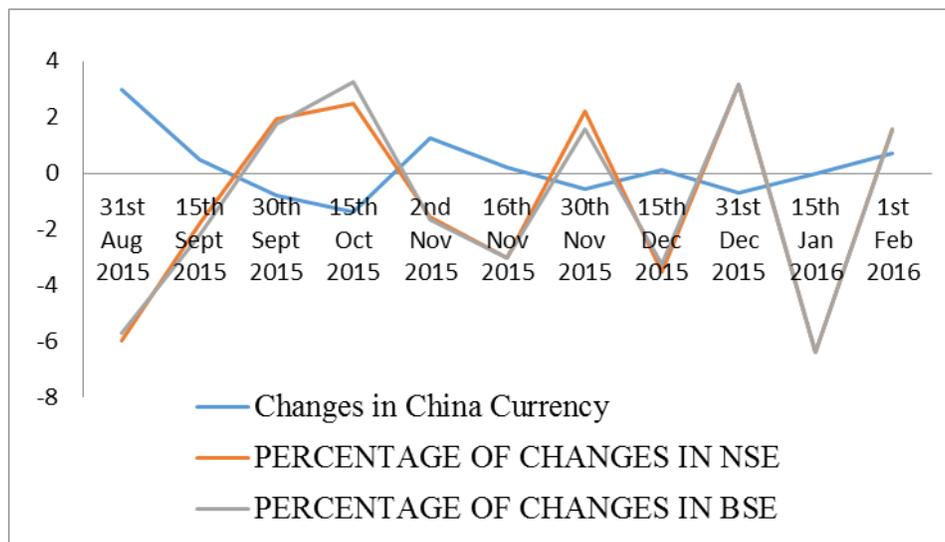
| Date           | Chinese Yuan to<br>Indian Rupee<br>(1CYN = Rs) | NSE points | BSE points |
|----------------|--|------------|------------|
| 1st Aug 2015   | 10.05  | 8477.3     | 27878.21   |
| 31st Aug 2015  | 10.35  | 7971.3     | 26283.09   |
| 15th Sept 2015 | 10.4   | 7829.1     | 25705.93   |
| 30th Sept 2015 | 10.32  | 7980.35    | 26154.83   |
| 15th Oct 2015  | 10.18  | 8179.5     | 27010.14   |
| 2nd Nov 2015   | 10.31  | 8050.8     | 26559.15   |
| 16th Nov 2015  | 10.33  | 7806.6     | 25760.1    |
| 30th Nov 2015  | 10.27  | 7980.1     | 26169.41   |
| 15th Dec 2015  | 10.28  | 7700.9     | 25320.44   |
| 31st Dec 2015  | 10.21  | 7946.35    | 26117.54   |
| 15th Jan 2016  | 10.21  | 7437.8     | 24455.04   |
| 1st Feb 2016   | 10.28  | 7555.95    | 24824.83   |

Source: nseindia.com

Table No.2 Percentage of changes in China currency, BSE and NSE

| Date           | Changes in China Currency | Percentage of Changes In NSE | Percentage Of Changes In BSE |
|----------------|---------------------------|------------------------------|------------------------------|
| 31st Aug 2015  | 2.99                      | -5.97                        | -5.72                        |
| 15th Sept 2015 | 0.48                      | -1.78                        | -2.2                         |
| 30th Sept 2015 | -0.77                     | 1.93                         | 1.75                         |
| 15th Oct 2015  | -1.36                     | 2.5                          | 3.27                         |
| 2nd Nov 2015   | 1.28                      | -1.57                        | -1.67                        |
| 16th Nov 2015  | 0.19                      | -3.03                        | -3.01                        |
| 30th Nov 2015  | -0.58                     | 2.22                         | 1.59                         |
| 15th Dec 2015  | 0.1                       | -3.5                         | -3.24                        |
| 31st Dec 2015  | -0.68                     | 3.19                         | 3.15                         |
| 15th Jan 2016  | 0                         | -6.4                         | -6.37                        |
| 1st Feb 2016   | 0.69                      | 1.59                         | 1.51                         |

Source: nseindia.com



In order to study the impact of China currency (Yuan) devaluation on Indian stock markets in particular and Indian economy in general, the relevant data has been gathered and presented in above table. The table shows that, Changes in Chinese currency for the period six months i.e, August 31, 2015 to February 1, 2015 and percentage change in NSE and percentage change in BSE are also taken for the same period. The analysis of the data presented in the above table shows that, the Chinese currency has been devaluated between 2.99 to 0.69

within the six month period. In four times it has shown a negative trend also. Similarly during the same period both BSE and NSE was also showing a fluctuating and declining trend. But one interesting fact is that, whenever the Yuan shows negative trends, the Indian stock markets were showing positive trends. Whenever Yuan shows an increasing trend, the Indian stock markets show a declining trend. Only in few cases both Yuan and Indian stock markets were moving in a similar direction but in rare situations.

The impact of these changes in various sectors can be viewed in two ways ie, short term and long term. The short term impact may be negative in some noncore sectors like automobiles, pharmaceuticals, textile and capital goods because of changes in terms of trade. However, in the long run there will not be much impact on our Indian economy and other related sectors, because things will automatically balance and the governments try to interfere to change the situation. If the Yuan continues to decline its value, then it might create pressure to India and governments may provide relief to the exporters by way of cutting the key interest rates to resolve the situation.

### **Devaluation of Yuan and its Impact on Indian Economy**

Due to devaluation of Chinese currency in recent times the Indian sub continent has been negatively influenced in its various facets of economy. The major areas influenced are discussed below.

#### **Crude oil prices**

China is one of largest importers of crude oil and brent crude among the World. Deepening economic fears about China crude oil price as well brent crude prices fell down deeply. The crude oil barrel records \$38.63 which is low price from six years. Apart from crude price brent crude price per barrel also decreased and records \$43.28 on 24-08-2015.

#### **Commodity prices**

Industrial and commodity multinationals face the most pressing concerns, as they scramble to stem the profit slide from weaker consumption. China has enormous spending commodities like iron ore and copper and other commodities. Since a decade, prices surged for iron ore, a main ingredient in making steel, as new skyscrapers, rail lines and other infrastructure were built across China. But now the situation is changed. Due to China's weaker prospects, the price of commodities is pulling back. The fallout in commodities has been especially painful for emerging markets that depend on sales of those resources. This will also have an impact on Indian economy also, because we are the exporter of commodities.

#### **Rupee value**

On 24-08-2015 China has devalued the Yuan for a second day in continuation of previous day and it had leads to drop currency value over 4 per cent in two days. It will boost to US dollar, were as other currencies had lose their balance. Indian rupee records two years low of Rs.66.74. sharp fall of rupee had made more costly. This situation will force the RBI to hold on higher interest rates. It will hit the ongoing economy recovery. As India is facing trade deficit, it will further pressure on rupee. Since Stock market returns become unattractive, falling rupee is bad impact on dollar-denominated loans and foreign flows.

### **Pressure on Exports**

By and large, falling rupee is boosting the domestic exports. But analysts thought that there is no scope to improve domestic exports because of a global slowdown. China and India compete each in respect to several export items such as textiles, gems and jewelry, etc. will also go against domestic exports. There is a large gap between Indian and China marketers in respect to marketing and price of the products. For improving the exports, China had devalued the currency value. So, Indian exporters would face stiff competition from China markets.

### **Indian Film Industry**

China Economy crash favor to Indian film fraternity, because Yuan was suddenly devalued. Now film makers have opportunity for shooting with lowest cost. This may be opportunity to China to gain forex, and it is also chance to India to save forex as well as to visit many locations.

### **Textiles:**

Textiles is the one of the biggest sector in India in which China compete with its textile industry. Though China is in high end in textiles industry due to this legacy segment Indian companies can face tough competition. The devaluation of 1.9% can swallow the profits of some textile industries in India.

### **IT sector:**

India's IT sector is dependent on foreign clients. When an IT company gets a project from a client, it pre-decides on the length of the contract and the cost of the project. The fluctuation in the exchange rate can bring about a considerable difference in the performance of a company. Some companies undertake a range of measures like hedging exchange risks using forwards and futures contracts. This helps in mitigating some of the losses due to exchange rate fluctuations, but none-the-less the impact is substantial.

### **Chemicals:**

Both China and India produces organic and inorganic chemicals largely and they exports to various countries. There exist a competition between India and China in exporting the complex and base chemicals. For the complex chemicals the margin is higher whereas the base chemicals show the lower margin. So, the base chemicals can be more attractive. But China decreasing its price can make other countries who are importing from India, will give a chance to make more profit. This leads to the face-off from Indian Market.

### **Metals:**

Indian metal industries can be positively affected on Chinese Devaluation. Indian steel industries faced a burnt attack from Chinese imports. So the recent raising of Chinese Yuan can be an impact on Indian Steel importers and hence leads the Indian industries to play a major role.

### **Consumables:**

Most of the electrical and electronic consumables are imported from China. So due to the decrease in the value of Yuan, the goods, components can be available at cheaper cost and this leads to lower the price of consumables in India.

**Ecommerce:**

Ecommerce industry can also have the positive impact of devaluation of China's Yuan. Most of the goods sold in ecommerce are largely imported from China. Because of decreasing the price of goods leads to the benefits for the industry to announce the mega-sale promotions in further days.

**Policy implications:**

Policy makers are trying to assess the impact of exchange rate movements on the real economy; Firstly, the short-run impact of a real depreciation on firm's output growth is likely to be negative. This indicates the need for an effective reserve management policy that allows monetary authorities to meet the challenges posed by sudden episodes of sharp Rupee depreciation, as happened recently. It also implies that the call for the RBI to 'assist' with the revival of economic growth in the presence of uncertainties in the domestic and external policy environment is likely to be counterproductive if it leads to a downward pressure on the domestic currency.

At the same time, maintaining a competitive real exchange rate is imperative for boosting intermediate and long-term economic growth and maintaining the external balance. Thus, using scarce foreign exchange reserves to prevent currency depreciation in the face of sustained downward pressure on the currency due to growing fiscal deficit and/ or massive capital outflows would be problematic, apart from being unsustainable.

**Conclusion**

Though Indian is self reliant in various fields, for majority of electronic consumer goods, chemicals and other assembled parts we are depending largely on Chinese economy. Any negative change in Chinese currency certainly will have greater impact on exchange value of Indian rupee and its imports. The study broadly evaluated the impact of Yuan (CNY) depreciation on the various facets of the Indian economy like general commodity prices, exports of various essential commodities, impact on other major industries like steel, textile, cement, pharmaceuticals etc. The devaluation of Chinese Yuan will impact on rupee volatility, increased pressure on exports and stock markets may not produce attractive returns. This will ultimately results in dumping of Chinese products like take away market from domestic producers as Chinese goods becoming cheaper.

Another interesting fact is that, whenever the Yuan shows negative trends, the Indian stock markets were showing positive trends. Whenever Yuan shows an increasing trend, the Indian stock markets show a declining trend. Only in few cases both Yuan and Indian stock markets were moving in a similar direction. It shows that the changes in Yuan have an invariable impact in Indian economy in general as well the Indian stock markets in particular. It is suggested that the RBI has to tune its repo rates and control the negative implications of changing Chinese exchange rates and take appropriate measures for strengthening the Indian rupee as well Indian exports. As an ultimate solution for all these odds, India should try to keep its currency stable.

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