Foreign Exchange Management during fluctuating exchange rates: Challenges and Problems

Dr. Rishipal
Prof. & HOD, Department of Business Administration
Indus Institute of Engineering & Technology, Jind, Haryana, India
Email- rishipal_anand@rediffmail.com

Nidhi Jain
Asst. Prof., Department of Business Administration
Indus Institute of Engineering & Technology, Jind, Haryana, India
Email- nidhijain.138@gmail.com

Abstract- In the era of globalization, industrialization and advancement, it is not possible for a State, industry and individual to manage its multifarious economic activities without foreign currency. The value of currency depends upon the availability of various economic resources and means of production in the state.Availability of these economic resources differs from State to State and moreover, the resources responsible for evaluation of currency are not stable and fixed. So, the value of currency keeps on changing with respect to its purchasing power in the state and foreign currencies. In the present world of volatile economic state, procurement, preservation and management of foreign currency and its exchange has become a tedious job. This paper will descriptively explore the various challenges and problems faced in the management of foreign exchange.

Key Words- Globalization, Industrialization, Economic Resources, International Currency and economic state

1. INTRODUCTION

Foreign Exchange

During the primitive time, trade had been possible by barter system only but with the development of human civilization, barter system became incapable to manage the transactions of trade. Mass production and consumption forced the barter system to be highly disadvantageous. One of the major disadvantages of this system was,the parties in a transaction had to have something the other wanted. To overcome this problem and develop an alternative, monetary exchange system came into existence which was relatively easy in practice and stable for both the parties involved in the transaction. With the development of nations, each with its own monetary and currency system, and international trade, a foreign exchange mechanism became necessary and developed. With the help of foreign exchange, goods and services produced in one country can be sold and purchased by other countries. Regardless of directions of trade, such an international transaction must be denominated in a currency other than that of either the seller or buyer; i.e., one of the partyin the transaction must either buy or sell goods and services by using foreign currency. The development of foreign exchange practices and procedures is similar to that of internal monetary systems. Foreign exchange is the monetary mechanism by which transactions in two or more currencies are affected. It does so through the international banking system, and the result is a foreign exchange transaction. Foreign

Exchange means conversion of one currency in to other through selling and purchasing of foreign currency, besides this it includes:

(1) All deposits, credits & balances payable in any foreign currency.

(2) The drafts, letter of credit and bills of exchange expressed in Indian currency but payable in any foreign currency.

(3) All instruments payable at the option of the drawee or the holder thereof or any other party in Indian currency or partly in one & partly in another.

Foreign Exchange Rate

The exchange rate expresses thenational currency's quotation in respect to foreign ones. For example, if one US dollar is worth 48 Indian rupees, then the exchange rate of dollar is 48 rupees. If something costs 144 rupees, it automatically costs 3 US dollars as a matter of accountancy. In simple words, exchange rate means how much one currency is worth in terms of another currency. Thus, the exchange rate is a conversion factor, a multiplier or a ratio, depending on the direction of conversion. In a slightly different perspective, the exchange rate is a price. If the exchange rate can freely move, the exchange rate may turn out to be the fastest moving price in the economy, bringing together all the foreign goods with it. Fluctuations in exchange rate impact heavily to the following:

- Exporters
- Importers
- Foreign Investors

There are two types of exchange rate: Fixed and Floating. Some countries have fixed exchange rate systems while some have floating. As the name suggests, the fixed exchange rate doesn’t fluctuate because of government intervention. The floating exchange rates on the other hand keeps on changing continuously just like the stock market. Thus the government intervention is almost negligible. In India, we have a Managed Floating Exchange Rate System. This means that the Indian government intervenes only if the exchange rate seems to go out of hand by increasing or reducing the money supply as the situation demands.

Changes in the exchange rate can have a powerful effect on the macro-economy affecting variables such as the demand for exports and imports; real GDP growth, inflation and unemployment. While analyzing changes in currency exchange rate, following points must be considered:

- The scale of any change in the exchange rate.
- Whether the change in the currency is short term or long term.
- How businesses and consumers respond to exchange rate fluctuations – the concept of price elasticity of demand is important here.
-

II. CONSEQUENCESOFAPPRECIATIONINTHECURRENCYVALUE

1. Cheaper imports for consumers: Appreciation in currency leads to lower import prices – this boosts the real living standards of consumers at least in the short run – for example an increase in the real purchasing power of Indian residents when travelling overseas or the chance to buy cheaper computers or motor vehicles from the United States or Europe.
2. Lower costs for producers: When the domestic currency exchange rate is high, it is cheaper to import raw materials, component parts and capital inputs such as plant and equipment – this will be beneficial for businesses that rely on imported components or who are wishing to increase their investment of new technology from overseas countries. A fall in import prices has the effect of causing an outward shift in the short run aggregate supply curve. And if a country can now import more productive technology, the long run aggregate supply curve may shift out.
3. Lower inflation: A strong exchange rate helps to control the rate inflation because domestic suppliers now face stiffer international competition from cheaper imports and will look to cut their costs and prices accordingly in order not to suffer from a loss of international competitiveness. Cheaper prices of imported foodstuffs and beverages will also have a negative effect on the rate of consumer price inflation.
4. Increase in the trade deficit: The lower price of imports leads to increase in demand by consumers and this can cause a large trade deficit. Exporters lose price competitiveness because they will find it more expensive to sell in foreign markets and face losing market share – this can damage profits and employment in some sectors and industries.
5. Slower economic growth: If exports fall, this causes a reduction in aggregate demand and reduces the short-term economic growth as measured by the % change in real GDP. Some regions of the economy are affected by

this more than others. In the North east for example, manufacturing industry accounts for over 28% of regional GDP whereas the percentage for the UK as a whole is just 19% (WTO: 2011 Press Releases).

6. If exports fall, then it will affect adversely to industrial growth and capital investment because investment is partly dependent on the strength of demand.

III. CONSEQUENCES OF DEPRECIATION IN THE CURRENCY VALUE

1. Imports will become dearer. Products which use imported components will become expensive.
2. Domestic producers will gain as they will have a cost advantage over imported goods. Output will rise and so it will improve employment in the country.
3. Devaluation as a policy instrument can boost exports and output, and so create jobs.
4. It generates inflation.

IV. NEED OF FOREIGN EXCHANGE

There was a time in human civilization that money, whether in coins or in paper, didn't exist. When you need something, you would have to give up one of your possessions for another's. Of course, this hardly ever happens now as barter, except maybe for e-bay, as it could become a very complicated process in the large-scale. Money has become an effective tool to make businesses and ultimately, our daily lives, easy and simple. When you need a commodity or service, all you need to do is to have the right amount of money in order to have that thing you desire.

Because of emergence of nations and with more and more countries opening up to the world and finally world become a global village, it is inevitable that we become more involved with each other. The Indians travel all the time to America and Japan for purchase of latest technology and electronic gadgets, the Asians are selling their nicely-crafted handicraft to the Europeans, An Indian fruit wholesaler sells apples to a buyer in UK. All of these are indicative as to how we are all connected, one way or another. However, when you travel, you cannot bring your nation's money alone and expect to live on a foreign land. This is where foreign exchange becomes important to you.

Each nation is represented by its own national currency. For example the India has the Indian Rupee while the US has the American Dollar. When an Indian travels to America, he would need to exchange his rupees to dollar in order to buy things in that country. This is called foreign exchange.

Multiple countries are also doing business with each other and this is another situation where foreign exchange becomes important. When an Indian exporter exports his mangoes to the US, he does not get paid in rupees but in dollar equivalent. Foreign exchange is an exchange of two national currencies, in this case, the rupee and the dollar. Hence it is clear that foreign exchange works and how we are affected by it one way or another.

Sometimes it also happens that the transactions between two countries will be settled in the currency of the third country. In that case both the countries, which are transacting will require converting their respective currencies in the currency of the third country. For that also the foreign exchange is required.

Let us say that the businessman who operates in more than one country needs to understand not only the mechanism of the foreign exchange system, but also why changes in monetary values occur and how to cope with them.

So, foreign exchange is required for the following purposes:

- To do trade in foreign countries
- While travelling to foreign countries
- To settle the transactions between two countries
- For foreign tourists

V. FOREIGN EXCHANGE MANAGEMENT AT NATIONAL LEVEL

The buying and selling of foreign currency and other debt instruments by businesses, individuals and governments happens in the foreign exchange market. Apart from being very competitive, this market is also the largest and most liquid market in the world as well as in India. Foreign exchange market constantly undergoes changes and innovations, which can either be beneficial to a country or expose them to greater risks. The management of foreign exchange market becomes necessary in order to mitigate and avoid the risks. Central banks would work towards an orderly functioning of the transactions which can also develop their foreign exchange market.

Before 1990, importers and exporters of various commodities were required to get appropriate licences from the Indian Government before they could participate in the foreign exchange market. Generally, import procedures followed the international standard of opening of letters of credit (L/Cs) and subsequent confirmation by correspondent banks abroad.

The introduction of Foreign Exchange Regulation Act was done in 1974, a period when India's foreign exchange reserve position wasn't at its best. A new control in place to improve this position was the need of the hour. FERA did not succeed in restricting activities, especially the expansion of TNCs (Transnational Corporations). The concessions made to FERA in 1991-1993 showed that FERA was on the verge of becoming redundant. After the amendment of FERA in 1993, it was decided that the act would become the FEMA. This was done in order to relax the controls on foreign exchange in India, as a result of economic liberalization. FEMA served to make transactions for external trade (exports and imports) easier – transactions involving current account for external trade no longer required RBI's permission. The deals in Foreign Exchange were to be 'managed' instead of 'regulated'. The switch to FEMA shows the change on the part of the government in terms of foreign capital.

Whether under FERA or FEMA's control, the need for the management of foreign exchange is important. It is necessary to keep adequate amount of foreign exchange reserves, especially when India has to go in for imports of certain goods. By maintaining sufficient reserves, India's foreign exchange policy marked a shift from Import Substitution to Export Promotion.

Main changes are following:

1) Activities such as payments made to any person outside India or receipts from them, along with the deals in foreign exchange and foreign security is restricted. It is FEMA that gives the central government the power to impose the restrictions.

2) Restrictions are imposed on people living in India who carry out transactions in foreign exchange, foreign security or who own or hold immovable property abroad.

3) Without general or specific permission of the Reserve Bank of India, FEMA restricts the transactions involving foreign exchange or foreign security and payments from outside the country to India – the transactions should be made only through an authorized person.

4) Deals in foreign exchange under the current account by an authorized person can be restricted by the Central Government, based on public interest.

5) Although selling or drawing of foreign exchange is done through an authorized person, the RBI is empowered by this Act to subject the capital account transactions to a number of restrictions.

6) People living in India will be permitted to carry out transactions in foreign exchange, foreign security or to own or hold immovable property abroad if the currency, security or property was owned or acquired when he/she was living outside India, or when it was inherited to him/her by someone living outside India.

7) Exporters are needed to furnish their export details to RBI. To ensure that the transactions are carried out properly, RBI may ask the exporters to comply to its necessary requirements

VI. FOREIGN EXCHANGE MANAGEMENT AT INDUSTRIAL LEVEL

The last two decades have witnessed an increasing trend in fragmentation of production and outsourcing across countries mainly due to declining tariff barriers and developments in transportation and communication technologies. This phenomenon has significantly increased international trade in intermediate goods and is among the main feature of the globalization process. Given both the new and traditional sources of comparative advantage, factors that inflate or deflate the costs of production in a certain location play their own role in offshoring decisions. Different industries response in different ways to movements in exchange rate. Less contract intensive industries tend to be more responsive to movements in exchange rate of the foreign country than more contract intensive industries.

The organization is put to exchange risk. This means that for the same product, if a business contracts with seller for a specific amount due to rate fluctuations that will be paying more. The customs duty structures, VAT etc. are directly linked to such rates which will have further impact. Cash outflow also increases thereby straining the working capital requirements. In short, this directly affects the profitability of a project/business. A multinational company faces special problems when preparing a budget. The problems arise because of fluctuations in foreign currency exchange rates, the high inflation rates found in some countries, and local economic conditions and governmental policies that affect everything from labor costs to marketing practices.

VII. ROLE OF FLUCTUATING EXCHANGE RATES IN FOREIGN EXCHANGE MANAGEMENT

Fluctuations in foreign currency exchange rates create unique budgeting problems. Exporters may be able to predict with some accuracy their sales in the local foreign currency. However, the amounts they eventually receive in their own currency will depend on the currency exchange rates that prevail at the time. If, for example, the currency exchange rates are less favorable than expected, the company will ultimately receive in its own currency less than it had anticipated. Multinational firms are participants in currency markets by virtue of their international transactions. To manage the exchange rate risk inherent in every multinational firm's operations, a firm needs to determine the specific type of current risk exposure, the hedging strategy and the available instruments to deal with these currency risks. Companies that are heavily involved in export operations hedge their exposure to exchange rate fluctuations by buying and selling sophisticated financial contracts. These hedges ensure that if the company loses money in its exporting operations because of exchange rate fluctuations, it will make up that loss with gain on its financial contracts. When a multinational company uses hedging operations, the costs of those activities should be budgeted along with other expenses. After identification of the types of exchange rate risk that a firm is exposed to and measurement of the associated risk exposure i.e. determination of the transaction, translation and economic risks, along with specific reference to the currencies that are related to each type of currency risk, a multinational company can use following types of hedge instruments:

- Forward Market Hedge
- Option Market Hedge
- Future Market Hedge
- Money Market Hedge

VIII. ECONOMIC REASONS FOR FLUCTUATIONS IN EXCHANGE RATE

Two very commonly used terminologies (already described above) are Currency Appreciation & Currency Depreciation. When rupee is said to be appreciating it means that our currency is gaining strength and its value is increasing with respect to foreign currency. However, when rupee depreciates it means our currency is getting weaker & its value is falling with respect to foreign currency. Currency's appreciation or depreciation against the dollar depends on the change in demand and supply for both the currencies. If the demand for rupee is comparatively high, rupee appreciates; if low, it depreciates. Numerous factors determine exchange rates, and all are related to the trading relationship between two countries. The following are some of the principal determinants of the exchange rate between two countries:

1.Interest rates should have an important impact on exchange rate but one has to be careful to check additional conditions. Interest rates on Treasury bonds should influence the decision of foreigners to purchase currency in order to buy them. In this case, higher interest rates attract capital from abroad and the currency should appreciate. Similarly other fixed-interest financial instruments could be objects of the same dynamics. Accordingly, an increase of domestic interest rates by the central bank is usually considered a way to "defend" the currency. Nonetheless, it may happen that foreigners rather buy shares instead of Treasury bonds. If this were the strongest component of currency demand, then an increase of interest rate may even provoke the opposite results, since an increase of interest rate quite often depresses the stock market, favouring a tide of share sales by foreigners.

2. Foreign direct investments: Restrictive monetary policy usually depresses the growth perspective of the economy. If FDI are mainly attracted by sales perspectives and they constitute a large component of capital flows, then FDI inflow might stop and the currency weaken.

3. Inflation rate is often considered as a determinant of the exchange rate as well. A high inflation should be accompanied by depreciation. The more so if other countries enjoy lower inflation rates, since it should be the difference between domestic and foreign inflation rates to determine the direction and the scale of exchange rate movements.

If a hamburger costs in Japan 5% more than a year ago, while in USA it costs 8% more, then the dollar should have been depreciated this year by about 8-5=3%.

High inflation usually give rise to depreciation, whose exact dimension need not match the inflation itself or its difference with foreign inflation rates.

4. The balance of payments can highlight pressures for devaluation or revaluation, reflected in large and systematic trend of foreign currency reserves at the central bank. In particular, large inflows, due for instance to a rise in the world price of main export items, tend to raise the exchange rate. Conversely, a collapse in the trust of government to manage the economic conditions might provoke a flight of capital, the exhaustion of foreign currency reserves and force devaluation / depreciation.

5. Trading in currencies in the foreign exchange market: The exchange rate fluctuates minute by minute because of speculative trading in the foreign exchange market. Though trading in foreign exchange market causes fluctuations in the exchange rate, over a period the change is backed by the fundamental factors like the growth potential in the economy, interest rate differential and the inflation rate existing in different countries.

6. Political Stability and Economic Performance: Foreign investors inevitably seek out stable countries with strong economic performance in which to invest their capital. A country with such positive attributes will draw investment

funds away from other countries perceived to have more political and economic risk. Political turmoil, for example, can cause a loss of confidence in a currency and a movement of capital to the currencies of more stable countries.

IX. EFFECT OF CHANGING EXCHANGE RATES ON NATIONAL ECONOMY AND INDUSTRIAL GROWTH

Exchange rate fluctuation has a significant impact on the overall economy of a country. Currency appreciation against foreign currency is an indication of the strengthening of economy with respect to foreign economy. For an industry exchange rate risk is variability in the value of a project, or of an interest in the project, that results from unpredictable variation in the exchange rate. There are two types of exchange rate risk: project and financing related. Project exchange rate risk arises when the value of a project's inputs or outputs depends on the exchange rate. Typical infrastructure projects sell their outputs domestically, so, valued in local currency, revenues usually are not subject to exchange rate risk. But any input that is tradable, even if it is not imported, will have a world price, so its cost, measured in local currency, will vary inversely with the exchange rate. The costof fuel, for example, creates exchange rate risk for a thermal electricity generator. Financing choices affect the amount of exchange rate risk borne by different participants in the project (shareholders, creditors, customers, taxpayers). In particular, loans requiring repayment in foreign currency expose shareholders to exchange rate risk. As a result, shareholders may seek to shape the contractual arrangements to pass on some or all of the risk to the government or customers (through exchange rate guarantees or indexation of the tariff to the exchange rate). Consequences of change in exchange rates on industrial growth and on economy can be measured by analyzing the influence of fluctuations in exchange rate on overall demand and supply of goods and services.

Effect of Changing Exchange Rates on Demand

Pricing - Soaring costs may compel companies to increase their product prices or reduce product offerings, which may then translate into reduced demand or lost sales.

New Markets - Demand for imported goods may surge in markets where currencies are rising, creating new markets and revenues whereas when currency value decline, it will affect adversely on the demand of imported goods.

Customer Risk - Customers impacted by the falling value of domestic currency could significantly reduce orders as business declines.

Effect of Changing Currency Value on Supply

Input - The price of raw materials, subassemblies and other finished goods imported from India and other Asian countries will change with change in currency value.

Shipping - The cost of shipping is likely to change because fees collected by offshore shippers tends to be denominated in foreign currency; as the foreign currency value slides, revenues will be squeezed when converted to the local currency and revenue will increase with appreciation in the value of foreign currency.

Supplier risk –when there are chances of decline in foreign currency value, suppliers with large export portfolios may run out of the business due to the erosion of operating margins.

X. FLUCTUATING EXCHANGE RATES: PROBLEMS AND CHALLENGES

Government intervention to cure one problem raises a host of new, unexpected problems. In a world of fiat moneys, each country has its own money. The international division of labor, based on an international currency, has been broken, and countries tend to divide into their own autarchic units. Lack of monetary certainty disrupts trade further. The standard of living in each country thereby declines. Each country has freely-fluctuating exchange rates with all other currencies. A country inflating beyond the others no longer fears a loss of gold; but it faces other unpleasant consequences. The exchange rate of its currency falls in relation to foreign currencies. This is not only embarrassing but even disturbing to citizens who fear further depreciation. It also greatly raises the costs of imported goods, and this means a great deal to those countries with a high proportion of international trade.

In recent years, therefore, governments have moved to abolish freely-fluctuating exchange rates. Instead, they fixed arbitrary exchange rates with other currencies.At present, the world is enmeshed in a chaotic welter of exchange controls, currency blocs, restrictions on convertibility, and multiple systems of rates. In some countries a "black market" in foreign exchange is legally encouraged to find out the true rate, and multiple discriminatory rates are fixed for different types of transactions. Almost all nations are on a fiat standard, but they have not had the courage to admit this outright, and so they proclaim some such fiction as "restricted gold bullion standard." Actually, gold is used not as a true definition for currencies, but as a convenience by governments: (a) for fixing a currency's rate with respect to gold makes it easy to reckon any exchange in terms of any other currency; and (b) gold is still used by the different governments. Since exchange rates are fixed, some item must move to balance every country's

payments, and gold is the ideal candidate. In short gold is no longer the world's money; it is now the governments' money, used in payments to one another.
To buy foreign currency RBI and Government has to sell Indian Rupees and result of rupee selling is following:

- Higher petrol and diesel prices
- Higher subsidy bill
- Higher inflation
- National poverty

Clearly, the inflationists' dream is some sort of world paper money, manipulated by a world government and Central Bank, inflating everywhere at a common rate. This dream still lies in the dim future, however; we are still far from world government, and a national currency problem have so far been too diverse and conflicting to permit meshing into a single unit.
The benefits of openness to trade are well understood, but the disadvantages of openness are less well understood. More open the economy, the more exposed are its firms to exchange rate movements.Major challenges before government while managing foreign exchange are:

- What tasks should be performed?
- What should be the legal foundation of action to be taken?
- How are the tasks to be performed?

Intervention in the foreign exchange market would have helped counter inflation; but the central bank has failed to grasp such a dexterous policy tool. It becomes difficult for the central bank to plan because of uncertain exchange rate movements at any one time.
India is currently experiencing following problems:

1. Chronic and high inflation;
2. A large fiscal deficit with falling revenues;
3. Wide current account deficit overtly dependent on short-term portfolio capital;
4. Slowing growth with no prospects for investment recovery;
5. A flat stock market overseeing earning downgrades;
6. Large and complex foreign exchange market;
7. Frequent changes and Innovations in foreign exchange market;
8. Slow economic growth because of decreasing GDP;
9. Negative growth of employment due to decline in exports profit and
10. Declining foreign exchange reserve because of disequilibrium of country’s balance of payment

Points stated above are evidence of a precarious macroeconomic situation. Monetary and fiscal policies are both overstretched. Intervention would have been askillful move to get out of this blind alley. Major challenges before Government to cope up with above stated problems are following:

1. To make sound and credible policies so as to reduce macro imbalances in the economy.
2. To improve the flexibility of product and factor markets in order to cope and adjust to shocks arising from volatility of currency markets.
3. To develop and strengthen their financial systems in order to enhance their flexibility to shocks.
4. To develop a sound and efficient banking system with deep and liquid capital market contributes to the efficient intermediation of financial flows.
5. Need to build a regulatory and supervisory capability to keep pace with financial innovation and the emergence of new financial institutions activities.

XI. FLUCTUATING EXCHANGE RATES: REMEDIES

Government strategy and policy has long lasting impact on currency value. Strong Government can make economy stronger and ultimately it will make currency more strong. Government can manage foreign exchange byAccumulated international reserves. The main objectives in managing a stock of reserves for any developing country, including India, are preserving their long-term value in terms of purchasing power over goods and services, and minimizing risk and volatility in returns. After the East Asian crises of 1997, India has followed a policy to build higher levels of Foreign Exchange Reserves that take into account not only anticipated current account deficits but also liquidity at risk arising from unanticipated capital movements. Accordingly, the primary objectives of maintaining Foreign Exchange Reserves in India are safety and liquidity; maximizing returns is considered secondary. In India, reserves are held for precautionary and transaction motives to provide confidence to the markets, those foreign obligations can always be met. The Reserve Bank of India (RBI), in consultation with the

Government of India, currently manages Foreign Exchange Reserves. As the objectives of reserve management are liquidity and safety, attention is paid to the currency composition and duration of investment, so that a significant proportion can be converted into cash at short notice. Broad objectives of maintaining foreign exchange reserve are as follows:

1. Support and maintain confidence in the policies for monetary and exchange rate management including the capacity to intervene in support of the national or union currency;
2. Limit external vulnerability by maintaining foreign currency liquidity to absorb shocks during times of crisis or when access to borrowing is curtailed and in doing so;
3. Provide a level of confidence to markets that a country can meet its external obligations;
4. Demonstrate the backing of domestic currency by external assets;
5. Assist the government in meeting its foreign exchange needs and external debt obligations; and
6. Maintain a reserve for national disasters or emergencies.

Foreign exchange risk can also be minimized by proper allocation of risk in different projects. Exchange risk can be optimally allocated by applying following measures:

1) They can influence the underlying source of the risk. Governments, for example, can reduce the rate of depreciation and the volatility of the exchange rate by keeping budget deficits small and inflation low.

2) They can influence the sensitivity of the value of a project or of their interest in it to the risk. Project sponsors, for example, can reduce the sensitivity of the value of their shareholding to the exchange rate by reducing the project's reliance on foreign currency debt.

3) They can hedge or diversify away the risk.

In Indian context, RBI also has taken up several monetary policy measures which have some impact on the system especially on the value of Rupee. The steps taken by RBI are as follows:

- On July 31 2007, RBI raised the cash reserve ratio by 50 basis points, to 7% in order to drain liquidity from the system and thereby to handle inflation.
- It lowered the amount of money raised from external commercial borrowing that can be converted into rupees. It is expected that this will reduce the capital inflow and dampen the pace of Rupee appreciation.
- It has increased reserve requirement.
- For capital account transactions, the Reserve Bank regulations provide for general permissions/automatic routes for investments in India by non-residents, investments overseas by residents and borrowings abroad, etc.
- There is a "Standing Consultative Committee on Exchange Control" consisting of representatives from various trade bodies and authorized dealers which meets twice a year and makes recommendations for policy formulation.

Appreciation of the currency makes imports cheaper and exports expensive. So, it can spell good news for economies and companies which rely on import of goods like heavy machinery, technology, microchips etc. According to reports by Associated Chambers of Commerce and Industry of India (ASSOCHAM) sectors like Petro & Petro Products, Drugs &Pharma and Engineering Goods which have import inputs of as much as 77%, 19% and 21% respectively would stand to gain the most if rupee appreciates(ASSOCHAM Report, 2010). They would have to pay less for the imported raw materials which would increase their profit margins.

Similarly, a depreciating currency makes exports cheaper and imports expensive. So, it is welcome news for sectors like IT, Textiles, Hotel & Tourism etc. which generates revenue mainly from exporting their products or services. Currency depreciation makes goods & services cheaper for the foreign buyers thus leading to increase in demand and higher revenue generation. The foreign tourist would find it cheaper to come to that country, thus increasing the business of hotel, tours & travel companies.

Indian IT sector is dependent on foreign clients, especially US, for more than 70% of its revenue. 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 contracts with US clients are usually quoted in dollars term. So, the fluctuation in the exchange rate can bring a considerable difference in the performance of a company. Take the example of Infosys results between 2007 and 2008 to understand the impact that the fluctuation in exchange rate can have on the performance of a company. The income of Infosys, in 2008, increased by 34.1% to $ 3912 million but because of rupee appreciation of 11.2%, from Rs. 45.06 to Rs. 40, in rupee terms, its income increased only by 19% (Infosys Annual Report, 2008). However the IT sector does not just sit idle and let exchange rate play the spoil sport. It undertakes various measures like hedging exchange risks using forward and future contracts. This helps them in mitigating some of the loss due to exchange rate fluctuation but none the less the impact is substantial.

Exchange rate is thus an important tool that can be used to analyze many key industries like IT, Textiles etc. Fluctuating exchange rate has a significant impact on the economy, industries, companies, foreign investors etc.

Rupee appreciation is beneficial for industries which rely heavily on imported inputs while depreciation of rupee is good news for industries which are exporting majority of their production.

XII. REFERENCES

1. Ates, Aysegul and Kemal Turkcan (2009) "An Examination of exchange rate pass-through to u.s. motor vehicle products and auto-parts import prices."Global Economy Journal.Vol 9, Issue 1.
2. Baek, In-mee and Okawa, Tamami (2001) "Foreign Exchange Rates and Japanese Foreign Direct Investment in Asia, 53 (2001) 69-84
3. Bardhan, D Ashok and Jaffe, Dwight (2004) "Intra-Firm Trade and Multinationals: Foreign Outsourcing and Offshoring in Manufacturing: Working Paper.
4. Elaine Hutson& Simon Stevenson (2010), Openness, hedging incentives and foreign exchange exposure: A firm-level multi-country study
5. Geoff Riley, Eton College (2006) Guidelines for Foreign Exchange Reserve Management, (2001) International Monetary Fund
6. Ian H. Giddy and Gunter Dufey, The Management of Foreign Exchange Risk
7. Murray N. Rothbard International Monetary Fund (2003), Guidelines for Foreign Exchange Reserve Management
8. John Eatwell, The Challenges Facing International Financial Regulation
9. Kiflu Gedefe Molla (2010), The Role of Foreign Exchange Rates in Offshoring: Industry level Evidence from Sweden
10. Michael G. Papaionnou, (2006) Exchange Rate Risk Measurement and Management: Issues and approaches for firms, South-Eastern Europe Journal of Economics 2, pg. 129-146
11. Philip Gray and Timothy Irwin(2003)Allocating Exchange Rate Risk in Private Infrastructure Projects, The World Bank Group Private Sector Development Vice Presidency.
12. Renu Kohli, (2011) The Reserve Bank of India's lost policy lever, East Asian Bureau of Economic Research
13. Valentino Piana (2001), Exchange Rate.