Exchange rate movements

6.68 The management of the Indian Rupee continues to remain broadly market-determined with the RBI intervening only in the event of smoothening excessive volatilities in the foreign exchange market. Trends in the monthly average exchange rate of the Indian Rupee against the US Dollar during the years 2002-03 and 2003-04 indicates that the Rupee dropped to a low of 48.90 against the US Dollar in May 2002. It began strengthening thereafter to reach a monthly average rate of Rs 45.02 against the US Dollar in March 2004. The sharpest month-over-month appreciation in the value of the Rupee vis-à-vis the US Dollar was observed in the months of July and October 2003 respectively. But while the Rupee has almost consistently gained against the US Dollar since May 2002, it has simultaneously weakened against other major currencies like the Euro, Pound and the Yen.

6.69 One of the major reasons behind the strengthening of the Indian Rupee against the US Dollar over the last two years is the sustained increase in the volume of foreign exchange inflows, resulting in a gradual strengthening of the Rupee against the US Dollar. Besides, a gradual weakening of the US Dollar against other major currencies of the world, has also influenced the Rupee-Dollar rate through cross-currency volatility.

6.70 The effect of the cross-currency movements can be best judged by Nominal Effective Exchange Rate (NEER) and Real Effective Exchange Rate (REER) indices. The 5-country export weighted NEER index (base 1995=100) is seen to have decreased from 75.18 in 2002-03 to 75.01 in 2003-04. The 5-country REER (base 1995=100), however, is seen to have increased from 99.79 in 2002-03 to 103.03 in 2003-04. A marginal increase in REER despite a slight decline in NEER indicates that the decline in NEER has been more than offset by the higher inflation in the country vis-a-vis that in major export destinations. The finding is consistent with the generally subdued consumer price levels prevailing in advanced economies during 2003-04.