

Exchange rate movements

6.69 Overall orderly conditions prevailed in the foreign exchange market in 2003-04 and during 2004-05, so far. During early 2004-05, the rupee ended a continuous twenty four months (May 2002-April 2004) run of appreciation against the US dollar and started weakening from May 2004 onwards. The new phase, however, turned out to be relatively short-lived, as the rupee started to gain against the US dollar from September 2004. The third quarter of 2004-05 (i.e. October-December) saw a sharp firming up of the rupee against the US dollar with the nominal monthly appreciation a high of 2.6 percent in December 2004.

6.70 The current financial year witnessed a somewhat inconsistent trend of the value of the rupee vis-à-vis other major currencies (i.e. the Euro, Pound Sterling and the Japanese Yen). In April 2004, the rupee appreciated against all major currencies. A complete reversal of the trend occurred during May-July 2004, when the rupee weakened against all major currencies. This was also the period when there were significant withdrawal of portfolio funds. In August and September 2004, the rupee gained against all the currencies, except the US dollar, against which it depreciated only marginally in August 2004. During October-December 2004, the rupee depreciated against the Euro, Pound, and the Yen (except December 2004), while

appreciating against the US dollar (Figure 6.4). In January 2005, the rupee appreciated against all the currencies.

6.71 The trends revealed by the nominal movements of the rupee are broadly consistent with those indicated by the indices of Nominal Effective Exchange Rate (NEER) and Real Effective Exchange Rate (REER). The 5-country export-weighted NEER (base 2000 = 100), after reaching a peak of 94.04 in April 2004, declined continuously to 89.25 in November 2004. The corresponding price-adjusted movements in exchange rates, which are obtained from the 5-country export-weighted REER (base 2000 = 100), also show a decline from a level of 104.97 in April 2004 to 99.83 in November 2004. As against the general depreciating trend since April, 2004, it is interesting to note that while only September 2004 is an exception in terms of both NEER-5 and REER-5, even June and August 2004 experienced some appreciation of the rupee in terms of REER-5. June-August 2004 saw a sharp flare-up in domestic wholesale prices; this inflation differential vis-à-vis partner countries more than neutralized the nominal depreciation during June and August, 2004. However, despite strengthening nominally against the US dollar, after September 2004, with gradual softening of domestic inflation, the rupee started to depreciate in real terms, mainly on account of its sharp fall against the Euro, Pound and the Yen.

