

## Exchange Rate Developments

6.76 India has been following a broadly market-determined exchange rate policy for quite some time, allowing the Indian rupee to move in response to the changes taking place in global foreign exchange markets. The Rupee has indeed demonstrated adequate flexibility, which is evident from the pattern of its movement against major global currencies (i.e. the Euro, Pound, US Dollar and Japanese Yen). During 2003-04, the average value of the Rupee against the US Dollar, Japanese Yen, Pound and the Euro, respectively, were Rs 45.92, Rs 40.71 (per 100 Yen), Rs 77.74 and Rs 54.01, respectively. The Rupee appreciated by around 2.2 per cent against the US Dollar in 2004-05 and recorded an annual average value of Rs 44.95. However, against the other currencies, the Rupee showed a depreciating trend in nominal terms. The highest depreciation of 6.3 per cent was recorded against the Pound, at an annual average value of Rs 82.94 during 2004-05. Similarly, Rupee depreciated by 4.5 per cent and 2.6 per cent against the Euro and Japanese Yen, respectively, and recorded annual average values of Rs 56.55 and Rs. 41.81, respectively, during 2004-05.

6.77 The trends of appreciation/depreciation displayed by the Rupee in nominal terms against the four major global currencies in 2004-05 changed somewhat during 2005-06. At the end of the first ten months of 2005-06, i.e. April-January 2005-06, the Rupee appreciated by around 2.1 per cent against the US Dollar compared to the corresponding period of the previous year. While such appreciation maintained the progressively strengthening trend displayed by the Rupee against the US Dollar in recent years, month-wise analysis reveals that, after July 2005, the Rupee has depreciated against the Dollar in all months up to November 2005. Within this period, the sharpest monthly depreciations (around 2.1 per cent) were noted during October and November 2005. Since December 2005, the Rupee has started strengthening again. On the other hand, while the Rupee weakened against the Euro, Pound and Yen during 2004-05, it has strengthened against all the three currencies during the

current year. During April-January 2005-06, the Rupee has appreciated by 6.4 per cent against the Yen, 4.3 per cent against the Euro and 4.5 per cent against the Pound respectively, vis-à-vis the corresponding previous period. Month-wise analyses for these currencies indicate that during 2005-06, after gaining consistently against the Euro during April-July 2005, the Rupee has been steadily weakening thereafter. Such a trend has also become noticeable vis-à-vis the Pound from November 2005. While the Rupee has continued to gain against the Yen, the extent of gains has started reducing during the later months of the calendar year 2005.

6.78 During the current financial year, the Rupee exhibited two-way movement reflecting the movement of dollar in the international market, the developments in global interest rates (particularly the US Fed rates) movement of capital flows and oil prices. While the bilateral exchange rate developments indicated above underline nominal trends, the changes in the exchange rate are best reflected in indices of Nominal Effective Exchange Rates (NEER). The month-wise NEER-5 (Base : 2000 = 100), which shows the appreciation/depreciation of the Rupee vis-à-vis a composite basket of currencies (i.e. US Dollar, Euro, Pound Sterling and Yen), shows a consistently appreciating trend during April-July 2005 and a depreciating trend from August-November 2005 (Figure 6.4). The depreciation, however, has been almost negligible during December 2005. This is broadly consistent with the bilateral currency trends mentioned earlier. The Real Effective Exchange Rate (REER) indices, which are the NEER indices adjusted for price differentials, also reflect a strengthening of the Rupee till July 2005 and a steady weakening thereafter till October 2005. The REER appreciated marginally in November 2005 but depreciated again in December 2005. It is however, interesting to note that the depreciation in the two indices during August-October 2005, was more in real terms than in NEER (Figure 6.4). The observation probably indicates that a weakening of the Indian Rupee vis-à-vis major global currencies during the period was not matched by a similar weakening of domestic prices vis-à-vis other country prices in the currency basket.

Fig. 6.4

Monthwise Indices of NEER-5 and REER-5 during  
2005-06 (Base 2000 = 100)

