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ORIGINAL RESEARCH PAPER

Management

CURRENCY EXCHANGE RATES AND CONDITION OF ECONOMY

KEY WORDS:

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INTRODUCTION:

Currently the exchange rate of Rupee against dollar has crossed all time low above Rs.90 and people are confused about the government declaration and the economic conditions of the country. At the same time the GDP calculation by Indian government has been awarded "C" grade by international body saying the GDP calculations by government are fraudulent and faulty. This makes the common people to think "CAN WE TRUST GOVERNMENT OR NOT" and makes it important to find the realities and clarify our minds about the connection between currency exchange rates and economic condition of the country. One has to look in to it and clarify the doubts about the connection of economy and rupee exchange rates.

Historically speaking the currency exchange rates during Dr. Manmohan Singh government used to be hovering around Rs.55 and the current Prime Minister used to say that it is a failure of government and the currency exchange rate of rupee should be $1= Rs.1 but now when the exchange rate of rupee against dollar has crossed Rs.90 is it keeping mum. This is making this research more important to clarify the mystery.

To the same let us go systematically by formulating objectives of this research and then find and analyze factual details and conclude the research so that we can comment on the economic conditions of the country with such high exchange rate.

Objectives: We can have following objectives

a) What is Exchange rate and how it is decided?

b) Relation between Exchange rate and economic conditions of country

c) Advantages and disadvantages of HIGH and LOW exchange rates to the economy

a) What is Exchange rate and how it is decided?

A **currency exchange rate** is the **price of one country's currency in relation to another country's currency**. It tells you how much of one currency you can exchange for a unit of another currency at a given moment.

For example, an exchange rate of 1 USD = 90.13 INR means that one US dollar can be exchanged for approximately 90.13 Indian Rupees.

Exchange rates are ultimately determined in global foreign exchange markets by the supply and demand of currencies. Economic factors like inflation, interest rates, and geopolitical events influence these market forces. Under the current global floating exchange range system (more on that soon), currency fluctuations result from the forces of supply and demand on a global scale. **In short:** Exchange rates compare the value of two currencies as they change over time. Currency values fluctuate constantly because they're traded 24/7, five days a week. **Exchange rates are updated frequently** throughout each trading day, depending on market activity and timing across global financial centres. There are different types of exchange rates in use around the world, depending on how a country manages its currency.

Currency exchange rates are determined in two main ways:

- Government policy, called **fixed exchange rates**
- Market forces, known as **floating exchange rates**

In a **fixed exchange rate system**, the government or central bank proactively maintains currency values relative to a specific standard. Historically, fixed exchange rates were anchored to gold or silver, with currency units defined as a specific weight of metal.

A drawback of fixed rates is that governments and central banks often have to work against market forces to maintain a currency peg (the policy a country uses to set a fixed exchange rate). This might call for intervention via monetary policy tools such as reserve management, interest rate adjustments, and capital controls. Nowadays, most of the world operates with **floating exchange rates**, where governments and central banks allow currency values to fluctuate freely in financial markets. Some argue that today's global economy incorporates elements of both free-floating and managed systems, with occasional government intervention to maintain currency values.

Fixed Exchange Rates

Under fixed exchange rate systems, central banks actively shape monetary policy to peg their currency's value within a narrow range. This is intended to support their economic goals and maintain financial market confidence. Central banks have several monetary policy tools to do this. Here are three of the most important.

Reserve management: Central banks maintain reserves of foreign currencies and can buy or sell them in the open market to influence demand and supply and stabilize exchange rates.

Quantitative easing: Central banks buy government bonds and other securities to lower interest rates and increase the domestic money supply.

Interest rate adjustments: By adjusting interest rates, central banks can attract or discourage the incoming flow of capital from outside the country, which impacts currency exchange rates.

Floating Exchange Rates

Today, the world's major currencies have floating exchange rates where currency values fluctuate in currency markets. This includes the world's most traded currencies: the United States dollar, the euro, the Indian rupee, and the Japanese yen. India moved to a **managed floating exchange rate regime** in **March 1993**, ending a system of pegged rates and dual rates after the 1991 economic reforms, allowing market forces to largely determine the rupee's value while the Reserve Bank of India (RBI) intervenes to curb volatility.

In this system, the supply and demand of the currencies themselves largely set currency values. In other words, market forces drive exchange rates. These forces include:

Economic performance indicators, such as national gross domestic product (GDP) growth and industrial output, impact currency valuations.

India's per capita income is around $2,700 - $2,800 USD (Re243000-252000PA=20200-21000PM) as of 2024-2025 (This is average of entire population mean including 1% population owning 40% of total earnings of Indians so lower income people will have much lower income than per capita)

In the 2025 Global Hunger Index, India ranks **102**nd out of 123 countries with sufficient data to calculate 2025 GHI scores

In the 2025 **World Happiness Report**, India ranks 118th out of 147 countries

India's Purchasing Power Parity (PPP) indicates that the Indian Rupee (INR) has significantly more buying power for local goods and services compared to the US Dollar (USD) due to lower costs

Political stability and governance build investor trust. Perceived political risk also influences currency values.

Prevailing interest rates also play a crucial role. For example, higher rates can attract foreign capital, leading to appreciation of the currency.

Trade and current account balances shift the supply and demand dynamics of currencies, as international demand for a nation's exports will create demand for their currency.

Other important influences on currency exchange rates include inflation rates, market sentiment, geopolitical events, fiscal policies, commodity prices, and cross-border capital flows.

The **interbank foreign exchange market** also plays a huge role in determining global currency valuations. The interbank market is where major banks and financial institutions balance currency demand and supply to set benchmark exchange rates. These benchmark rates then guide retail exchange rates for consumers and businesses around the world.

Macro Factors

Macroeconomic fundamentals such as inflation, interest rates, and economic growth can have huge effects on currency exchange rates. Here's how:

Inflation: High inflation reduces a currency's purchasing power, making exports more expensive, weakening demand, and leading to a drop in a currency's value.

Interest rates: Central banks use interest rates to stimulate or cool economic activity, which affects exchange rates. Higher national interest rates attract foreign capital and make a currency more attractive to hold. Conversely, lower rates tend to have the opposite effect.

Economic growth: GDP measures the health of an economy, and GDP growth signals stability and investment opportunities. This is attractive to foreign investors and can increase demand for the nation's currency, positively affecting its valuation. Currently Indian GDP calculation method has been questioned by world bodies the main reason behind this is Governments (Central as well as States) are declaring BIG BUDGET SCHEMES with short completion periods and including the entire budgeted amount as expenditure in GDP calculations.

Relation Between Exchange Rate And Economic Conditions Of Country

Exchange rates are affected by 14 different factors, when we go through them minutely, we understand the relations between exchange rate and economic conditions of the country. The factors are

1. Inflation: Inflation leads to price increase of all commodities and the products reducing the purchasing power of the national currency reducing the demand for the products and commodities. This situation the exports are affected adversely as high-priced product/commodities become un-attractive to importers from other countries and exports go down.

When inflation is low prices drop and products become attractive to importers from other countries and exports go up improving "BALANCE OF TRADE" the currency becomes strong

2. Interest rates: High interest rates attract FDIs (Foreign Direct Investments) bringing in the strong currency in the country that leads to countries foreign currency stock going up making the local currency STRONG

3. Trade deficits: This point is explained under INFLATION already but we must look in to the effect of NEGAIVE balance of trade. Negative balance of trade leads to reduction of foreign exchange (hard currency- acceptable to all the countries in exchange of products being purchased by Indians) with the RBI leading to RBI required to purchase foreign exchange (Hard currency) in open market at HIGH price reducing the value of Rupee further.

In the regulated rates Countries hold prescribed amount of HAD currency and OR Gold reserves. Currently India is not having the required (in comparison to external debts) gold reserves and hard currency. As of late 2025 (around September), India's official gold reserves, held by the **Reserve Bank of India** (RBI), are approximately **880 metric tonnes**, placing India among the top ten gold-holding nations globally, with a significant portion stored domestically and the rest with international institutions like the Bank of England (BoE) and Bank for International Settlements (BIS).

Debts of the country (Investor confidence): High debts on the country reduces investor confidence on the country reducing inflow of FDIs. There are many instances when some countries nationalized many industries in that country to reduce the debt, but this led to losses to the investors from other countries,

Deficits across states have led to accumulated debt of 27.5% of GDP (as of March 2025), leading to crowding out of expenditure on other development activities. Since GST implementation in 2017, aggregate revenue from taxes subsumed under GST has declined from 6.5% of GDP in 2015-16 to 5.5% in 2023-24

Can Currency rate fall even when GOLD and FOREX reasons are HIGH?

A currency's exchange rate can fall despite high gold and foreign exchange reserves because numerous other powerful economic factors determine its value in a floating exchange rate system. High reserves provide a safety net but do not override the daily forces of **supply and demand** in the foreign exchange market.

Key reasons for a currency's decline despite high reserves:

Current Account Deficit (Trade Imbalance): If a country consistently imports more than it exports, the demand for foreign currency (e.g., the US Dollar, which is often used in international trade) is higher than the demand for its domestic currency. This persistent net outflow of a nation's currency puts downward pressure on its value, irrespective of its reserves.

Higher Domestic Inflation: If a country's inflation rate is significantly higher than that of its trading partners, its goods become less competitive in the global market. This decreases demand for its exports and thus its currency, leading to depreciation.

Interest Rate Differentials: If other countries (especially major economies like the US) raise their interest rates, foreign investors may move their capital to those countries to seek better returns. This outflow of capital increases the supply of the domestic currency in the forex market, causing its value to fall.

Economic and Political Instability/Risk Aversion: Global investors prefer stability. If a country, despite high reserves, faces political uncertainty, policy changes, or a general lack of confidence in its future economic growth, investors might pull their money out (capital outflow), which can cause the currency to depreciate.

Strengthening of Other Currencies: A currency's value is always relative to others. If a major global currency, like the US Dollar, appreciates sharply due to its own strong economic performance or safe-haven demand during global crises, other currencies may depreciate in comparison, even if their own economic fundamentals (including reserves) are stable.

Central Bank Actions: Ironically, a central bank might actively accumulate more foreign reserves (by buying foreign currency with domestic currency) to buffer against future shocks, which can increase the supply of the domestic currency and thus cause its value to fall in the short term.

In essence, high reserves can act as a "protective shield" and help a central bank manage volatility, but they cannot fully counteract the sustained pressure from adverse fundamental economic factors or global market dynamics.

MOU signed and actual Inflow of FDI

It is found that Propaganda shows very HIGH inflow of FDI and creation of jobs, but in actual effect the inflow is much lower that the MOUS signed, this happens because of **Unpredictable policy and Tax regime** Difficult exit policies, red tapism, bureaucratic inertia, and political deadlock play a great role in maintaining the gap between MoUs signed and actual FDIs in the Indian economy. Prolonged litigations involving government. Unilateral Withdrawal from Bilateral investment treaties.

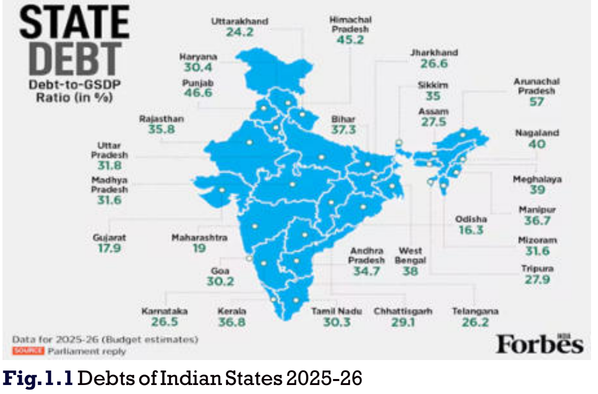

Fig.1.1 Debts of Indian States 2025-26

So, High debts lead to LOW FDIs

5. Imports-Exports (balance of Trade): AS explained earlier when the balance of trade is NEGATIVE (current situation for India) the need for strong international currency (Doller/Euro/Pound) goes up reducing the value of local currency.

India's current account deficit is at record high from 2022-23 India's current account deficit narrowed to USD 12.3 billion, or 1.3% of GDP, in the July–September 2025-26 quarter, down from a revised USD 20.8 billion, or 2.2% of GDP, in the same period last fiscal year.

6. Economic Indicators: Countries economic indicators are GDP, Per capita Income, Various indexes showing happiness/health/poverty etc. India is showing HIGH GDP growth rates but the world watchers have given "C" grade to the calculations of GDP showing suspect on the methods used to calculate the GDP. India is at FOURTH place in GDP but in all other indexes we are at almost the bottom.

7. Political stability and economic performance: Thankfully India is politically stable and so even with HIGH inflation economic performance is not BAD

8. Market sentiments: India is attracting good level of FDI lead by Singapore and Mauritius (suspected money laundering by Indians)

9. Government/Public debts: High level of Government/Public debts reduces the value of the currency internationally. Currently all state governments and central government are having Very high level of Debts (% of GDP that is accepted at 2.5% but currently are in TWO-digit levels)

10. Terms of trade: In good economic conditions the terms of trade are favourable to the country, but when the conditions are not so good the importing countries charge high tariffs reducing the imports – exports for exporting country. We are facing such situation with USA.

11. Current account deficits: We already discussed this point earlier

12. Government interventions: Governments intervein by purchasing foreign exchange and reduce exchange rates OR keep the local currency at LOW exchange rates helping exporters to improve exports (China does this)

13. Stock Markets: Stock markets attract FIIs (foreign investment institutes), many countries manipulate the stock markets artificially (Indian stock markets show such instances) attracting FIIs. Indian stock market gets mostly from Mauritius and Singapore (suspected money laundering amounts of Indians)

14. Economic recessions: Economic recession always leads to loss of currency value, thankfully we do not have such situation

CONCLUSIONS:

After going through all these facts, we can conclusively say as following

1. The rupee is constantly falling because of HIGH inflation rates that increases the prices of all the commodities and products making them less attractive for exports and so there is very little demand for Indian rupee/ low inflow of dollars internationality (to purchase Indian products) leading to weak Rupee against International currencies.
2. Negative balance of trade (More imports as against exports- failure of ATMANIRBHAR BHARAT?) leading to low or NO inflow of dollars.
3. Very high debts on the country are reducing investor confidence on India, though government declares many contracts being signed for FDI actual investment is not visible. Without actual investments coming jobs are getting created
4. Red tapism, corruption prevents/reduces FDIs from coming to India

It is very difficult to pinpoint the REASON behind the CRASH of Indian currency to become the lowest value currency in entire Asia. It is an combined effect of policy stability, negative balance of trade and HIGH debts for central government as well as state governments.

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