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Comparative Analysis of Impact of Exchange Rate Volatility on Aggregate Exports Undertaken by India and UK

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Abstract:

Exchange rate volatility can be defined as currency appreciation or depreciation that can adversely or positively influence profitability of trades. The aim of this study is to analyse two prominent national economies, India and the United Kingdom. The findings shed light on volatility of exchange rate in India and analysed the negative impact on the country's trade exports. This has been done by following a secondary study methodology where a number of peer-reviewed articles are thematically analysed. On contrary to this volatile economy, the UK shows a promising growth in its net export rates. Critical appraisal of scholarly articles helps to understand the effects of this volatility in two contrasting economies and their exchange rates. Hence, this research concludes that exchange rate volatility can play a significant role in import export practices of a country.

Keywords: *Exchange rate, Exchange rate volatility, Inflation, Exports, Aggregate exports, Devaluation of domestic currency.*

I. INTRODUCTION

Background of the research

Exchange rate volatility refers to a situation where in the appreciation or depreciation in the currencies affects the trades' profitability. It has been found that in recent years both the economy of India and the UK have been subjected to exchange rate volatility that has in turn affected their aggregate exports considerably. As per reports, the exchange rate volatility in India has been found to negatively affect the exports. On the other hand, it has been seen that the overall exports of the UK have been affected favourably due to the exchange rate fluctuations. Therefore with the help of this research, a comparative analysis of the effect of exchange rate volatility on both UK and India's exports have been undertaken. The study aims to find out the reasons behind differences in impact or similarities observed if any in the context of fluctuations in exchange rate on aggregate exports for both countries.

II. RATIONALE

It is known that the Exchange rate fluctuations if leads to depreciation of currencies then it appear to be beneficial for exports and unfavourable for imports (Daly, 2019). This is because since in case of imports, countries have to purchase by paying money in terms of foreign currency which proves to be expensive. On the other hand, in the case of exports, exporters benefit as they receive money in terms of foreign currency (Akram& Rashid, 2018). Hence, if this theory of exchange rate volatility that

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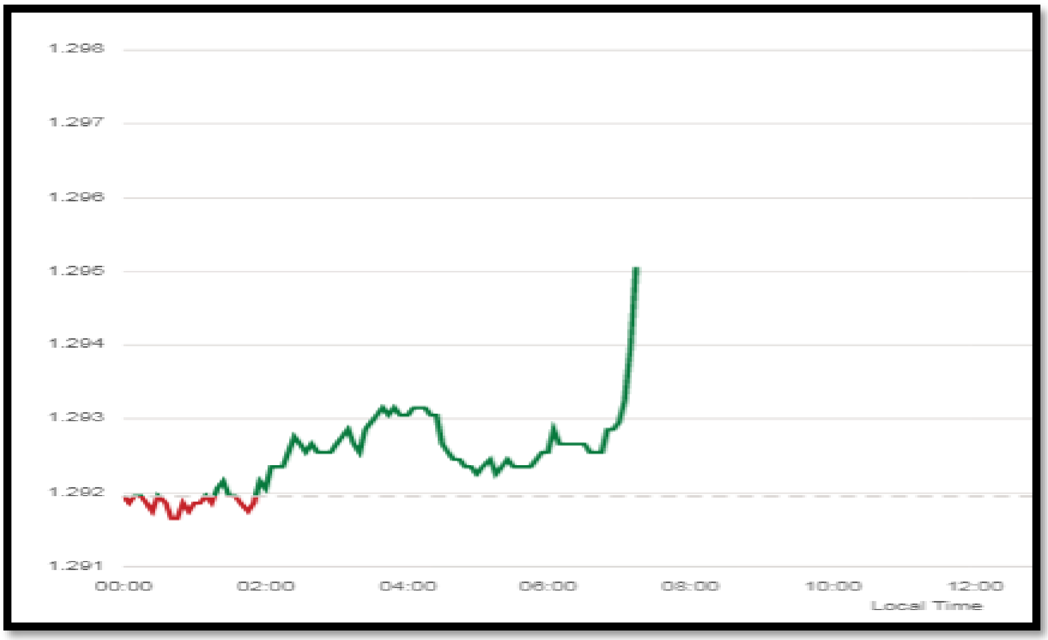
ultimately leads to depreciation in currency, is to be considered, then, exports seems to be favourably affected for India and UK. However, on comparison, it has been found that in spite of falling rupee, India' exports have not seen much growth in past years. On the contrary, the UK has registered a high growth in exports and adverse exchange rate volatility has not affected exports drastically.

In context of India, the volatility in rate of exchange has led Rupee to fall against major currencies in the world for example Pound sterling and US dollars. As per recent observations, the present rate of 1 Rupee is 0.011 Pound sterling (exchangerates.org.uk, 2019). On the other hand, in terms of US dollars, 1 Rupee equals 0.014 US$ (economictimes.indiatimes.com, 2019). Based on the current state of India's currency depreciation against major currencies of the world, it could have been predicted that the exports would rise. On the contrary, it has been recognised that the exports have only accounted for 27% of the GDP and in certain areas such as that of jewellery; the exports have increased (economictimes.india times.com, 2019). In case of the UK's currency it has been seen that the UK currency is going strong against the US dollars. This is because as per reports, 1 pound sterling is equal to 1.30 US dollars (bbc.com, 2019) [*Refer to Figure 1*].



(Source: bbc.com, 2019)

FIGURE 1: GBP against USD

It has been found out that even against the Indian currency, Pound sterling has performed well and current rate is 1 pound sterling equal to 92.97 Rupees. It has been identified that in spite of appreciation for UK's currency, the exports have not fell rather it has recorded a growth. Therefore, it can be said that the biggest issue from the point of view of exporters is that in spite of decline in domestic currency they are not able to benefit substantially (Dua& Suri, 2018). Thus, the study focuses on the comparative analysis behind the differences in effects of volatility in exchange rate on exports.

III. AIMS AND OBJECTIVES

Aims

The research aims to compare the effect of volatility in exchange rate between the UK and India's exports.

Objectives

The goals that this study aims to fulfil through detailed study are outlined below;

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- To understand the effect of fluctuations in exchange rate on exports
- To analyse the effect of volatility in rate of exchange on India's exports
- To assess the effect of fluctuations in rate of exchange on UK's exports
- To compare between the impacts observed in case of both UK and India
- To offer recommendations on ways to eliminate the adverse effects of exchange rate fluctuations

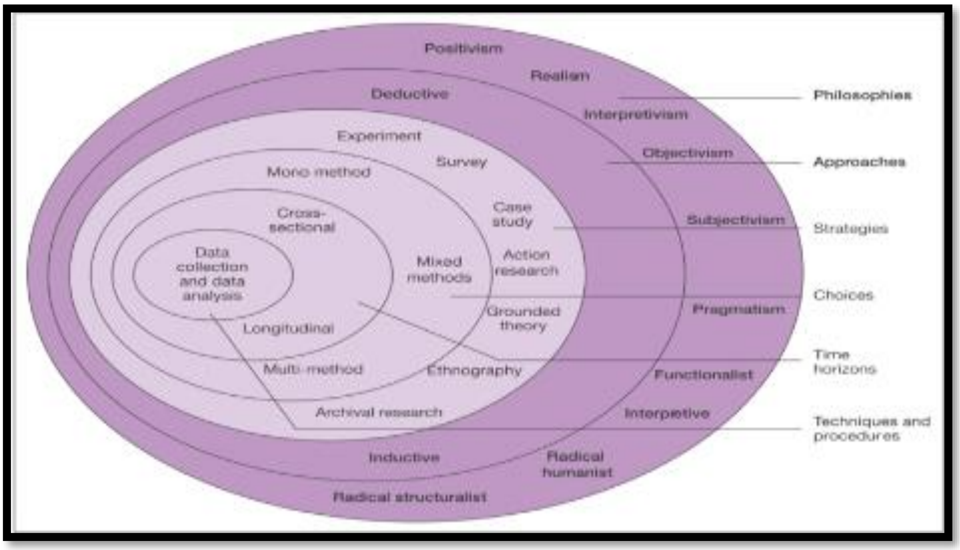
Research questions

- What is the effect of fluctuations in exchange rate on exports?
- How volatility in rate of exchange affects India's exports?
- How fluctuations in rate of exchange affect UK's exports?
- What are the differences or similarities identified between the impacts observed in case of both UK and India?
- What recommendations on ways to eliminate the adverse impact of fluctuations observed in exchange rate, can be offered?

IV. MATERIALS AND METHODS

Research philosophy

To undertake the research on analysing and comparing the effect of fluctuations in rate of exchange on aggregate exports of UK and India, ***Post Positivism research philosophy*** has been used. It has helped in analysing the factors effectively as well as the past researches have been evaluated by seeking appropriate warrants for arriving at conclusions (Quinlan *et al.* 2019).



(Source: Saunders *et al.* 2009)

FIGURE 2: Research Onion

Research approach

Deductive research approach has been undertaken to identify the differences or similarities in the context of the effect of volatility in rate of exchange on UK and India's exports. It has been seen that deductive approach has offered varied number of logical reasons (Walliman, 2017). This logical basis of conducting the research has helped in validating the circumstances that are responsible for favourable or unfavourable impact of exports of UK and India.

Research design

A ***descriptive research design*** has been followed and it has helped in describing and understanding the association between aggregate exports and volatility in exchange rate. It has helped in understanding the characteristics of the variables involved (Quinlan *et al.* 2019). These are identified to be UK's exports, India' exports, volatility in exchange rate in India and exchange rate volatility in the context of UK. It also helped in identifying the differences or

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similarities between the impacts observed on exports of two countries.

Data collection methods

The data collection method has been chosen to be secondary data analysis. Reason behind choosing the ***secondary data collection method*** is known to lay in the fact that volatility in exchange rate and its impact on aggregate exports belongs to macroeconomic level (Silverman, 2016). Therefore, the data related to exchange rates impact cannot be collected through primary data collection method as people do not possess the idea about current rates of currencies, its performances, as well as its effect on aggregate exports. Data related to such macroeconomic factors can be gathered from different websites, journals, articles and books. For this research, different journals that are relevant to volatile exchange rate and its impact on aggregate exports both in the case of the UK and India have been used. On the other hand, exchange rates and amount of exports that are related to current period have been found out from websites. Based on all of these data, a secondary thematic analysis has been conducted.

V. RESULTS

It has been found out that the rupee exchange rate is one of the major determinants of aggregate exports that India undertakes. Similar is the case with other countries that is UK where in pound sterling as the currency decides the faith of exports rates. As per the opinion of Kaur, (2018), it has been identified that in the long run of an economy rupee currency depreciates. Moreover, Kaur, (2018) indicated towards the depreciation of Rupee or any currency to be beneficial for exports. In addition to this Belke&Ptok (2018) in their research recognised that the export relationship between Europe and the UK exists. They further through the results made it clear that the variety of specifications have been estimated for modelling uncertainty in economy, constant uncertainty, fluctuations in exchange rate and in European equity markets. However their research has not been able to show evidence of effects on British exports due to exchange rate volatility. The kind of relationship that exists between the Europe and UK has in the past affected the export rates significantly and it has been due to Brexit. It has been seen that exports declined gradually during the phase of Brexit and it was also during this time that UK' currency fell weak. This outlined an important factor that proved classical theory of exports and currency to be wrong. This is because, though the pound sterling became weak during the phase of Brexit, still, there was no form of increase in exports. Hence the main focus of Belke&Ptok (2018) has been found to be on European side. Thus it has also highlighted one of the significant aspects in relation to the classical relationship that exists between exports and exchange rates. It has been identified that exports of a country such as that of UK reacts abruptly if the fluctuations in exchange rate go beyond a specific boundary. The author has stated that there are numerous factors responsible behind deciding the increase or decrease in export levels of a country. Therefore, decrease in currency cannot be adjudged to be positive for exports. On a different tangent, Jacob &Kattookaran (2017), investigated whether the exchange rate fluctuations affect the returns from stock market in India. By using ***ARDL model*** the effects of exchange rate on the stock market return has been analysed in the context of India. Jacob & Kattookaran (2017) has recognised that there are adverse association between stock market returns and exchange rate fluctuations. In this case the role of local currency is also found to be essential because effect of local currency might lead to decline in stock returns. Moreover, it has been seen that the depreciation in currency leads to increase in competition among the domestic exporting firms and this leads to rise in stock market prices. However, the findings that Jacob &Kattookaran (2017), presented is not completely out of focus, this is because, it helped in identifying an additional factor that leads to changes in exchange rate and decides the future of exports. Furthermore, it has been seen that this also holds true for the other countries like

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that of UK. Since the currency of UK that is Pound sterling is going strong in present times, still it can be said that the domestic firms in UK must also be competing aggressively. This is to enhance their stock performances in the market and hence it can be a reason behind rise in exports. Shafi, Liu & Rehana (2015) has found out the impact of imports, exports, and inflation, along with interest rates on the rate of exchange. Based on the findings of Shafi, Liu & Rehana (2015) it has been made clear that all the factors mentioned above have a significant impact on the real effective exchange rate. The impact on REER has been seen to be existence in both in the short and long run. Shafi, Liu & Rehana (2015) on the contrary have analysed a reverse ideology and has stated that increase in exports leads to an increase in real effective exchange rate. Moreover, exchange rate has a positive relationship with that of the economic growth of the UK. This means that currency fluctuations have no significant role to play in the international market of UK. Therefore, other factors are responsible behind increase or decrease in aggregate exports in UK. Tripathy& Gil-Alana (2017) on the other hand, have helped in analyzing the asymmetric volatility of foreign exchange rates against that of Indian rupee. This has been done by identifying related macro-economic regimes in India. Volatility spillovers and its relationships of Indian rupee (INR) with that of US dollar and other currencies have been analysed. Rashid & Waqar (2017) found out through their research that differences in the exchange rate and the rate at which it fluctuates affect the exports of manufacturing firms. Rashid & Waqar (2017) majorly focussed to investigate how and when exchange rate volatility affects international sales.

It has been observed that a decrease or increase in REER volatility reduces or enhances volumes of export. As per the opinion of Flavio & Macdonald (2016), it has been estimated that coefficients of the financial crisis are favourable and thus it is significant statistically. It indicates the relationship between export volume and trade is inelastic in nature. Hooy&Baharumshah(2015), examined trade and exchange rate volatility of Six Asian countries. It has been known that volatility in exchange rate is inherently asymmetric for all currency markets. Moreover it has been seen that the volatility in exchange rate has more adverse effect on the exports of developing countries rather than on industrialised countries. Hence it can be stated that the findings can be said to be applicable for both India and UK. This is because both of these countries have large number of industries and thus they are subjected to vital changes in exchange rates. On the other hand, exporters in India and UK have to face a huge exchange risk as large numbers of goods are exported to other countries.

VI. FINDINGS

It has been found out as per classical theory of volatility in rate of exchange that affects exports of a country, rise in currency rates leads to decrease in exports and vice versa. However in reality this has not been observed to be the case. This is due to the fact that Indian currency has declined gradually over a large number of years. Hence in this case the exports should have increased substantially, however in reality the opposite has been found out. This is because in relation to certain number of sectors, only a rise in exports has been registered.

It has been recognised that on an overall basis the exports have declined and there has been significant evidences of it. Therefore it can be said that weakening of currencies has not led to rise in aggregate exports because there are other factors also involved. These are known to be inflation, stock market performance and competition in exports. Since the inflation rate in India is high hence the prices of materials have increased and this altogether increases the cost of capital required to be exported. On the other hand, if there is less competition among the exporters, then exports decline considerably.

In case of UK, it has been observed that there is a significant rise in export levels. However in relation to UK also classical relationship that exists between exports and changes in exchange rates has proved to

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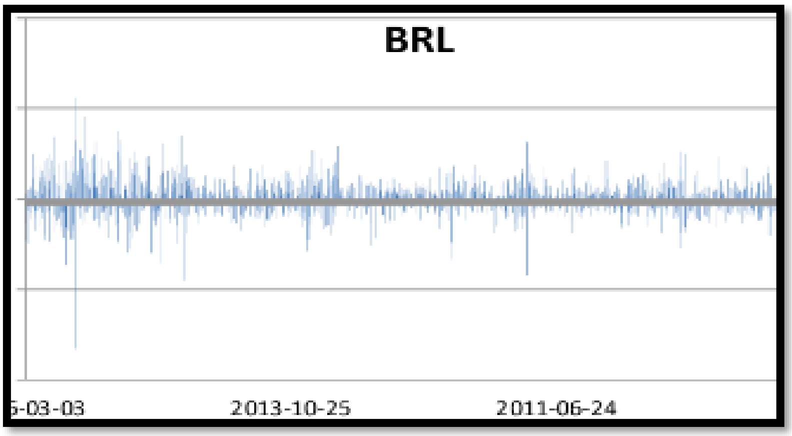
be inapplicable. This is because UK's Pound sterling post Brexit has acquired enough strength and has been identified to be strong against US Dollars as well As Indian Rupee. In spite of the rise in pound sterling, the exports have increased and a possible reason behind this is low rate of inflation and high competition among exporters. Therefore it can be said that along with volatility in exchange rates, factors such as inflation, competition among exporters of a country and others also play an important role to influence export levels.

VII. DISCUSSION

Secondary thematic analysis

Current scenario of volatility in exchange rate in India

Exchange rate volatility refers to the risks that arise out of the changes in currencies over a period of time (Bhat & Acharya, 2019). The current state of exchange rate has been found to follow a declining trend. This means that Indian rupee is at a stage where in it would continuously decline. Hence if a classical theory that states that decline in currency are favourable for rate of exports is considered then it can be inferred that exports of India would be stronger. However, contrary to this assumption, it has been seen that India's export in relation to certain sectors such as apparel and clothing as well as service industries has been lower than expected (economictimes.indiatimes.com, 2019). Only in case of industries like Jewellery, and IT, exports have been found to be higher (economictimes.indiatimes.com, 2019). Therefore it can be said that due to constant unfavourable changes in Indian Currency along with importers, exporters too face huge risk. [*Refer to Figure 3*]



(Source: researchgate.net, 2019)

FIGURE 3: Exchange rate volatility in Indian rupee in relation to euro

Present state of exchange rate volatility in UK

In the past the UK's exports and exchange rates have been seen to be influenced by Brexit. Mcmahon, (2018) identified that there are three pillars of Brexit Agreement. These have been identified to be Domestic support, market access and export competition. It has been outlined that due to Brexit, there have been changes or volatility observed in case of exchange rates. This means that in the past despite of decline in Pound sterling, the exports did not rise substantially because economic and trade policies were affected due to Brexit (Roy & Mathur, 2016). However as per present state, three has been a rise in exports input of the pound sterling are going stronger against US Dollars and Indian Rupee. It has been found out that last year the total exports have accounted for 30% of the GDP (fullfact.org, 2019). In 2017 there was a growth of 17% recorded in terms of exports in the UK and the UK stands at number 6 in the world among the top 10 exporters (fullfact.org, 2019). [*Refer to Figure 4 & 5*]

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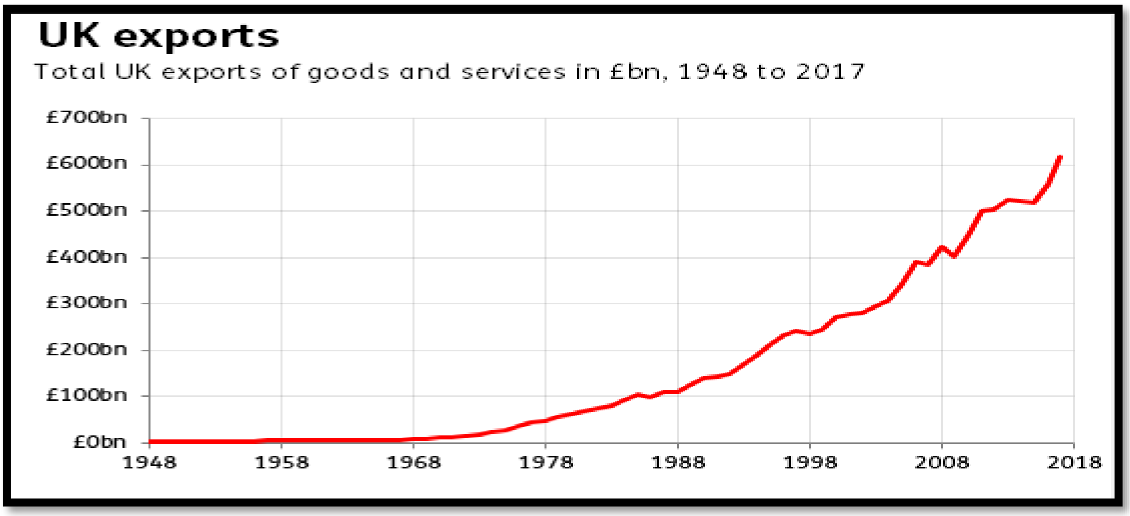
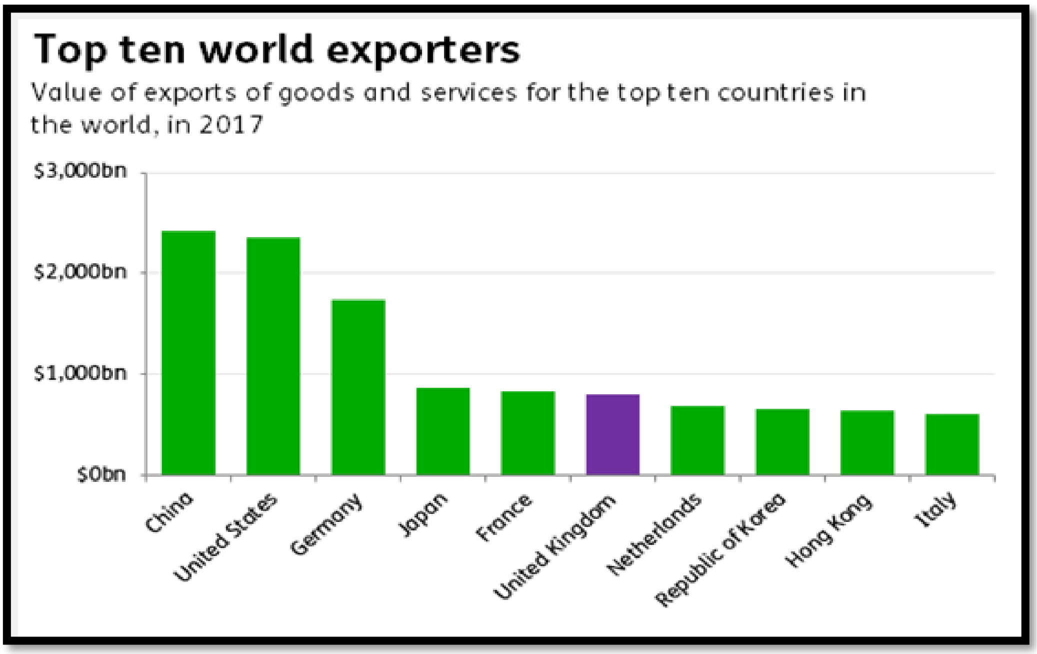


(Source: fullfact.org,2019)

Figure 4: UK exports



(Source: fullfact.org, 2019)

FIGURE 5: Top ten exporters in the world

Impact of Exchange rate volatility on aggregate exports

It has been found out that the overall impact of exchange rate volatility is assumed to be favourable for exports and negative for imports. Moreover as per classical theory also it has been proved that exporters tend to benefit from decline in home currency. However, Mcmahon (2018) identified that there are other factors also involved in case of deciding the effect on exports. For example trade policies, economic policies, inflation and others influence the exports. In case of India, it has been seen that since the inflation of the country has been drastically high for quite a few years, hence it might had led to a decrease in exports rather than increase. As of now the inflation rate in India is registered to be 3.15% (statista.com, 2019). Though it has decreased in comparison to that of 2018 from 3.18% to 3.15% still it has led to a rise in costs of materials as well as services (statista.com, 2019). As per the opinion of Sahoo & Trivedi (2018), devaluation of currency leads to rise in inflation and this in turn increases the prices of materials, labour and other factors used in exporting. Hence it can be said that devaluation of currency and exchange rate volatility led to a decline in aggregate exports in India.

On the other hand, in the case of the UK, a typically opposite scenario has been observed. This is because an increase in the rate of pound sterling would have helped in decreasing the inflation rate of the country. Hence it has led to a rise in exports instead of decline. On the other hand, trade policies as well as economic policies of the UK are stable in recent context. Therefore all these positive factors have led to rise in aggregate exports of UK.

Comparison between Impact of exchange rate volatility on aggregate exports in India and UK

Impact of exchange rate volatility has been seen to be favourable in case of UK and unfavourable in case of India. Exchange rate volatility has been found to have significant impact on exports of both countries. This is because other factors such as inflation, trade policies and economic policies have been identified to play an important role in deciding the increase or decrease in exports. Although the scenario in both countries that are UK and India are completely opposite of each other, still the influence of the factors that are currencies and inflation are the same. On comparison, it has been found out that the UK has been able to control the macroeconomic variables effectively and has improved its currencies performance post Brexit. Therefore the UK has performed effectively to increase its exports in spite of the presence of exchange rate volatilities.

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