Indirapuram Institute of Higher Studies HYPOTHESIS
NATIONAL JOURNAL OF RESEARCH IN HIGHER STUDIES

Volume 1, Issue 1, July 2018, Website: www.theiihs.com/ejournal

Email: editor@theiihs.com

IMPACTS OF THE POLICY OF DEVALUATION OF HOME CURRENCY ON INTERNATIONAL TRADE OF THE COUNTRY

Dr. (Prof.) Sharad Kumar Goel

Director, IIHS

Abstract

Competition is the reality of the world. It is also true for the international trade of the countries. Every country wants to get a favorable place in world's trade. For success in international trade devaluation of the home currency create a positive impact of that country. Devaluation of home currency is helpful in increasing exports and reducing the imports of the country. Devaluation of home currency is shown in difference between GDP (PPP) and GDP (nominal). Present article is showing the various aspects of policy of devaluation of home currency used by countries.

Key Words

GDP (PPP), GDP (Nominal), Devaluation policy, Supply of foreign exchange, Demand of foreign exchange

Introduction

Devaluation of home currency refers a situation where a country dilutes the value of its home currency in comparison of foreign currencies. Devaluation of home currency increases the opportunity of exports but it increase the cost of imports. It reduces the imports by increasing its price for domestic country. It also increase the competition capacity of the country but by decreasing the relative average price of exports, country gets less average revenue from exports in comparison of average revenue before devaluation. Policy of devaluation is shown in the difference between GDP (PPP) and GDP (Nominal) of the country.

Data presentation and Analysis

Table 1- GDP (PPP) of selected countries (For year 2016)

S.N.	Name of country	GDP (PPP)
1	China	21417150
2	United States	18569100
3	India	8702900
4	Japan	5266444
5	Germany	4028362
6	Russia	3397368
7	Indonesia	3032090
8	Brazil	3141333
9	United Kingdom	2796732
10	France	2773932
11	Mexico	2278072
12	Italy	2312559
13	Turkey	1927693
14	South Korea	1832073
15	Saudi Arabia	1756793
16	Spain	1686373
17	Canada	1597517
18	Iran	1352814
19	Australia	1128908
20	Thailand	1164928

Source – (World Bank Data)

Above table is showing GDP (PPP) of different countries. GDP (PPP) is showing the real income of the country earned during one financial year. Data is collected for the year 2016. Rank is assigned on the basis of ascending order. On the basis of data China is the country having highest total real income.

Table 2- GDP (Nominal) of selected countries (For year 2016)

S.N.	Name of country	GDP (NOMINAL)
1	China	11199145
2	United States	18569100
3	India	2263522
4	Japan	4939384
5	Germany	3466757
6	Russia	1283162
7	Indonesia	932259
8	Brazil	1796187
9	United Kingdom	2618886
10	France	2465454
11	Mexico	1045998
12	Italy	1849970
13	Turkey	857749
14	South Korea	1411246
15	Saudi Arabia	646438
16	Spain	1232088
17	Canada	1529760
18	Iran	425326
19	Australia	1204616
20	Thailand	406840

Source – (World Bank Data)

Above table is showing GDP (nominal) of different countries. GDP (nominal) is showing the monetary income of the country earned during one financial year. Data is collected for the year

2016. Rank is assigned on the basis of ascending order. On the basis of data China is the country having highest total real income.

Table 3- Ratio of Real GDP and Nominal GDP of selected (For year 2016)

S.N.	Name of country	GDP (PPP)/ GDP (NOMINAL
1	China	1.91
2	United States	1.00
3	India	3.84
4	Japan	1.07
5	Germany	1.16
6	Russia	2.65
7	Indonesia	3.25
8	Brazil	1.75
9	United Kingdom	1.07
10	France	1.13
11	Mexico	2.18
12	Italy	1.25
13	Turkey	2.25
14	South Korea	1.30
15	Saudi Arabia	2.72
16	Spain	1.37
17	Canada	1.04
18	Iran	3.18
19	Australia	0.94
20	Thailand	2.86

Source – Computed from table (1) and table (2)

Above table is showing the ratio of GDP (PPP) and GDP (nominal) of different countries. Ratio of GDP (PPP) and GDP (nominal) is showing the value of purchasing power parity (PPP) of the countries. On the basis of calculated purchasing power parity following points can be outlined.

1. Value of the purchasing power parity is showing the degree of devaluation used by that

country.

2. Higher value of PPP is showing the higher devaluation degree or dependence on devaluation policy of the country.

3. PPP = 1, is showing no devaluation of home currency of the country.

4. PPP > 1, is showing home currency if more strength then its real value of the country.

Effects of devaluation policy on foreign reserves of the country

1. Increase in supply of foreign currencies in home country - Devaluation of home currency make cheap the home goods for foreigners. It increases the supply of foreign currency in home country.

2. Decrease in demand of foreign currencies in home country - Devaluation of home currency makes dearer the foreign goods for home country. It is responsible for decrease in demand of foreign in home country.

3. Increase in demand of home currency in foreign countries - Devaluation of home currency makes cheap the home goods for foreigners. It is responsible for increase in demand of home goods in foreign markets and makes opportunity of foreign investment in home country. It also increases the demand of home currency in foreign countries.

4. Decrease in supply of home currency in foreign countries Devaluation of home currency make dearer the foreign goods for home countries. It is responsible for decrease in demand of foreign goods in home markets. It also decreases the supply of home currency in foreign countries.

Benefits of Devaluation of home currency

1. Chances to increase the export of the country - Devaluation of home currency make cheap the home goods for foreigners. It increases the demand of home goods in foreign markets and helpful in increasing the export of the country.

2. Increase in competition capacity of the country - Devaluation of home currency make cheap the home goods for foreigners. It increases the demand of home goods in foreign markets. Increasing demand of home goods in international market improves the competition capacity of the country.

3. Decrease in imports of the country - Devaluation of home currency makes dearer the foreign goods for home country. It decreases in demand of foreign goods in home country and responsible for decrease in imports of the country.

4. **<u>Increase in FDI and portfolio investments</u> -** Devaluation of home currency makes cheap the home goods for foreigners. It is responsible for increase in demand of home goods in foreign markets and makes opportunity of foreign investment in home country. Increase in FDI and other investment helpful in growth and financial betterment of the country.

5. **<u>Reduction in Balance of Trade</u> -** Devaluation of home currency makes cheap the home goods for foreigners. It increases the demand of home goods in foreign markets or improves exports. Other side it also decreases in demand of foreign goods in home country or reduce the imports. Its overall effect is positive on balance of trade.

6. **<u>Positive for foreign exchange reserves</u>** - Devaluation of home currency makes cheap the home goods for foreigners. It is responsible for increase in demand of home goods in foreign markets and makes opportunity of foreign investment in home country. It also increases the demand of home currency in foreign countries, and also responsible for decrease in demand of foreign goods in home markets. It also decreases the supply of home currency in foreign countries. Its overall effect on foreign reserves is positive for the country.

7. **<u>Use of unused production capacity of the country</u>** – Increase in exports and decrease in imports is helpful in exploring the unused capacity of production in country. It also increase the efficiency in production in country as increasing the production capacity doesn't increase the total fixed cost in same proportion of the increase in total variable cost.

<u>Losses of Devaluation of home currency</u>

1. **<u>Increase in the cost of imports</u>** – Devaluation of home currency increases the opportunity of exports but it increase the cost of imports. By increasing the cost of imports country gets the less quantity of import goods in comparison of the imports, before devaluation.

2. **<u>Decrease in rate of revenue or price of exports</u>** - Devaluation of home currency increases the opportunity of exports but it increase the cost of imports. It also increase the competition capacity of the country but by decreasing the relative price of exports, country gets less average revenue from exports in comparison of average revenue before devaluation.

3. **<u>Starting of counter action used by other countries</u>** – Devaluation of home currency affects the interest of the country as well as affects the interest of other competitive countries in international markets. It is responsible for counters of the competitive countries in form of monetary and other changes in their policy.

4. **<u>Harmful for long run relation among countries</u>** - Devaluation of home currency affects the interest of the country as well as affects the interest of other related countries It badly affects the overall interest of all the related countries by high rate of fluctuation in exchange rates and in changes in exports and imports. Highly fluctuated situation is harmful for long run relations among countries.

Conclusion

It is observed that policy of devaluation is adopted by the countries by following reasons.

1. Country has unused production capacity
2. Proportionate share of country in international trade is very low
3. Country wants to increase its exports
4. Developing countries needed more transaction of trade
5. To counter the strategy of competitive country

Finally it can be said that policy of devaluation is much relevant in present time. Various countries are using the policy of devaluation to gradual increase their role in international market, but it provides the opportunity in short run until other countries are not taking counter action of the same.

References

1. Due, P., Sen, P. (2006) "Capital flow Volatility and Exchange Rates:
2. Reserve Bank of India statistics- http://www.rbi.org.in/scripts/statistics.aspx
3. Simon W.L.S. (1997), "Is There Life Outside the ERM? An Evaluation of the Effects of Sterling's 4. Devaluation on the UK Economy", International Journal of Finance and Economics, 2,199-216
4. Singh Kavaljit "Why is Indian rupee Depreciating"?- Madhyam Briefing paper .Pg 1-5
5. Fundamentals of Marketing, McGraw Hill, New York
6. Gunter Barrie and Adrian Furnham (1992)
7. Gupta C B - Essential of Marketing Management (2014),Sultan Chand & Sons, New

Delh

8. Halbert, Michael (1965); The Meaning and Sources ofMarketing Theory, McGraw-Hill, New York.
9. Kapferer, Jean-Noel (1992), Strategic Brand Management,New York: Free Press.
10. Mahajan J P and Mahajan, Anupma (2014), MarketingManagement, Paperback, New Delhi.
11. The Economic Times (Daily)
12. The Hindustan Times (Daily)
13. Financial Express (Daily)
14. Business Today (Magazine Weekly)