fluctuations in the exchange rate in the face of internal and external shocks. Exchange rate fluctuations are likely, in turn, to determine economic performance. In judging the desirability of exchange rate fluctuations, it becomes, therefore, necessary to evaluate their effects on output growth and price inflation (Magda Kandil, 2006).

The relationship between the exchange rate and economic development is certainly an important subject, from both descriptive as well as policy prescription perspective. Several developing countries that have implicitly or explicitly fixed their exchange rates to the currency of another country (say, the U.S. dollar) and whose inflation rates are higher than that of the foreign country (the United States) often experience persistent current account deficits and eventual devaluations of their currencies. Devaluation often invites inflation and thus pushes the economy into an inflation devaluation spiral, causing a serious setback in economic development.

Inflation rates change across time mainly due to two reasons, a) change in the monetary policy framework (eg. shifting from fixed exchange rate regime to a floating exchange rate regime, or adopting an inflation targeting framework rather than focusing on exploiting short-run output gains etc.), and b) change in the ‘inflation process’ (Cecchetti and Debelle (2006)). However, as claimed by Sargent (1999), these two reasons may be interrelated. Thus, several researchers attempt to explain change in inflation process with reference to changes in exchange rate regimes. However, it appears that no agreement has been reached so far on the issue that; changes in exchange rate regimes are associated with changes in inflation persistence. On one hand, several studies suggested that flexible exchange rate regimes resulted in higher persistence of inflation, on the other hand, some researchers show that changes in inflation persistence are not associated with exchange rate regimes shifts, but there are some other factors like oil price shocks, central bank reforms, outbreak of wars etc. which explains the persistence in the inflation rate.
The link between exchange rate volatility and trade is well established. The basic idea is the following. If commodity traders are risk averse (even risk-neutral), higher exchange rate uncertainty may lead to a reduction in the volume of trade because they may not want to risk their expected profits (Brodsky, 1984). Whenever there is uncertainty, a trader or economic agent will demand for a higher price as compensation for their exposure to currency risk. This decreases volume of trade and direct investment.

Exchange Rate is one of the vital factors for any country as it determines the level of imports and exports. The exchange rate explains that if the domestic currency appreciates with respect to a foreign currency then its goods become more expensive in the international market which results in loss in price competitiveness and if the domestic currency depreciates then exports will become cheaper and thereby increasing price competitiveness in the international market.

The Asian Currency Crisis in 1997 demonstrates how critically exchange rates impact economic developments (Stanley Fischer (2001)). Stanley Fischer, First Deputy Managing Director of the IMF, noted that one of the three factors that led to the crisis was the maintenance of pegged exchange rate regime for too long which encouraged external borrowing and led to excessive exposure to foreign exchange risk in both the financial and corporate sectors. Other factors contributing to the crisis were wide swings of the yen/dollar exchange rate over the past three years.

Hence, exchange rate volatility can affect the competitiveness of firms in different countries. In fact, it can potentially have a positive or a negative effect. On the one hand, firms are faced with the risk inherent in volatile exchange rates. On the other hand, firms have the opportunity to move production to reap the advantage of economies of scale to the countries where the exchange rates are less volatile. (Cushman (1985), Goldberg and Kolstad (1995)).
SECTION 1.1

Conceptual framework of Exchange Rate:

“Foreign exchange” refers to currency of a nation denominated in the currency of another nation or group of nations. Any person who exchanges money denominated in his own nation’s currency for money denominated in another nation’s currency acquires foreign exchange. That holds true whether the amount of the transaction is equal to a few dollars or to billions of dollars; whether the person involved is a tourist encashing a traveller’s cheque in a restaurant abroad or an investor exchanging hundreds of millions of dollars for the acquisition of a foreign company; and whether the form of money being acquired is foreign currency notes, foreign currency denominated bank deposits, or other short term claims denominated in foreign currency. A foreign exchange transaction is a shift of funds, or short-term financial claims, from one country and currency to another. The Foreign Exchange Management Act (FEMA) defines foreign exchange as foreign currency and includes all deposits, credits and balance payable in any foreign currency and any drafts, traveler’s cheques, letters of credit, and bills of exchange drawn by banks institutions or persons outside India but payable in Indian currency.

Exchange rates are regularly quoted between all major currencies, but frequently one important currency, e.g. the dollar, is used as a standard currency to express and compare all rates. The exchange rate of all fully convertible currencies is determined, like any price, by supply and demand conditions in the market. This market is called Foreign Exchange Market. More fundamentally, such supply and demand conditions are determined by whether the country’s basic Balance of Payments is in surplus or deficit.

Almost every nation has its own national currency or monetary unit whether its American dollar, Mexican peso or Indian rupee. All the countries use their respective currencies for making and receiving payments within its own borders. But foreign currencies are usually needed for payments across national borders. Thus, in any nation whose residents conduct business abroad
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or engage in financial transactions with persons in other countries, there must be a mechanism for providing access to foreign currencies, so that payments can be made in a form acceptable to foreigners. In other words, there is need for “foreign exchange” transactions i.e. which exchanges one currency for another.

One of the most important aspects of currency exchange rates is that the value of a certain currency fluctuates with respect to another. The value of a given currency rises and falls with supply and demand of that currency, which in turn, determines the exchange rate. For instance, if the U.S. set very high interest rates, foreign savers might want to save in U.S. financial institutions and demand dollars, which would increase the relative value of the dollar. On the other hand, if the U.S. government decided to print a large amount of new currency, the money supply would increase, diluting the value of existing dollars.

Another important aspect of currency exchange is the tendency for certain currencies to become overvalued or undervalued. The value of a currency can be derived from its ability to purchase a certain bundle of goods. If exchange rates perfectly reflected the purchasing power of money, one would be able to exchange money from one currency to another and purchase the exact same bundle of goods in either country.

The Foreign Exchange Management Act, 1999 (FEMA) regulates the whole Foreign exchange market in India. Before the introduction of this act, the foreign exchange market in India was regulated by the Reserve Bank of India through the Exchange Control Department, by the Foreign Exchange Regulation Act (FERA), 1947. After independence, FERA was introduced as a temporary measure to regulate the flow of the foreign capital. But with the economic and industrial development, the need for conservation of foreign currency was urgently felt and on the recommendation of the Public Accounts Committee, the Indian government passed the Foreign Exchange Regulation Act, 1973 and gradually, FERA was converted into FEMA. The Reserve Bank
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is responsible for administration of the FEMA Act 1999 and regulates the market by issuing licenses to banks and other selected institutions to act as Authorised dealers (ADs) in foreign exchange market. The act was put into operation from June 1, 2000. The foreign exchange department under RBI is responsible for the regulation and development of the market.

In the foreign exchange market a number of conceptual exchange rates are used such as:

The nominal exchange rate (NEER), \(e\), is defined as the number of units of the domestic currency that can purchase a unit of a foreign currency. A decrease in this variable is termed as nominal appreciation of the currency. An increase in this variable is termed as nominal depreciation of the currency.

The real exchange rate (REER), \(Q\), is defined as the ratio of the domestic price level abroad, where the latter is converted into domestic currency units via the current nominal exchange rate.

Formally, \(Q = \frac{e(P_d/P_f)}\)

Where the domestic price level is denoted as \(P_d\) and the foreign price level as \(P_f\). This rate tells us how many times more goods and services can be purchased abroad (after conversion into a foreign currency) than in the domestic market for a given amount in practice. Thus the changes in the real exchange rates are more important than its nominal level. Therefore, while assessing the effect of exchange rates on international trade, it is desirable to consider the real exchange rate rather than focusing on nominal exchange rate.

The most common type of foreign exchange transaction involves the payment and receipt of foreign exchange within two business days after the day the transaction is agreed upon. The two-day period gives adequate time for the parties to send instructions to debit and credit the appropriate bank accounts at home and abroad. This type of transaction is called a spot transaction and the exchange rate at which the transaction takes place is called the spot rate.
A forward transaction involves an agreement to buy or sell a specified amount of a foreign currency at a specified future date at a rate agreed upon today. The equilibrium forward rate is determined by the market forces of demand and supply of foreign exchange for future delivery. If the forward rate is below the present spot rate, the foreign currency is said to be at a forward discount with respect to the domestic currency. On the other hand, if the forward rate is above the present spot rate, the foreign currency is said to be at a forward premium.

Like a commodity price and its market, in the foreign exchange market also there is an equilibrium rate of exchange and there is a market or short-term rate of exchange. The equilibrium rate is the "norm" around which the market rate of exchange oscillates. The equilibrium or normal rate of exchange is determined differently under different monetary standards. The market rate of exchange will reflect the temporary influence of forces of demand and supply in the foreign exchange market, but it will be oscillating around an equilibrium rate of exchange. According to Scammell "an equilibrium rate is that rate which, over a standard period, during which full employment is maintained and there is no change in the amount of restriction on trade or on currency transfer, causes no net change in the holding of gold and currency reserves of the country concerned." This definition seems to be very useful for policy, or for the forming of judgments upon a given exchange rate phenomenon.

In simple words, however, the equilibrium rate of exchange is the rate of exchange at which the par value of home currency with foreign currency is exactly maintained, which means it is neither undervalued nor overvalued. Further, it is perpetual and stable over a long period of time. In fact, the concept of equilibrium rate of exchange is analogous to the Marshallian concept of 'normal price' in the theory of value. It is the normal rate in the sense that it is determined by the long term equilibrium in the balance of trade so that demand and supply of foreign exchange in the long run are appropriately
Introduction

A nation would be encouraged and its imports would be discouraged until the deficit in its balance of payments was eliminated. The exchange rate equilibrium has been depicted in the Figure 1.1 where the working of the demand and supply forces has brought equilibrium in the exchange rate.

**Figure 1.1**

*Exchange Rate under Gold standard*


In the figureOE is the equilibrium rate of exchange as per the mint parity (under gold standard system) at which the demand for and supply of foreign exchange are equal. Further, it can be seen that a change in the supply schedule for dollars within the interval ZT would simply result in a divergence of the...
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exchange rate from mint par, a shift in the demand for dollars within the range RQ would similarly result in a deviation of the rate from mint parity. Thus, exchange rate may rise upto OU or fall upto OL.

But it cannot rise beyond the gold export point or fall below the gold import point, because at these points the demand for and supply of foreign exchange becomes perfectly elastic by the outflow or inflow of gold. The point s/a is regarded as "gold export point"; at this point the demand curve becomes perfectly elastic. U and L thus set the limit to a devaluation of equilibrium exchange rate from mint parity. And the equilibrium will be restored in this situation when the country gaining gold finds its money supply increasing and prices and incomes are rising, and the reverse will happen in the case of a gold exporting country.

The specie (gold) points are important in the determination of foreign exchange rate under gold standard because they give us an idea of the maximum fluctuations to which the exchange rate in the foreign exchange market is subject to change day-to-day. They also explain why and how the actual rate of exchange differs from that normal rate of exchange which is determined by the mint parity criterion.

Today, however, the method of determining currency values in terms of gold content or mint parity is obsolete for the obvious reasons that:

(i) None of the countries in the world is on gold or metallic standard.
(ii) Free buying and selling of gold internationally is not permitted by various governments.
(iii) Most of the countries today are on paper standard or fiat currency system.

1.2.2 Purchasing Power Parity Theory:

With the breakdown of the gold standard during the period of World War I (1914-18), gold parities and free movements of gold ceased. The mint par of exchange, therefore, lost significance in the exchange markets. Exchange rates
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fluctuated far beyond the traditional gold points and there was complete confusion. To explain this phenomenon and the problem of determination of the equilibrium rate of exchange between inconvertible paper currencies the theory of Purchasing Power Parity enunciated.

Though the original version of the theory can be found in John Wheatley's "Remarks on currency and Commerce (1802)" and in Ricardo's writings too, it was developed and popularized in 1918, by the Swedish economist Gustav Cassel who used the term "Purchasing Power Parity" to explain the working of the theory. Cassel suggested Purchasing Power Parity as the appropriate level at which the exchange rate is set.

The basic idea underlying the purchasing power parity theory is that foreign exchange (foreign money) is demanded by the nationals of a country because it has the power to command goods (purchasing power) in the foreign country. When the domestic currency of a nation is exchanged for foreign currency, what in fact is done is that domestic purchasing power is exchanged for foreign purchasing power. It follows that the main factor determining the exchange rate is the relative purchasing power of the two currencies, for when two currencies are exchanged, what are exchanged, in fact, are the international purchasing powers of the two currencies. Thus, the theory states that the rate of exchange tends to rest at the point at which there is equality between the respective purchasing powers of the currencies.

Hence, the theory seeks to explain that under the system of autonomous paper standards the external value of a currency depends ultimately and essentially on the domestic purchasing power of that currency relative to that of another currency. The theory, however, has been presented in two versions:—

1. The absolute version.
2. The relative version.
Absolute version:

This version of Purchasing Power Parity theory stresses that the exchange rates should normally reflect the relation between the internal purchasing powers of the various national currency units. That is to say, the exchange rate should equal the ratio of the outlay required to purchase a particular set of goods at home as compared with what it would be abroad.

Let us assume that a representative collection of goods costs Rs.500 in India and $100 in the U.S.A. If the current rate of exchange is Rs.5 = $1, the given quantities of representative articles will cost the same in both country, and the exchange rate is at the purchasing power parity. Thus:

\[
\text{Exchange Rate} = \frac{\text{Number of units of Currency A} \times \text{Ip of B}}{\text{One unit of currency B} \times \text{Ip of A}}
\]

Where Ip stands for internal purchasing power, which is the reciprocal of the index of general price level of respective countries.

The right hand side of the equation shows the foreign exchange rate, where B is regarded as the foreign money and A is regarded as domestic currency. In statistical terms thus the rate of exchange \( R \) may be expressed as:

\[
R = \frac{P_b Q_o}{P_a Q_o}
\]

Where, \( R \) stands for the price of country A’s currency in terms of country B’s currency. \( P_a \) stands for the prices in country A and \( P_b \) for the prices in country B. \( Q_o \) stands for the corresponding weights. Here P, the prices, relate to a representative bundle of items with assigned weights being the same for the two countries. Thus, the foreign exchange rate is determined by the ratio of the internal purchasing power of the foreign money and the internal purchasing power of the domestic money. The ratio of the internal purchasing powers of the two currencies is called the purchasing power parity. Thus, in its absolute form, the theory maintains that the rate of exchange will be in equilibrium when the purchasing power of money is equal in all the trading countries.
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The absolute doctrine of the purchasing power parity is based on the assumption that prices of goods should be equalized by trade everywhere in the world. Where goods cost more in country A than in B, when A's prices are converted into B's currency at the existing exchange rate, A's currency is overvalued by the percentage of higher cost.

Relative version:

The relative version of the Purchasing Power Parity theory was propounded by Cassell as a means for measuring departures from "equilibrium". As compared to the absolute doctrine, it is stated in a more simple form and concerns itself with the relationship between changes in exchange rates. The theory in its relative version states that the change in the equilibrium rate of exchange will be governed by the changes in the ratio of their respective purchasing power. Here some past exchange rate is assumed to be an equilibrium rate, and is adopted as the base rate. And as changes in purchasing power can be measured by changes in the indices of domestic prices of the countries concerned, the changes in equilibrium rate can be measured by the ratio of the price indices of the respective countries. Thus, the new equilibrium rate (in the given or later period) can be known by relating the indices of domestic prices in the given period related to price indices in the two countries in the base period to the base rate (old equilibrium rate).

In symbolic terms thus the formulation of purchasing power parity (PPP formula) may be expressed as:

\[ R_1 = R_o \frac{P_{bi}}{P_{bo}} \]

Where,

- \( R_1 \) : stands for new exchange rate (new equilibrium rate).
- \( R_o \) : stands for base rate (old equilibrium rate).
- \( R_{bi} \) : stands for price Index of country b (foreign) in current period.
- \( P_{bo} \) : stands for Price Index of country b (foreign) in base period.
P_{a1} \text{ : stands for Price Index of country a (home) in current period.} \\
P_{ao} \text{ : stands for Price Index of country a (home) in base period.} \\

The formula, in other words, implies:—

\[
\text{Foreign exchange rate (current period)} = \text{Base} \times \frac{\text{Foreign Price Index (in current period)}}{\text{Foreign Price Index (in base period)}} \times \frac{\text{Domestic Price Index (in base period)}}{\text{Domestic Price Index (in current period)}}
\]

To illustrate the point, let us assume that in the base year India – U.S. rate is Re 1 = 20 cents and price indices are 100 in both countries. Now suppose that in the later period the price index in India goes up to 300, and in US it goes up to 150, then the new rate will be:

\[
\text{Re 1} = 20 \text{ cents} \times \frac{150}{100} \times \frac{100}{300} = 10 \text{ cents}
\]

That is to say, when prices in country A doubled relative to prices in B, from base period to current period, the exchange rate R should fall by half (or the price of foreign exchange expressed in local currency should double).

The PPP theory also suggests that inflation has its impact on the exchange rate. A country's currency tends to appreciate/ depreciate in proportion to the difference between domestic inflation rate (DIR) and foreign inflation rate (FIR), if it is to maintain its purchasing power parity (PPP). Thus:—

\[
\text{PPP} = \text{DIR} - \text{FIR}
\]

If DIR > FIR, there is depreciation of domestic currency’s exchange rate.
If DIR < FIR, there is appreciation of domestic currency's exchange rate.

In short, inflation and exchange rate depreciation are interdependent and jointly determined.

Differentials in inflation between the domestic and world economy may explain the changes in exchange rates through the above stated forms of PPP
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hypothesis, when officially exchange rates are being pegged and adjusted endogenously in alignment with price ratio.

1.2.3 Balance of Payments Theory:

The balance of payments theory of exchange rate holds that the price of foreign money in terms of domestic money is determined by the free forces of demand and supply in the foreign exchange market. It follows that the external value of a country's currency will depend upon the demand for and supply of the currency. The theory states that the forces of demand and supply are determined by various items in the balance of payments of a country. According to the theory, a deficit in the balance of payments leads to fall or depreciation in the rate of exchange, while a surplus in the balance of payments strengthens the foreign exchange reserves, causing an appreciation in the price of home currency in terms of foreign currency.

A deficit in balance of payments of a country implies that demand for foreign exchange is exceeding its supply. As a result, the price of foreign money in terms of domestic currency must rise, i.e., the exchange rate of domestic currency must fall. On the other hand, a surplus in the balance of payments of the country implies a greater demand for home currency in a foreign country than the available supply. As a result, the price of home currency in terms of foreign currency rises, i.e., the rate of exchange improves.

In short, the balance of payments theory holds that the exchange rates are determined by the balance of payments commuting demand and supply positions of foreign exchange in the country concerned. As such, the theory is also designated as "Demand – Supply Theory". The theory asserts that the rate of exchange is the function of the supply of and demand for foreign exchange and not exclusively the function of prices obtained between two countries as arrested by the Purchasing Power Parity Theory which does not take into account invisible items. According to the balance of payments theory, the demand for foreign exchange arises from the 'debit' items in the balance of payments, whereas the supply of foreign exchange arises from the 'credit'...
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items. Since the theory assumes that the demand for and supply of foreign currency are determined by the position of the balance of payments, it implies that supply and demand are determined mainly by factors that are independent of variations in the rate of exchange or the monetary policy.

According to the theory, given demand-supply schedules, their intersection determines the equilibrium exchange rate of a currency. It should be noted that the lower price of a currency, the greater will be the demand for it, and therefore the demand curve slopes downward. On the other hand, the supply curve slopes upward from left to right indicating that a lowering of the value of price of the currency tends to contract its supply. This is shown in the figure:

**Figure 1.2**

*Exchange Rate Determination under BOP Theory*

IMF classified different exchange rate regimes. This classification system is based on members' actual, de facto, arrangements as identified by IMF staff, which may differ from their officially announced arrangements. The scheme ranks exchange rate arrangements on the basis of their degree of flexibility and the existence of formal or informal commitments to exchange rate paths. It distinguishes among different forms of exchange rate regimes, in addition to arrangements with no separate legal tender, to help assess the implications of the choice of exchange rate arrangement for the degree of monetary policy independence. The system presents members' exchange rate regimes and monetary policy frameworks to provide greater transparency in the classification scheme and to illustrate the relationship between exchange rate regimes and different monetary policy frameworks. The following explains the categories such as i) Exchange arrangements with no separate legal tender ii) Currency board arrangements iii) Conventional fixed peg arrangements iv) Pegged exchange rates within horizontal bands v) Crawling pegs vi) Exchange rates within crawling pegs vii) Managed floating with no predetermined path for the exchange rate viii) Independently floating, as classified by IMF:

1. Exchange arrangements with no separate legal tender

The currency of another country circulates as the sole legal tender (formal dollarization), or the member belongs to a monetary or currency union in which the same legal tender is shared by the members of the union. Adopting such regimes implies the complete surrender of the monetary authorities' control over domestic monetary policy.

2. Currency board arrangements

A monetary regime based on an explicit legislative commitment to exchange domestic currency for a specified foreign currency at a fixed exchange rate, combined with restrictions on the issuing authority to ensure the fulfillment of its legal obligation. This implies that domestic currency will be issued only against foreign exchange and that it remains fully backed by foreign assets, leaving little scope for discretionary monetary policy. Some flexibility may still
be afforded, depending on how strict the banking rules of the currency board arrangement are.

3. Conventional fixed peg arrangements

The country pegs its currency within margins of ±1 percent or less vis-à-vis another currency; a cooperative arrangement, such as the Exchange Rate Mechanism II (ERM II); or a basket of currencies, where the basket is formed from the currencies of major trading or financial partners and weights reflect the geographical distribution of trade, services, or capital flows. The currency composites can also be standardized, as in the case of the Special Drawing Rights (SDR). There is no commitment to keep the parity irrevocable. The exchange rate may fluctuate within narrow margins of less than ±1 percent around a central rate—or the maximum and minimum value of the exchange rate may remain within a narrow margin of 2 percent—for at least three months. The monetary authority maintains the fixed parity through direct intervention (i.e., via sale/purchase of foreign exchange in the market) or indirect intervention (e.g., via the use of interest rate policy, imposition of foreign exchange regulations, exercise of moral persuasion that constraints foreign exchange activity, or through intervention by other public institutions). Flexibility of monetary policy, though limited, is greater than in the case of exchange arrangements with no separate legal tender and currency boards because traditional central banking functions are still possible, and the monetary authority can adjust the level of the exchange rate, although relatively not so frequently.

4. Pegged exchange rates within horizontal bands

The value of the currency is maintained within certain margins of fluctuation of more than ±1 percent around a fixed central rate or the margin between the maximum and minimum value of the exchange rate exceeds 2 percent. As in the case of conventional fixed pegs, reference may be made to a single currency, a cooperative arrangement, or a currency composite. There is a limited degree of monetary policy discretion, depending on the band width.
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5. Crawling pegs
The currency is adjusted periodically in small amounts at a fixed rate or in response to changes in selective quantitative indicators, such as past inflation differentials vis-à-vis major trading partners, differentials between the inflation target and expected inflation in major trading partners. The rate of crawl can be set to adjust for measured inflation or other indicators (backward looking), or set at a preannounced fixed rate and/or below the projected inflation differentials (forward looking). Maintaining a crawling peg imposes constraints on monetary policy in a manner similar to a fixed peg system.

6. Exchange rates within crawling bands
The currency is maintained within certain fluctuation margins of at least ±1 percent around a central rate—or the margin between the maximum and minimum value of the exchange rate exceeds 2 percent—and the central rate or margins are adjusted periodically at a fixed rate or in response to changes in selective quantitative indicators. The degree of exchange rate flexibility is a function of the band width. Bands are either symmetric around a crawling central parity or widen gradually with an asymmetric choice of the crawl of upper and lower bands (in the latter case, there may be no preannounced central rate). The commitment to maintain the exchange rate within the band imposes constraints on monetary policy, with the degree of policy independence being a function of the band width.

7. Managed floating with no predetermined path for the exchange rate
The monetary authority attempts to influence the exchange rate without having a specific exchange rate path or target. Indicators for managing the rate are broadly judgmental (e.g., balance of payments position, international reserves, parallel market developments), and adjustments may not be automatic. Intervention may be direct or indirect.
8. Independently floating
The exchange rate is market-determined, with any official foreign exchange market intervention aimed at moderating the rate of change and preventing undue fluctuations in the exchange rate, rather than at establishing a level for it.

SECTION 1.3
Objectives of the present study:

1. To examine the exchange rate regime in the pre reform period in India: To meet this objective we have dealt with the qualitative study of the history of exchange rate regime in India. This has helped us in establishing a base for our study. We have started with the pre-colonial period to the era of globalization i.e. how exchange rate has passed through number of phases.

2. To examine qualitatively the impact of the fluctuations in the foreign exchange rate on the Indian Economy in the post-reform period: To meet this objective we have analysed the trends in the exchange rate and also the trends in the selected macro-economic indicators in the post-reform period.

3. To examine econometrically the impact of the exchange rate volatility on the selected macroeconomic indicators of Indian Economy in the post reform period: To fulfill this objective we have dealt with the econometric analysis of selected macroeconomic variables in two different chapters. One chapter dealt with the impact of exchange rate volatility on GDP and inflation rate of the Indian economy and other analyzed the impact of exchange rate volatility on trade openness and Foreign Direct Investment of the Indian economy.

4. To suggest the policy implications: This objective is very important from the point of view of policy making decision to be taken by the central bank for the development of the economy through exchange rate policies and for future research.
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Chapter 2: Review of literature: attempts to review the existing literature both on the theoretical grounds and empirical evidence, regarding the relationship between exchange rate and various macro-economic indicators such as exchange rate and inflation rate, exchange rate and GDP, exchange rate and openness of the economy, exchange rate and Foreign Direct Investment.

Chapter 3: Data Source and Methodology: covers the details about the sources from where data has been collected and explanation of the methodology adopted for examining the impact of exchange rate on macroeconomic indicators.

Chapter 4: Exchange Rate Regime in Pre-reform and Post-reform period in India: throws light on the exchange rate regime in pre and post reform period in India. It also examines qualitatively the impact of the fluctuations in the exchange rate in the post-reform period on the Indian economy as well as trends in the selected macro-economic indicators.

Chapter 5: Impact of exchange rate volatility on the inflation rate and GDP: An Econometric Analysis: examines the impact of exchange rate volatility on GDP and inflation rate of the Indian economy.

Chapter 6: Impact of exchange rate volatility on trade openness and FDI: An Econometric Analysis: examines the impact of exchange rate volatility on the trade openness and FDI of the Indian economy.

Chapter 7: Summary, Conclusions and Policy Implications: this chapter contains summary, major conclusions of the study and also indicates broad policy recommendations.