
IMPACT OF FOREIGN CURRENCIES ON THE NATION'S ECONOMY AND LABOUR MARKET

Om Kumar Pandey, LLB, Techno India University

ABSTRACT

Through exchange rate changes, foreign currencies significantly influence a country's economy and labour market. These changes affect employment levels, foreign direct investment (FDI), inflation, and trade balances. Though it makes exports less competitive and may cause job losses in export-dependent sectors, a strong domestic currency increases buying power and lowers import costs. On the other hand, a weaker currency increases exports and promotes economic growth while also causing inflation and higher living expenses. Currency movements directly impact the labour market as exchange rate volatility affects wages, job creation, and labour migration. A falling currency usually leads to more inflation, which lowers actual salaries and lessens workers' buying power. Decisions on foreign investment are also connected to currency stability; investors choose stable economies to reduce their risk exposure. This research paper evaluates and examines the impact of foreign currencies on the Nation's economy and labour market.

Keywords: Foreign currency, exchange rates, economy, inflation, trade balance, employment, labour market, foreign direct investment, monetary policy, fiscal policy, purchasing power, economic stability, capital flows.

INTRODUCTION

"Foreign currency fluctuations shape a nation's economy by influencing trade, inflation, and job opportunities."

Foreign currencies are significant in determining the economy and labour market of a country. The exchange rate of a country's currency against foreign currencies determines employment, trade, inflation, and foreign investment. Volatility in exchange rates in the current integrated global economy has both positive and negative impacts on businesses, workers, and policymakers. A strong domestic currency cheapens imports, lowering the cost of production and the purchasing power of consumers. It increases the cost of exports, however, and thereby adversely affects those industries that are export-based and export employment in such export-based industries. A weak currency, otherwise, can increase exports by making them competitive but increase the cost of imported goods, resulting in inflation and lower real wages. Foreign direct investment (FDI) is also a key sector affected by exchange rate stability. Investors want stable currencies because volatility exposes them to higher financial risks. Volatility in an exchange rate discourages investment, so fewer jobs are generated and there is less economic growth. Also, countries that borrow in foreign exchange stand to repay debt when their domestic currencies fall in value, so government budgets and social schemes become harder. The impacts of foreign currencies also reach the labour market, where wage rates, employment opportunities, and immigration are decided. A declining currency results in more employment in export-oriented industry but may lower real wages due to inflation. Remittances by foreign workers, a primary source of income for many families, vary with the movement of currencies, influencing overall consumption and stability of the economy. This article discusses how foreign currencies have multiple impacts on the economic performance of a nation and labour market mechanisms. It considers exchange rate volatility, trade competitiveness, investment, inflation, and government policy that facilitates the mitigation of such effects. These factors must be known by policymakers and business operators in order to be able to cope with the impacts of foreign currency fluctuations.

IMPORTANCE OF FOREIGN CURRENCY IN A GLOBALISED ECONOMY

Foreign exchange is the backbone of the world's economy today because of its potential to boost international trade, investment, and financial stability. Foreign exchange is needed by countries for importing goods and services, foreign investment, and repaying foreign debts as

they enter cross-border trade. High foreign exchange reserves in a country facilitate stabilizing the economy, investors' confidence, and financial security against financial crises. Foreign exchange is used by companies and multi-national companies to boost its business, obtaining raw materials, and operating international supply chains. In addition, exchange rates of foreign currencies affect economic competitiveness as a strong currency can render exports costly, and a depreciating currency can stimulate trade because exports become cheaper. Foreign exchange markets also attract investors who trade in currencies to hedge and benefit from exchange rate fluctuations. Foreign currency inflows in the form of remittances and tourism also support national economies, particularly for developing nations where they support livelihood and economic growth. Foreign currency reserves are the responsibility of central banks to stabilize inflation, manage interest rates, and curb currency depreciation. During times of economic uncertainty, a nation with enough reserves can weather financial shocks and ensure economic stability. Foreign currency also facilitates international financial transactions, enabling nations to access the international capital market and obtain funds for development activities. With the highly integrated world economy, foreign currency facilitates economic exchange between nations, promotes international trade, and promotes economic cooperation. Without a sound and efficient foreign exchange system, world economies would be facing trade imbalance, restraint on investments, and economic instability. Foreign currency is therefore a key component of the contemporary globalized economy that influences financial stability, economic growth, and international relations.

EFFECT OF FOREIGN CURRENCY EXPOSURE ON ECONOMIC GROWTH

Foreign exchange exposure is one of the primary drivers of Indian economic growth, which affects trade, investment, inflation, and financial stability. Being a highly import-dependent country, especially crude oil, India is highly vulnerable to exchange rate volatility. A falling rupee raises the price of imports, resulting in imported inflation, raising the price of essential commodities and fuel, impacting consumer purchasing power and overall economic growth. A strong rupee reduces the price of imports but harms exports by making Indian products and services non-competitive in the international market. Foreign exchange volatility directly impacts the trade balance and the current account deficit (CAD). Though a weak rupee can boost the revenue of exports in the IT and textile industries, it also raises the cost of external debt servicing, burdening corporate and government finances. Foreign investment inflows in the form of Foreign Direct Investment (FDI) and Foreign Portfolio Investment (FPI) are

sensitive to currency fluctuations. A volatile rupee can result in capital flight, sucking liquidity out of the stock markets and impacting overall economic confidence. Investors like stable currency conditions, and excessive depreciation can deter long-term investment. Additionally, external debt servicing becomes costlier when the rupee falls, as businesses and the government require more local currency to service foreign-denominated debt. This can exert pressure on the fiscal deficit and result in lower public expenditure on infrastructure and development projects, slowing economic growth. The Reserve Bank of India (RBI) controls foreign currency risk through monetary policy and forex reserves. When the rupee falls, the RBI can intervene by selling foreign exchange reserves or by adjusting interest rates to re-balance the market. But extended intervention will distort domestic liquidity and credit, which have negative impacts on business and economic growth. Raising interest rates to stem currency fall will increase the cost of borrowing for consumers and businesses, deterring investment and demand in the economy. Foreign currency exposure in a general sense has a two-fold obligation to fulfil for the economic growth of India. While a falling rupee will support exports and tourism, uncontrolled volatility will trigger inflation, deter foreign flows, and increase charges of external debt. Prudent fiscal decisions, good forex management, and a strong external sector strategy are needed so as to remain on safe grounds and attain stable economic growth. A stable currency environment creates investor confidence, promotes trade, and strengthens economic resilience and thus becomes the cornerstone of India's growth process in the long run.

FOREIGN EXCHANGE RATE AND THEIR ECONOMIC IMPACT

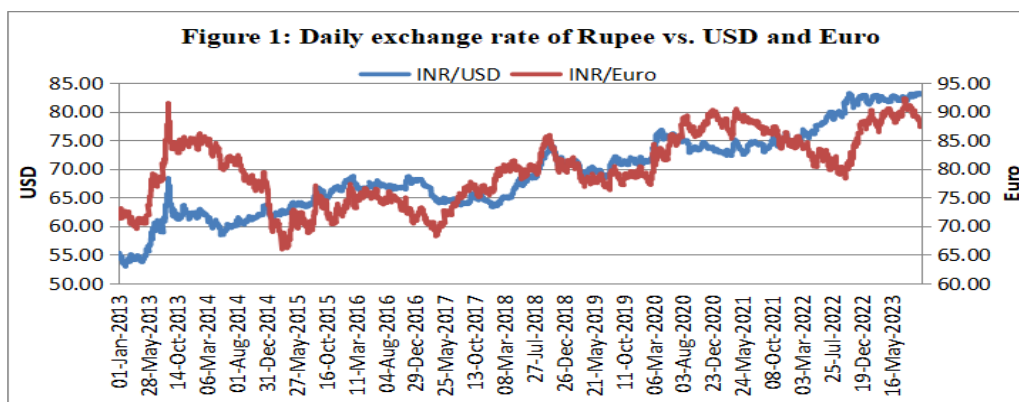
Foreign exchange (forex) rates are very important in determining a country's economy as they affect trade, inflation, and the overall financial well-being of the country. Foreign exchange rates show the value of one currency against another and the price of imports and exports. A strong currency reduces the cost of imports but can negatively impact exports by increasing their price, thus making them unaffordable for foreign customers, and cause trade deficits. On the other hand, a depreciated currency can stimulate exports by making them more competitive but can raise the price of imports and lead to inflation. Changes in currency also affect foreign investments since investors want to put money into stable currencies with good returns. To preserve economic stability, governments and central banks intervene in the currency markets using monetary policies, interest rates, and foreign exchange reserves. High foreign exchange rate volatility can cause uncertainty in international markets, therefore affecting business plans,

inflationary expectations, and economic growth. Floating exchange rate countries let the market forces decide values; fixed or pegged systems stabilise currencies by linking them to better-performing currencies. Foreign exchange rates affect foreign debt payment, remittances, and travel as well as consumer and business buying power. Policymakers, investors, and companies must grasp exchange rate dynamics if they are to grasp the subtleties of world trade and finance.

INCREASING AND DECREASING VALUE OF CURRENCY, IMPACT ON TRADE BALANCE

The strength of a nation's currency has a significant role to play when determining its trade balance, which is the export minus the import. If a currency strengthens, that is, it appreciates in relation to other currencies, it increases the cost of a nation's goods and services for foreign consumers. This tends to decrease the exports since foreign consumers and businesses might opt for cheaper substitutes elsewhere. Concurrently, a rising currency renders imports less expensive since local consumers and businesses are able to buy foreign goods and services at a reduced price. Consequently, rising imports and falling exports can cause a deteriorating trade balance, which can augment a trade deficit or decrease a trade surplus. Alternatively, when a currency devalues, loses value against other currencies, the nation's exports become cheaper for overseas purchasers. This could increase overseas demand for domestically made goods and services and hence export volumes. Imports, however, are more costly since buying overseas products will cost more of the domestic currency. This can deter imports, leading domestic consumers and firms to turn to locally manufactured substitutes. Consequently, currency depreciation can enhance a nation's trade balance by lowering the trade deficit or raising the trade surplus. Nevertheless, the effect of currency movements on the trade balance is not always direct or instantaneous. The "J-curve effect" indicates that after a depreciation, a nation's trade balance can first deteriorate before it improves. This is because the current trade agreements and commitments may take time to adjust to new prices. The price elasticity of demand for a country's exports and imports will also determine the extent to which it benefits from a depreciation in currency. If demand by foreigners for exports is very sensitive to price, depreciation has a high ability to increase volumes of exports. But if demand is inelastic, little impact can be expected. Equally, if the production of a nation depends mostly on imported intermediate goods or raw materials, depreciation can raise production costs, cancelling out the advantage of increased exports. Inflation, economic policies, and worldwide demand

conditions are some other influences that contribute to whether or not movements in the currency affect trade. A nation with robust domestic production capacity and diversified exports can gain more from currency depreciation, whereas an import-dependent economy for basic goods can suffer from inflationary pressures. Finally, the interconnection between currency value and trade balance is intricate, and it needs to be managed carefully to maintain stability and long-term growth.



1

RELATIONSHIP BETWEEN FOREIGN CURRENCIES AND INFLATION

The interlinked and complicated interaction of inflation and foreign exchange impacts the foreign and domestic economy and financial markets. Inflation is a chronic increase in the overall price level of goods and services during a defined period, leading to a loss in purchasing power. Exchange rates, defined as the price of a unit of a given currency relative to a foreign currency, fundamentally influence the inflation trend of an economy. As the currency of a nation weakens against foreign currencies, imported items become costly, leading to cost-push inflation. These best fits import-based nations that import crucial commodities such as oil, food, and raw materials. As import prices rise, businesses pass on the cost to customers, which reflects higher overall inflation. Conversely, an increase in the appreciation of the domestic currency slows inflation by lowering the import cost. Products from abroad become less expensive with appreciation in the domestic currency, and the value of imported raw materials and consumer goods comes down. This slows inflationary pressure by providing price stability in the domestic market. A strong currency, however, hurts exports by raising the price of locally manufactured goods to foreign buyers, thereby slowing economic growth. This delicate

¹ <https://icpp.ashoka.edu.in/intervention-and-the-indian-exchange-rate/> (Last Visited on 24th March 2025 at 8:20 pm)

balance between currency appreciation and inflation serves to highlight the importance of stable exchange rates to economic stability. Monetary policy has a significant role to play in regulating inflation and exchange rates. Central banks use shifts in interest rates to regulate inflation and currency value. For example, in times of higher inflation, central banks raise interest rates to curtail excess borrowing and spending, drawing in foreign investment and strengthening the currency. A stronger currency can then be used to reduce the import cost and regulate inflation. In times of deflation or low inflation, central banks lower interest rates to induce borrowing and spending, which may weaken the currency and even cause inflation to rise. World economic fundamentals such as geopolitical tensions, trade policies, and supply chain disruptions also decide the relationship between inflation and foreign currencies. For example, a sudden increase in world oil prices can transfer inflationary pressure to oil-importing countries, and their currencies depreciate. Similarly, the fluctuation in trade agreement and tariffs can affect currency value and inflation rates. In today's globalized economy, foreign exchange market movements have a far-reaching impact on inflation and overall economic health. Policymakers thus must keep a close eye and regulate exchange rates and inflation in a bid to attain sustainable economic growth and financial stability.

IMPACT ON INDIAN SHARE MARKET OF FOREIGN CURRENCIES

Indian share market is highly sensitive to foreign exchange fluctuations, i.e., the value of Indian Rupee (INR) compared to other stronger currencies like the US Dollar (USD). A falling rupee affects industries differently. Industries based on exports such as IT, pharma, and textiles are helped by a weak rupee as their foreign currency incomes convert into greater profit in terms of INR, hence inflating share prices. Import-dependent industries such as oil & gas, airlines, and auto manufacturing are subjected to higher costs in the form of costly crude oil and raw material imports, resulting in lower profit margins and negative stock market sentiments. Foreign Institutional Investors (FIIs) also respond vigorously to movements in the exchange rate. An appreciating rupee encourages foreign investment since it increases returns, resulting in stock market booms. A depreciating rupee, on the other hand, can cause FII outflows since investors prefer stable currencies, resulting in stock market crashes. FIIs contribute significantly to the market liquidity of India, and their withdrawal can result in volatility in the indices such as the Nifty 50 and Sensex. Interest rates and inflation are also influenced by currency fluctuations. A depreciating rupee makes imported goods costlier, thus causing inflation. To combat inflation, the Reserve Bank of India (RBI) can raise interest rates, making

borrowing costly for firms and reducing economic growth. This may be harmful to stock prices, especially for industries sensitive to interest rates like banking, real estate, and auto. In addition, foreign exchange reserve movements also affect investor sentiments. If Indian forex reserves decline because of currency devaluation, it raises concerns about economic stability, leading to stock market volatility. Global events, including the monetary policy of the US Federal Reserve and geo-political tensions, determine the forex rate and, consequently, the Indian stock market. Investors are therefore forced to keep currency movement under surveillance to be able to manage market risk effectively.

IMPACT ON TAX BURDEN DUE TO FOREIGN CURRENCIES INVOLVEMENT IN INDIA

Involvement of foreign currencies in India has far-reaching consequences on the tax incidence of India, affecting businesses, investors, and individuals engaged in foreign exchange operations. Receipt, generation, or exchange of foreign currencies has tax consequences under Indian taxation law. For instance, companies receiving income in foreign currencies have to convert the income into Indian Rupees (INR) at exchange rates set by the Reserve Bank of India (RBI) for taxation. Variation in exchange rates has an effect on taxable income, and tax burdens increase or decrease. Further, individuals receiving foreign remittances, e.g., receipt of salary or gift from foreign countries, are taxed under the Income Tax Act based on residential status and type of income. Foreign investment by India, i.e., Foreign Direct Investment (FDI) and Foreign Portfolio Investment (FPI), is taxed in the form of capital gains tax, dividend distribution tax, and securities transaction tax, among others. International trade businesses are also subject to Goods and Services Tax (GST) and customs duty while exporting or importing goods and services from or to foreign countries, affecting their tax burden further. Double Taxation Avoidance Agreements (DTAAs) between India and foreign countries reduce tax burdens by avoiding double taxation of similar income in two countries. Tax compliance under foreign currency transactions is, however, cumbersome, with businesses and individuals subject to compliance with the Foreign Exchange Management Act (FEMA) and transfer pricing rules. Non-compliance is subject to fines and litigation. In short, though foreign exchange activity is a stimulus to the Indian economy through foreign trade and investment, it also involves complex tax requirements which the tax authorities must meet in the right way so as to get the maximum tax return while being in accordance with the law.

CONCLUSION AND SUGGESTIONS

To reduce the adverse impact of foreign currencies on the economy and labor market of a nation, certain steps are to be taken. Stable exchange rate policies have to be followed by the government to avoid negative fluctuations with undesirable consequences on business, inflation, and employment. Diversification of the economy away from reliance on a single sector, i.e., agriculture or oil export, will act as a shock absorber. Support to local industry with government encouragement, tax holidays, and availability of credit at ease will reduce import dependence and generate employment. Further, export competitiveness development with support to local industries and improvement in terms of trade will build foreign exchange earnings. With the local currency weakening, making Foreign Direct Investment (FDI) easy with transparent regulations, improved infrastructure, and pro-business policies will generate much-needed employment and investment inflows from abroad. Management of money with good monetary policies, strategic imports, and regulation of the market must be done properly because devaluation of currency raises the cost of goods and services, lower purchasing power, and impacting living standards. For this reason, good monetary policies, strategic imports, and regulation of the market must exist to regulate prices. Again, skills and productivity of workforces must be enhanced through vocational training and upgradation to make workers competitive in a volatile economic scenario. Governments can also attempt to reduce dependence on foreign debt by encouragement of local investment and generating additional revenues locally because excessive dependence on overseas borrowing makes a country vulnerable to exchange rate risks. Remittances and diaspora investment facilitation by investor-friendly policies will generate foreign exchange inflows to propel the economy and generate employment as well. In conclusion, foreign currency impacts on a nation's economy and labor market can be monumental, influencing inflation, jobs, purchasing power, and exports. Though a lower currency is fantastic for exports, it raises the cost of imports and inflation for consumers and workers. A strong currency, on the other hand, renders the exports of a nation uncompetitive, impacting export-dependent industries to foreign nations. Efficient monetary policy, diversification of the economy, development of domestic industries, improving export policy, foreign investment attraction, inflation management, and human capital development are required to counteract undesirable effects. Assuming these parameters, a nation can achieve economic stability, induce sustainable employment, and increase levels of living overall despite currency volatility negatives.