

# Devaluation as a Reason for Economical Growth or Crisis

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Received: December 14, 2016

Accepted: January 3, 2017

Online Published: January 20, 2017

doi:10.5539/ijef.v9n2p205

URL: <http://dx.doi.org/10.5539/ijef.v9n2p205>

## Abstract

In the article the concept of devaluation, its types, the aim of use of devaluation as a financial instrument, as well as the economic crisis, caused by a sharp drop in oil prices on the world market and devaluation of some national currencies have been discussed. In addition, the article also the effects of devaluation on the economy are examined, its negative and positive aspects, causes and results were analyzed. Some proposals are offered about what steps to take for the successful devaluation, what to do in case of a crisis on the example of some countries.

**Keywords:** devaluation, exchange rates, inflation, exports, domestic production, oil profits, consumer spending, index, currency reserves

## 1. Introduction

As a result of world globalization it becomes difficult to pursue an independent policy and keep under control the situation in the monetary policy of the developing countries pursuing independent and neutral policy.

Thus, sudden changes in the prices of the strategic products in the world stock markets make immediate influence on the domestic markets in all countries.

So one can observe an economic war the purpose of which is to make financially weak the opposite countries using the oil prices as a tool to redistribute the world between superpower countries. This influences to the oil-exporting countries immediately, and to the importing countries indirectly.

On the other hand, it is not less the impact to this field of the international organizations and analysts which basing on the political decisions and statistical analysis prepare and announce the forecasts on the different scenarios in the different countries of the world. So, the developed forecasts influence to the subconscious of the citizens and make them to be chaotically active and as a result make the situation more complicated.

Considering this in the paper the definition of devaluation, its different types, positive and negative influences, formation of the stable currencies, and also varying of the oil prices in the world markets in last three years, as a result of this, devaluation in some countries, was discussed.

## 2. What Is Devaluation?

Devaluation (in Lat. De - decreasing, Valeo- value) is a decline in gold of the content of the currency, or is a decrease of the national currency with respect to gold, silver and foreign currency exchange rate.

Nowadays this term is usually used for the national currencies that decreases relatively stable ones (Wikipediya). Fixed exchange rate system, devaluation and revaluation may be used by the politicians (national banks) to press the markets and as a motivation tool to control the national currency. The floating exchange rate system generates the currency changes, known as re-estimate of the value of the currency under the pressure of the market.

Devaluation arises as a result of the various financial crises in the national economy, or non-stability, as well as inflation, long-lasting defisite balance of payments. Devaluation process is divided into 2 groups in terms of the intervention of the state in this process:

- Open devaluation;
- Closed devaluation.

**Open devaluation** is a significant removing of the national currency from the circulation by the government, or raising the national currency by replacement of the failed currency banknotes by the new ones.

**Closed devaluation** is a process that goes out independently from government intervention in the economy. In this case, replacement of the old banknotes by new ones or removing necessary volume of the currency from the circulation does not occur.

In addition, there is also a **competitive devaluation**. This is a special government policy to enhance the competitiveness of national products in the world markets, and thus stimulate the national export. At this time the rate of national currency decreases with respect to the foreign currencies, and the goods produced in the country gets lower prices in abroad. Thus, these products due to the price factor have high competitiveness in the world market.

### **Why dollar?**

In the Breton-Wood conference held in July, 1944 to achieve stability in the international economy after the Second World War an agreement reached was to establish International Monetary Fund (IMF) and applied a fixed exchange rate system to prevent “manipulations by the exchange rates aimed to get unfair competitive advantage over other member countries”.

According to the signed agreements the United States provided fixing the other currencies to the dollar by taking the fixed rate of 1 ounce of gold at 35 dollars. After the war, gold reserves of the United States which owned 70% of the world’s gold reserves, began to decrease rapidly from year to year.

The United States was forced take some measures to decrease the dollar-gold exchange in the reserves of the central banks of the foreign countries and to ensure the continuity of increasing of the reserves in dollars. However, in the middle of 1960s there was a period of high inflation in the United States. The fixed exchange rate system was under a pressure as a result of the not changing of the currencies due to the macroeconomical misalignment between the The United States and other countries. As a result, in 1973 USA officially refused standard of fixing the currency exchange to the gold. After the collapse of the fixed exchange rate system “Jamaican system” based on the free exchange rate of currencies began to be implemented. However, other key points of the Breton Woods agreement, in particular the implementation the dollar in the international trade was kept and dollar was accepted as a stable currency.

### **3. The Objectives of the Use of Devaluation as a Tool**

During the competitive devaluation aimed to enhance the competitiveness of national products on the world markets, and by this way stimulate the national export:

- Perfect opportunities are formed for the domestic production in the country. For example, if earlier it was more profitable to sell foreign agricultural goods, the devaluation of the national currency to foreign currencies could result in the development of agriculture;
- The products produced in the country will have a lower price in the world market, and thus export becomes more profitable;
- In addition, the devaluation could have a positive impact on the country’s macroeconomic indicators. For example, the country’s gold reserves may be increased.

The country can achieve positive results from the competitive devaluation, when the national currencies are stable in the world market.

As a result of various financial crises in the economy of the country, or imbalance, as well as inflation, long-lasting deficit in the balance of payments the central bank has to announce a closed devaluation. Then:

- Raising the prices of goods from abroad, static raising the peoples’ salaries their solvency decreases;
- Activation of the speculators and panic leads to withdrawal of money from accounts in national currency and following fall of the national currency dains devaluation;
- Devaluation stimulates increase of the prices of the domestic products. As a result the inflation rate rises, the money from day to day “falls” and that people begin to live as chaotic clients;
- Difficulty of small and medium businesses, payment problem leads to narrowing of the market and as a result to less product consumption. Small and medium businesses can not withstand those costs;
- Formation of the problematic situation with the credits in foreign currency. Since the credits are in foreign currency, the payers are not in comfortable situation.

### **4. Devaluations in Some Countries**

In last three years due to conflict of interest of the world powers for the redistribution of the world in the third

millennium and as a result of political and economic actions for this purpose we observe the sharp decline in oil prices. Thus, the oil starting in 2014 with 110 dollars in the first decade of June, reached the last highest price - up to \$115. After that, the price started a the rapid decline and in January 2015 fell to \$48. 58.3% decrease in the price of oil in six months, led to decreasing of the currency reserves of the exporting countries and currency rates. As a continuation of this process an increase in oil prices during the year 2015 up to \$ 68 and then declining stabilization around \$ 39 dollars, resulted to the imbalance of payments of the exporter countries and led to the devaluation. Fluctuations in oil prices in the last 3 years, we can see more clearly in the graph below (Figure 1) (IMF, 2016).

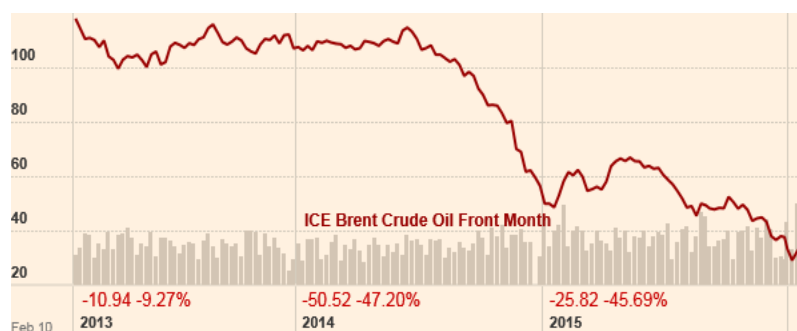


Figure 1. Changes in world oil prices in the last three years

Source: <http://markets.ft.com/research/Markets/Tearsheets/Summary?s=IB.1:IEU>.

Let us analyze the devaluation process in countries having a share in the world market and essential influence to Azerbaijan, as well as Russia, Kazakhstan and China. The processes are the same, but the circumstances are different in each country. More specifically, the reasons in Russia and Kazakhstan are relatively similar, but in China we see completely different process.

#### 4.1 Russia

Since July 2014, with the decline in oil prices in the world markets Russian ruble began to lose its value. In July \$1 was 35 rubles and at the end of December \$1 was 60 rubles. In accordance with the change in the price of oil in June, 2015 \$1 was 50 rubles, the ruble lost its value to end of the year and was 70 rubles per \$1. The fall of the national currency in Russia is invisible to a certain extent, but the trend shows that the devaluation of the ruble has become more resistant (Barchart.com.Inc., 2016a).

There is no need to analyze and discuss the reasons of the dollar rise in Russia. The main reason is the oil prices, because due to the direct dependence of the Russian economy on the oil export the ruble rate is uniquely dependent on oil revenues. For example, on December, 10 price of oil dropped immediately to \$ 39, and then the dollar rose up to 70 rubles. By the opinion of the economists if oil price will continue decrease then the ruble will parallely fall. At the same time, Russian Central Bank said in its quarterly report that the sharp change in the ruble rate does not expected in the short term. According to the report, oil prices will continue to be the main factor influencing to the ruble rate. At the same time, the report is silent on the ruble rise because it is clear that the factors supporting the ruble is not available at the moment. In such circumstances, the Central Bank should confine itself to words carefully.

Note that increasing of the rates in the case of uncontrolled depreciation of the national currency gave positive results in many countries (Great Britain, Iceland, Turkey, Hungary) and this tool is used in stress situations. Russia's refusal of this instrument, may be explained by the extremely unstable economic situation. The situation is so unstable that raising of the interest rates would lead to an immediate rise in prices that in its turn will lead to the chain of negative developments. As a result, the fate of the ruble and its exchange rate is generally unknown. Thus, after decreasing of the world oil price of 15% over the last few days and Russian Central Bank's announcement that it will not intervene in the exchange rate, the dollar to ruble increased by 2.4% and reached 80.6 RUB / USD. Now it is possible to rise the rate of dollar up to 100 rubles in the short term.

#### 4.2 Kazakhstan

In the first months of 2016 were also unsuccessful for Kazakhstan national currency. On January 22, the average measure of the dollar's exchange rate against tenge was 383.68, which increased by 8.52 tenge compared with the previous trading day. As a result, the exchange rate of tenge fell to its historic minimum and this fact again

drew attention to the processes taking place in the economy of Kazakhstan. Note that on February 10, 2014 as a result of the devaluation the dollar rate raised from 152.89 tenge to 182.60 tenge. The devaluation of tenge was already carried in 2015. More specifically, starting from August 20 Kazakhstan started to pursue of the floating exchange rate policy and within a day the dollar rose from 188 tenge to 255 tenge.

Then it was a period of stable rate of tange and at the end of September 1\$ was 270 tenge, and at the end of October 279 tenge. But in November as a result of new devaluation dollar exchange rate rose from 279 tenge to 307 tenge. Note that the head of the National Bank of Kazakhstan was resigned in early November, but this step did not contribute to the strengthening of the national currency, but lead to fall of tenge.

The processes in Kazakhstan do not differ from what is happening in Russia. The fall of tenge was associated with deterioration of the situation in the economy due to the oil price decreasing. As a result, the deterioration conjuncture in the country's foreign trade even in the case of stable demand for the dollar leads to the decrease in the national currency. The fall of tenge in Kazakhstan is accompanied by increased demand for the dollar, that also exacerbates the situation (Barchart.com.Inc., 2016b).

According to experts, there are not yet enough factors supporting the tenge, therefore, the fall of national currency of Kazakhstan will continue. Therefore, the Central Bank's intervention may be the sole restraining factor. Recall that in November, the National Bank of Kazakhstan has announced that in order to protect the country's strategic reserves it reduces its presence in currency market, but at the same time, in the case of sharp changes in the course of tenge, if the situation gets out of control, the National Bank reserves the right to intervene in the market. Economists are reluctant to forecast the exchange rate of tenge in Kazakhstan, but they say that if the price of oil would be 40 dollars, the dollar's exchange rate is expected to reach 350-360 tenge. If the oil price will fall the decrease of currency rate may be forecasted.

#### 4.3 China

In recent days, the processes in China is completely different from what is happening in Russia and Kazakhstan. If the devaluations of the national currencies of Russia and Kazakhstan occur in the result of the objective factors (fall of oil price), gradually and without government interference, China's yuan devaluation is a driven process. Recall that in August, 2016, National Bank of China has implemented large-scale devaluation over the last 20 years, and as a result the dollar exchange rate rose from 6.12 yuan to 6.23 yuan (Barchart.com.Inc., 2016c). As a result of the devaluation implemented in December, 10 exchange rate of the US dollar was equal to 6.42 yuan. In December after the next devaluation and in early January 2016, the exchange rate was equal to 6.58 yuan. The main purpose of such recrease of the rate of yuan was neutralization of the negative processes in the economy in a certain extent.

Thus, we observe decrease of export and domestic production in the Chinese economy and the resulting decline in economic growth. The fall the national currency aims primarily to support exporters, and provide artificial increase of the value of the exported products in the national currency. In this regard, the actions of the National Bank of China can be seen as a response to what is happening in the economy.

Another reason for the implementation of the "small" devaluations is to prevent panic situations after devaluation as in August. Note that, unlike Russia and Kazakhstan China has a great impact on the world economy, and therefore the steps taken are appreciated by the experts of the world.

It should be noted that in November, the International Monetary Fund has decided to include the yuan in the basket of reserve currencies, that is a sign of the high valuation foreign exchange policy of China. In any case, we can say that the National Bank of China implementing small devaluations, "checks" market and wants to find out the extent the depreciation of the yuan that may support the economy and at the same time not create panic.

Clearly, the national currency fall associated with serious risks, including payment ability of the Chinese companies for the dollar-denominated debts. But it is expectable that devaluation of the yuan will have also positive effects on the economy and this will exceed the negative effects.

In general, there may be two main scenarios for the future of China's currency policy. First, release rate of yuan freely pursuing the policy of floating exchange rate and the second - gradually decrease the rate of yuan using some control mechanisms. The second scenario seems to be more appropriate now, because any economic shock that may occur in China will have serious negative impact on the world economy. In this regard, the cautious liberalization of the Chinese government monetary policy is profitable for all players.

As an example from the history of devaluation we can show the sudden fall in the pound in 1992. In that case, Soros was able to earn a substantial income. He sold more than 10 billion pounds in a day, and it was a critical limit. After this serious sale, there were quite a large number of cheap pound in the market. At the same time, the

government did not find suitable to protect the currency. The fall of pound against the German mark was 12%. During this period, the Italian lira was also a devaluated currency and his fall was 7% (Kireev, 2001).

## 5. Results

### Causes of devaluation:

- Devaluation may be applied to increase the exports;
- If the prices of the goods, produced in the country increases, the devaluation may be applied to increase the purchasing power of the foreign currencies with the same rate.
- The devaluation may be applied for the periods when inflation could not be controlled, under the pressure of the International Monetary Fund (IMF).

### Effects of devaluation:

- Export increases, import decreases;
- The trade deficit is reduced;
- With the increase in exports the country's national income increases.

### The positive aspects of devaluation:

- The perfect opportunities are formed for domestic production. For example, if earlier it was more profitable to sell to foreign agricultural goods, the devaluation of the national currency could result in the development of agriculture;
- It is more profitable to export from the country;
- Devaluation also may have a positive impact on the macro-economic indicators of the country. For example, country's gold reserves may be increased.

### Negative aspects of devaluation:

- Devaluation reduces the population's solvency. The price of goods from abroad is rising, people have a static salaries and as a result same money gives less benefits;
- It begins a panic withdraw money from banks in national currency accounts and national currency devaluation is deepened;
- Devaluation creates an incentive to increase prices of domestic products. As a result, the country's inflation rate rises again;
- The payment problems of population results narrowing of the market and this in its turn leads to less product consumption. Small and medium-sized businesses can not withstand those costs;
- The credits in foreign currency become problematic.

### Results of devaluation:

- Export increases and import decreases;
- The trade deficit of the country is closed or the situation is normalized;
- With the increase in exports GDP gets additional contribution.

### What you need to do for the successful devaluation:

- Other countries should not apply opposite devaluation;
- The inflation should be in a low level in the country;
- Price-demand elasticity of the exported goods should be in high level.

For example, in the country with dominating agricultural products, the price-demand elasticity is in low level, even if the price of the product will fall, it becomes difficult to increase the export.

If for the product price-demand elasticity is less, there will not be any change for the unit price. In this case, the exporting country, will look for the ways to increase the export of this product.

## 6. Proposals

### 6.1 Steps to Be Taken by Customers

During the crisis, in the customer behavior the rational factors are dominated and this is a good chance for the "weak" brands with "strong" products. It needs to be noted that during the financial crisis in 2008-2009, the

Korean companies (Samsung, LG, Hyundai, KIA etc.) took more benefits. The reason for this was simple. People in crisis, want to buy more expensive things with cheaper price. For example, in 2008 Samsung defeated Sony in the upper premium segment TV, or KIA owned a large stake in the middle segment. But please pay attention. The crisis not the the cheap goods, but expensive goods with cheep prices become more popular. in an increasing demand for places. People think: “now, during the crisis I can buy the good that could not buy earlier”.

### 6.2 What to to with Workers?

Of course, during the crisis everyone thinks about the the reduction of the number of workers. It seems to us that the each worker is an additional cost and we should to reduce the costs. First, we must say that during the crisis, the weak spots of the companies are observed. In other words, during the sales the crisis in logistics, in procurement process is observed first. In this respect, the crisis is a good time for the reorganization of the the structure of the companies. But it must be done only in logic base. We must not forget that the business is moving by the human recourses and not logic, spontaneous behavior with workers can damage the foundation of this process.

### 6.3 How to Work with Providers?

We think that one of the important links in the business chain are providers and we can improve our relations with them and increase our “credit limit”. Often, the simplest and most recurring error in times of crisis is a wish to avoid the contacts. In other words, to avoid the contacts related with the delay in the payment dates. This is extremely wrong and narrow thinking. Especially, during the crisis we must meet regularly with providers, explain the situation and show them that this is a general problem. The same thing applies to creditors also.

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