

A STUDY ON IMPACT OF DEPLETING VALUE OF INDIAN RUPEE AND ITS CAUSES

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Abstract

India's economy has become deeply intertwined with global financial systems over the past few decades. The Indian Rupee (INR) has experienced significant fluctuations against major currencies, particularly the US Dollar (USD), influenced by domestic and international factors. This paper examines the key determinants of INR/USD exchange rate volatility and its effects on India's trade, investment flows, and economic stability. The study also evaluates the impact of global events, such as the COVID-19 pandemic, and proposes policy measures to enhance resilience against currency volatility. *Historical Overview of the Indian Rupee's Value.* The history of the Indian Rupee's exchange rate reflects the evolving economic landscape of India and its interaction with the global economy. In the early years after India's independence in 1947, the Rupee was pegged to the British Pound Sterling. India moved towards a managed floating exchange rate regime in 1975, where the Rupee's value was linked to a basket of currencies of its major trading partners. Examining the historical exchange rate of the Indian Rupee against the US Dollar provides a clear picture of its depreciation trajectory. In 1947, the exchange rate was approximately ₹3.30 per US Dollar. By 1990, this had fallen to around ₹17.01 per US Dollar. The liberalization of the Indian economy in the early 1990s brought about further adjustments, with the Rupee's value reaching ₹32.42 per US Dollar by January 1995 and ₹44.31 by January 2000. The depreciation trend continued into the new millennium, with the Rupee crossing the ₹50 mark against the Dollar in the early 2010s and reaching over ₹85 by April 2025. This long-term depreciation signifies a substantial erosion of the Indian Rupee's international purchasing power.

Keywords: Rupee Depreciation, Economic impact, Exchange Rate

Key Determinants of Exchange Rate Fluctuations:

Global Economic Conditions: The US Federal Reserve's monetary policy significantly impacts the INR/USD exchange rate. When the Federal Reserve raises interest rates, it attracts global investors seeking higher yields on US bonds. This "risk-off" sentiment often leads to capital outflows from emerging markets like India, resulting in INR depreciation. Conversely, a dovish Fed stance tends to strengthen the Rupee by encouraging foreign capital inflows. **Commodity Prices:** India's dependence on oil and gold imports makes it vulnerable to commodity price fluctuations. Crude oil, in particular, accounts for a significant portion of India's import bill. A surge in oil prices increases the current account deficit (CAD) and exerts downward pressure on the INR. Similarly, rising gold prices lead to higher demand for USD, further weakening the Rupee.



Fig 1 USD/INR exchange rate

Domestic Factors:

1. **Persistent Inflation:** A relatively higher inflation rate in India compared to its major trading partners, particularly the United States, erodes the purchasing power of the Rupee domestically and internationally. Higher inflation makes Indian exports less competitive and imports relatively cheaper, leading to increased demand for foreign currencies and thus depreciating the Rupee. For instance, if India experiences an average inflation rate of 6% while the US has an inflation rate of 2%, the real value of the Rupee declines relative to the Dollar over time.
2. **Widening Trade and Current Account Deficits:** A consistent trade deficit, where the value of imports exceeds exports, creates a higher demand for foreign currencies to pay for these imports. Similarly, a current account deficit, which is a broader measure of a country's transactions with the rest of the world, also puts downward pressure on the Rupee. India's reliance on imports, especially for crude oil, gold, and sophisticated machinery, contributes significantly to these deficits. Rising crude oil prices, for example, necessitate a larger outflow of Rupees to purchase the same quantity of oil in Dollars, thereby weakening the Rupee.
3. **Fiscal Deficit and Government Debt:** A high fiscal deficit, where government expenditure exceeds revenue, can lead to increased

borrowing. If this borrowing is financed through increased money supply, it can fuel inflation and depreciate the currency. Furthermore, a large public debt can make a country less attractive to foreign investors, leading to capital outflows and a weaker currency. While the Indian government has been working towards fiscal consolidation, the level of public debt remains a concern for international investors.

4. **Monetary Policy and Interest Rate Differentials:** The Reserve Bank of India's monetary policy decisions, particularly interest rate adjustments and foreign exchange interventions, can influence the Rupee's value. Lower interest rates in India compared to other major economies can make Rupee-denominated assets less attractive to foreign investors, leading to capital outflows and depreciation. Conversely, raising interest rates can attract foreign investment and strengthen the Rupee, but this can also have implications for domestic economic growth. RBI's interventions in the foreign exchange market to manage volatility can have short-term effects but may not always counter long-term depreciation trends.
5. **Capital Outflows:** Global economic uncertainties or a perceived lack of attractive investment opportunities in India can lead to foreign investors pulling out their investments. These capital outflows increase the demand for foreign currencies and reduce the supply of Rupees in the market, resulting in depreciation. Events such as global financial crises or significant policy changes can trigger such outflows.

Global Factors:

1. **Strengthening of the US Dollar:** The US Dollar is the world's reserve currency, and its strength is often influenced by global economic conditions and monetary policy in the United States. When the US economy is strong or the US Federal Reserve raises interest rates, the Dollar tends to appreciate against other currencies, including the Indian Rupee. This is because investors worldwide seek safer and higher-yielding Dollar-denominated assets.
2. **Geopolitical Instability and Global Economic Slowdown:** Global events such as geopolitical tensions, wars, or economic recessions can impact investor sentiment and lead to a "flight to safety," where investors prefer holding stable currencies like the US Dollar. This increased demand for the Dollar weakens emerging market currencies like the Rupee. A global economic slowdown can also reduce demand for Indian exports, leading to lower foreign exchange inflows and putting downward pressure on the Rupee.
3. **Crude Oil Prices:** As mentioned earlier, India is a major importer of crude oil. Fluctuations in global crude oil prices have a significant impact on India's import bill and the demand for US Dollars. Higher oil prices lead to a greater outflow of foreign exchange, weakening the Rupee.
4. **US Monetary Policy:** Decisions by the US Federal Reserve regarding interest rates and quantitative easing can have significant repercussions for global currency markets. Interest rate hikes in the US can attract capital away from emerging markets, strengthening the Dollar and weakening currencies like the Rupee.



Fig.2 crude oil prices

Impacts of the Depleting Value of the Indian Rupee on the Indian Economy

Negative Impacts:

1. **Increased Import Costs and Inflation:** A weaker Rupee makes imports more expensive in Rupee terms. This is particularly significant for essential goods like crude oil, fertilizers, and electronic components. Higher import costs can lead to imported inflation, which can then spill over into domestic prices, exacerbating overall inflationary pressures in the economy. Industries that rely heavily on imported raw materials also face higher production costs, which they may pass on to consumers. According to some estimates, a 5% depreciation in the INR can lead to a 25-30 basis point increase in inflation.
2. **Widening Trade Deficit:** While a weaker currency can theoretically boost exports by making them cheaper for foreign buyers, in India's case, the increase in import costs often outweighs the benefits to exports, especially when a significant portion of inputs for export-oriented industries are also imported. Furthermore, if domestic inflation rises due to a weaker Rupee, the competitive advantage gained by cheaper exports can be eroded.
3. **Increased Cost of Foreign Debt:** Indian companies and the government that have borrowed in foreign currencies face a higher repayment burden when the Rupee depreciates. The cost of servicing this foreign debt increases in Rupee terms, which can strain the finances of these entities and potentially impact the country's overall external debt situation.
4. **Reduced Purchasing Power:** A weaker Rupee reduces the purchasing power of Indian consumers and businesses when they transact internationally. They need to spend more Rupees to buy the same amount of foreign goods or services. This can affect everything from overseas education and tourism to the import of capital goods necessary for industrial development.

Positive Impacts:

1. **Boost to Exports:** A weaker Rupee makes Indian goods and services more competitive in international markets as they become cheaper for foreign buyers. This can potentially lead to an increase in export volumes and earnings, particularly for sectors like information technology, pharmaceuticals, textiles, and certain manufactured goods. However, as mentioned earlier, this benefit can be limited if import-intensive inputs are used in production

or if domestic inflation offsets the price advantage.

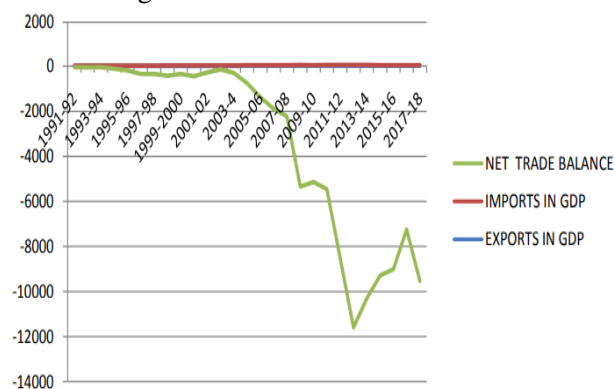


Figure 3. Imports and exports in GDP

2. **Higher Remittance Value:** Non-Resident Indians (NRIs) sending money back home benefit from a weaker Rupee, as their foreign currency remittances translate into a larger amount of Rupees. This can boost household incomes and consumption in India.
3. **Potential for Increased Domestic Investment:** If a weaker Rupee makes imports significantly more expensive, it might incentivize domestic industries to increase production and cater to local demand, potentially leading to higher domestic investment and job creation in import-substituting sectors.

Policy Responses to Mitigate the Depleting Value of the Indian Rupee

The Reserve Bank of India (RBI) and the Indian government have implemented various policy measures to address the depreciation of the Rupee and its adverse impacts:

1. **Monetary Policy Adjustments:** The RBI can use monetary policy tools, such as raising the repo rate, to make Rupee-denominated assets more attractive to foreign investors, thereby increasing demand for the Rupee and potentially strengthening it. However, this needs to be balanced against the need to support economic growth, as higher interest rates can increase borrowing costs for businesses and consumers.
2. **Foreign Exchange Interventions:** The RBI frequently intervenes in the foreign exchange market by selling US Dollars from its reserves to increase the supply of Dollars and reduce the demand for them, thereby trying to stabilize or strengthen the Rupee. The effectiveness of such interventions is often limited in the face of strong underlying economic fundamentals or global trends driving depreciation.

3. **Measures to Attract Capital Inflows:** The government can implement policies to attract more foreign direct investment (FDI) and foreign portfolio investment (FPI) into India. These inflows increase the supply of foreign currencies and boost the demand for the Rupee. Measures can include easing investment regulations, offering tax incentives, and improving the ease of doing business.
4. **Management of Current Account Deficit:** Efforts to reduce the current account deficit can help stabilize the Rupee. This can involve promoting exports through various incentives, reducing reliance on imports (e.g., through initiatives like "Make in India"), and diversifying trade.
5. **External Commercial Borrowing (ECB) Regulations:** The RBI can adjust regulations related to external commercial borrowings to manage the inflow and outflow of foreign currency through this channel.
6. **Currency Swap Agreements:** India has entered into currency swap agreements with some countries, which allow for the exchange of currencies at pre-determined rates. These agreements can help reduce the reliance on the US Dollar for bilateral trade and potentially stabilize the Rupee against other currencies.

Evaluation of Policy Effectiveness

The effectiveness of the policy responses in mitigating the depreciation of the Indian Rupee has been varied. While the RBI's interventions can provide short-term stability and manage volatility, they often cannot fundamentally alter the long-term depreciation trend driven by underlying economic factors like inflation and trade deficits. Monetary policy adjustments, such as interest rate hikes, can attract capital inflows but may also dampen domestic economic activity.

Long-term solutions to stabilize the Rupee's value require addressing the fundamental economic factors. Controlling inflation, reducing the trade

and current account deficits through export promotion and import substitution, maintaining fiscal discipline, and creating a stable and attractive investment environment are crucial for a sustainable strengthening of the Indian Rupee.

Conclusion

The depleting value of the Indian Rupee is a complex issue stemming from a combination of domestic factors such as persistent inflation, trade and current account deficits, and fiscal imbalances, as well as global factors like the strengthening of the US Dollar, geopolitical instability, and fluctuations in crude oil prices. This depreciation has significant and often adverse impacts on the Indian economy, including increased import costs, inflationary pressures, and a higher burden of foreign debt, although it can offer some benefits to exports and remittances.

While the RBI and the government have implemented various policy measures to manage the Rupee's value, their effectiveness in reversing the long-term depreciation trend is limited without addressing the fundamental economic weaknesses. Sustainable stability and strengthening of the Indian Rupee necessitate comprehensive and consistent policies focused on controlling inflation, enhancing export competitiveness, reducing import dependence, maintaining fiscal prudence, and fostering a robust and attractive investment climate. Addressing these underlying issues will be crucial for ensuring long-term economic stability and enhancing India's global economic standing.

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