



P.L.RAJ IAS & IPS ACADEMY

BUILDING BUREAUCRATS SINCE 2006

3. Falling Of Indian Rupee – Economy

The Indian rupee has depreciated sharply against the U.S. dollar, with the rupee-dollar exchange rate rising from around 85 rupees per dollar in 2025 to beyond 96 rupees per dollar in 2026.

1. This significant currency depreciation reflects persistent structural challenges in India's external sector including trade deficits, capital outflows, and global economic uncertainties.
2. The rupee's weakness has profound implications for inflation, debt servicing, and macroeconomic stability, requiring comprehensive policy responses.

1.Understanding Exchange Rates

Definition and Determination

1. The exchange rate refers to the value of one currency in comparison to another currency, determining how many units of domestic currency are required to purchase one unit of foreign currency.
2. In India, the rupee-dollar exchange rate indicates the number of rupees required to buy one U.S. dollar, serving as a key indicator of currency strength.
3. Exchange rates are largely determined by the demand and supply of currencies in international markets, reflecting investor confidence and capital flows.
4. A higher exchange rate indicates rupee depreciation as more rupees are needed to purchase the same quantity of foreign currency.

2.Reasons for Rupee Depreciation

Persistent Trade Deficit

1. India imports more goods than it exports, creating a persistent merchandise trade deficit that puts continuous pressure on the rupee.
2. Indian importers must exchange rupees for dollars to pay foreign suppliers for imported goods, increasing demand for dollars in foreign exchange markets.
3. The increased demand for dollars while supply remains relatively constant weakens the rupee against the dollar.
4. Imports include essential commodities like crude oil, electronics, machinery, and raw materials required for industrial production and consumption.

Rising Crude Oil Prices

1. India imports a large share of its crude oil requirements from abroad, making the economy vulnerable to global crude oil price fluctuations.
2. Rising global crude oil prices significantly increase India's import bill, requiring substantially more dollar payments for the same quantity of oil.
3. Higher oil imports increase dollar demand exponentially, exerting continuous downward pressure on the rupee value.
4. Energy security concerns combined with rising prices create a structural challenge for India's external sector.

Current Account Deficit

1. India consistently records a Current Account Deficit because the value of imports substantially exceeds the value of exports across all categories.

2. Although India earns foreign exchange through software exports and remittances from overseas Indians, these inflows are often insufficient to offset the trade deficit fully.
3. The persistent CAD indicates that India depends on foreign capital inflows to finance its external deficit, creating vulnerability to capital flow reversals.
4. Widening current account deficits signal economic imbalances that weaken investor confidence in long-term currency stability.

Foreign Portfolio Investment Outflows

1. FPI includes investments in stocks and bonds by foreign investors seeking returns in emerging markets like India.
2. FPI remains highly volatile because international investors shift funds quickly based on global financial conditions and risk assessments.
3. During periods of global uncertainty or when developed markets offer better returns, foreign investors withdraw funds from India rapidly.
4. FPI outflows reduce dollar supply in the foreign exchange market while increasing rupee supply, weakening the currency.

Rising U.S. Interest Rates

1. Higher interest rates in the United States attract global investors towards U.S. financial assets offering better returns with lower risk.
2. Investors withdraw funds from emerging economies like India and invest in safer U.S. Treasury bonds, money market funds, and bank deposits.
3. Capital outflows from India increase pressure on the rupee as demand for rupees declines while dollar demand rises.
4. Interest rate differentials between developed and emerging markets create powerful incentives for capital reallocation away from India.

Global Geopolitical Uncertainty

1. Geopolitical tensions increase uncertainty in global financial markets, causing investors to prefer safe-haven assets such as the U.S. dollar.
2. During periods of instability, investors shift portfolios away from risky emerging markets toward stable, developed market assets.
3. This risk-aversion behaviour strengthens the dollar globally while weakening all other currencies simultaneously.

3.Impact on India's Economy

Inflationary Pressures

1. Rising import costs increase domestic prices of fuel and essential commodities, eventually leading to increased transportation and logistics costs.
2. A weaker rupee makes all imported goods more expensive in rupee terms, including petroleum products, machinery, electronics, and raw materials.
3. This contributes to imported inflation in the economy, raising the overall price level and eroding household purchasing power.
4. Transportation and logistics costs increase as fuel becomes more expensive, raising prices of all domestically produced goods.

External Debt Burden Increases

1. Indian firms with dollar-denominated loans must repay more rupees after rupee depreciation, increasing debt-servicing costs substantially.

2. Higher debt-servicing obligations reduce corporate profitability and cash flow available for investment and expansion activities.
3. Increased debt burdens may force companies to reduce investments, employment, and dividend payments to shareholders.

Financial Market Volatility

1. Large FPI outflows trigger stock market declines and financial market instability, weakening investor confidence in the Indian economy.
2. Falling stock markets reduce wealth and discourage domestic investment as consumer confidence deteriorates.
3. Increased volatility raises borrowing costs for both government and corporations through higher interest rates on debt markets.

Export Competitiveness Mixed Effects

1. A weaker rupee theoretically makes Indian goods cheaper in international markets, as foreign buyers can purchase products at lower dollar prices.
2. However, in India's case, the benefit remains limited due to high import dependence of exporters on foreign raw materials and components.
3. Exporters must pay more rupees for imported inputs, offsetting the benefits of rupee weakness on export prices.

4.Role of the Reserve Bank of India

Forex Market Operations

1. The RBI intervenes in both spot and forward markets to stabilize the rupee during periods of sharp decline or excessive volatility.
2. When the rupee faces sharp declines due to sudden capital outflows, the RBI sells US dollars to absorb excess demand and support the rupee.
3. During periods of heavy dollar inflows, the RBI buys dollars to prevent excessive rupee appreciation that could harm export competitiveness.

Monetary Policy Measures

1. The Reserve Bank of India uses interest rate and monetary policy measures to maintain exchange rate stability and macroeconomic equilibrium.
2. Higher interest rates help attract foreign capital inflows and support demand for the rupee by offering better returns.
3. The RBI also controls inflation and maintains investor confidence through monetary policy, indirectly supporting currency stability.

Liquidity Management

1. The RBI manages liquidity conditions in the banking system to reduce excessive volatility in financial markets and currency markets.
2. The RBI injects or absorbs liquidity through instruments such as Cash Reserve Ratio adjustments, Statutory Liquidity Ratio changes, and Liquidity Adjustment Facility operations.

5.Way Forward

1. **Reducing Oil Dependence** – India should aggressively expand renewable energy capacity including solar and wind power, and promote electric mobility to reduce crude oil import dependence.
2. **Maintaining Adequate Forex Reserves** – The RBI should continue maintaining strong foreign exchange reserve buffers exceeding six months of imports to manage external shocks effectively.

3. **Ensuring Macroeconomic Stability** - India should maintain fiscal discipline, moderate inflation, and stable economic growth to strengthen investor confidence and support currency stability.

Source - [https - //www.thehindu.com/business/Economy/why-is-the-indian-rupee-falling/article71022536.ece](https://www.thehindu.com/business/Economy/why-is-the-indian-rupee-falling/article71022536.ece)