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FERTILIZER SUBSIDIES: LET THE MARKET DECIDE

Rupee's Depreciation and Its Impact on the Economy

- The Indian Rupee's recent depreciation, falling from approximately 83.8 to 85.8 per dollar between late September and early 2025, has introduced considerable uncertainty for both economic agents and policymakers.

- This shift, while affecting various sectors, has particularly complicated fiscal and costing calculations for a range of industries, particularly those reliant on imports and global commodity pricing.

Impact of the Depreciating Rupee on Costing and Fiscal Calculations

- The weakening of the rupee has become an additional source of concern for businesses and policymakers. Previously, when the rupee moved within a stable range of 82-84 to the dollar for almost two years from early October 2022, only the prices in dollars mattered. However, with the rupee's recent fall, both the dollar prices of goods and the corresponding exchange rate need to be factored in.

- This creates new challenges in managing costs and adjusting fiscal policies, particularly as global commodity prices—such as Brent crude—remain high, with crude crossing $75 per barrel for the first time in two months.

The Fertilizer Sector: A Case Study in Price Sensitivity

- The fertilizer sector has already begun feeling the impact of the rupee's depreciation. Di-ammonium phosphate (DAP), India's second-most consumed fertilizer after urea, serves as a key example of how currency fluctuations are altering the economic landscape. The current import price for DAP exceeds $630 per tonne, and a depreciation of Rs 2 per dollar increases the landed cost by Rs 1,260 per tonne.

- This increase in cost has led fertilizer companies to hesitate when it comes to importing, as the additional cost burden is significant. Their concern is not just the higher dollar price, but also whether the government would allow them to pass these increased costs on to farmers. The government, on the other hand, is reluctant to raise the maximum retail price (MRP) for DAP, currently capped at Rs 27,000 per tonne, despite the inflationary pressure caused by the weaker rupee.

Government's Response: Subsidy Extension and the Dilemma of Price Hikes

- In response to rising costs due to the rupee's depreciation, the government extended a special subsidy of Rs 3,500 per tonne for DAP imports, which was initially set to expire on December 31, 2024. While this subsidy extension is a positive move, it does not fully cover the effects of the rupee's depreciation. This leaves the government with two options: either allow fertilizer companies to raise the MRP or face a higher fiscal burden through increased subsidies.

- The continued subsidy may not be sustainable in the long term, especially if the rupee continues to weaken. Thus, the government is at a crossroads, needing to balance the interests of farmers, fertilizer companies, and taxpayers.

A Wake-Up Call for Hedging and Domestic Production

- The rupee's depreciation also serves as a wake-up call for businesses and the government alike. An overvalued rupee in the past allowed the government to keep prices of imported fertilizers and fuel artificially low for farmers and consumers. It also allowed firms to borrow cheaply in foreign currency without the need to hedge against exchange rate risks.

- However, with the rupee weakening, the previously easy and costless options are no longer viable. Companies, including major retailers, now face the reality of needing to reassess their sourcing strategies, which may no longer favor imports over domestic production. The government, too, faces the need to adjust its fiscal strategies to accommodate the changing economic conditions.

The Need for Market-Driven Pricing: A Policy Shift?

- The current situation presents an opportunity for the government to reconsider its role in regulating prices and exchange rates. In many instances, market forces should determine the price of imports, including fertilizers like DAP, and the exchange rate.

- By allowing more flexibility in market-driven decisions, the government can encourage more efficient economic outcomes and reduce the strain on its fiscal policy. This would also help businesses adjust to the new economic reality, encouraging them to shift towards more sustainable sourcing options and hedging strategies.

Conclusion: A Time for Strategic Policy Adjustment

- The weakening of the rupee in 2024 has created a complex situation for India's economy, particularly in terms of pricing imported goods and managing fiscal policy. While the government has acted by extending subsidies to mitigate the impact on sectors like fertilizers, it cannot continue to rely on such measures indefinitely.

- This period of depreciation presents a crucial opportunity for India to shift towards more market-driven decisions on pricing and exchange rates, allowing for greater economic resilience. At the same time, businesses need to reconsider their exposure to foreign currency risks and invest in more sustainable domestic supply chains. Ultimately, navigating the rupee's depreciation requires a balanced approach, prioritizing both immediate relief and long-term economic stability.

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