

3. Rupee Depreciation – Economy

Indian rupee slips to record low; likely central bank intervention caps losses

The Indian Rupee has hit a record low, driven by a US-India trade crisis, a globally strong dollar, and high import costs for oil. While this depreciation boosts exports, it fuels domestic inflation and increases foreign debt costs, prompting a policy focus on long-term economic resilience.

Introduction – Rupee Hits a Record Low

The Indian Rupee recently fell to a historic low of ₹88.36 against the US dollar. This significant depreciation has been triggered by a severe US-India diplomatic and trade crisis, compounded by a range of other global and domestic factors, creating substantial challenges for the Indian economy and its foreign policy.

What is Rupee Depreciation?

Definition – Rupee depreciation refers to the decrease in the value of the Indian Rupee relative to foreign currencies, particularly the US dollar, in the open currency market. This means that more rupees are needed to purchase one US dollar.

Depreciation vs. Devaluation – It is crucial to distinguish depreciation from devaluation.

Depreciation is a market-driven phenomenon resulting from forces of supply and demand, capital flows, and global economic conditions. Devaluation is a deliberate and official act by a government to lower its currency's fixed or pegged value.

India's Exchange Rate System – India follows a managed floating exchange rate system. Under this framework, the market determines the rupee's value, but the Reserve Bank of India (RBI) intervenes periodically by buying or selling foreign currency to control excessive volatility and maintain stability.

Reasons Behind the Recent Rupee Depreciation

The recent sharp decline in the Rupee's value can be attributed to both internal and external pressures.

Internal Factors

Rising Inflation – High domestic inflation erodes the purchasing power of the rupee, making Indian goods and services more expensive and less competitive on the global market.

Widening Trade Deficit – India's trade deficit surged to \$27.35 billion in July 2025, primarily driven by the high import costs of crude oil and electronics. A higher trade deficit means India spends more foreign currency (mainly dollars) than it earns, increasing dollar demand and weakening the rupee.

Foreign Capital Outflows – Foreign Portfolio Investors (FPIs) have been pulling money out of the Indian market. They withdrew ₹1.13 lakh crore from Indian equities in 2025 (as of July) due to escalating trade tensions and weaker corporate earnings. Many of these investors have shifted their funds to China, attracted by its financial incentives.

Domestic Structural Weaknesses – The Indian economy's heavy reliance on imports for essential commodities, such as importing 80% of its crude oil needs, creates a persistent demand for US dollars, putting continuous pressure on the rupee.

External Factors

US-India Trade Crisis – A major trigger for the depreciation has been the diplomatic and trade crisis with the US. The US imposed a 25% reciprocal tariff and an additional 25% penalty on Indian exports over disagreements on Russian oil imports and mediation controversies. This action threatens as much as 70% of India's exports to the US.

Rising Crude Oil Prices – The ongoing geopolitical crisis in West Asia has pushed global crude oil prices higher, significantly increasing India's import bill and its demand for dollars to pay for oil.

Strengthening US Dollar – The US Federal Reserve has been raising its interest rates to combat inflation. This has made the US dollar stronger against other world currencies (as reflected in the rising dollar index), causing the rupee to depreciate in comparison.

Geopolitical Tensions – The protracted Russia-Ukraine conflict and the new friction between the US and India have heightened global uncertainty, prompting a "flight to safety" where investors pull capital out of emerging markets like India and move it to more stable assets, primarily in the US.

Impact of Rupee Depreciation on the Indian Economy

A weaker rupee has both positive and negative consequences.

Positive Impacts

Boost to Exports – A depreciated rupee makes Indian goods and services cheaper for foreign buyers, potentially boosting exports. Sectors like IT, textiles, and pharmaceuticals are major beneficiaries.

Higher Remittance Value – Non-Resident Indians (NRIs) who send money home get more rupees for their foreign currency. Remittances rose to a record \$135.46 billion in 2024-25 and are expected to increase further.

Potential for Domestic Investment – Increased profitability from exports may encourage companies to invest more in expanding their production capacities.

Negative Impacts

Higher Import Costs – Imports become more expensive. For a country like India that heavily relies on imported crude oil, this widens the trade deficit and drains foreign reserves.

Inflationary Pressures – Expensive imports lead to "imported inflation." Higher costs for imported raw materials and components raise the production costs for businesses, which are then passed on to consumers, leading to higher domestic prices.

Capital Flight – A rapidly depreciating rupee can erode investor confidence, leading to further outflows by Foreign Institutional Investors (FIIs) and putting more pressure on the currency.

Increased Foreign Debt Costs – India's external debt, which stood at \$736.3 billion in March 2025, becomes more expensive to service in rupee terms. This increases the government's debt burden and strains public finances.

RBI's Approach and Potential Measures

RBI's Stance – Since November 2024, the RBI has adopted a less interventionist approach, allowing the rupee to depreciate in a controlled manner rather than defending a specific level. While the RBI has sold dollars from its reserves to curb extreme volatility, it has avoided aggressive interventions to conserve its foreign exchange reserves for more severe crises. Experts note that the new governor, Sanjay Malhotra, is continuing the policy of "strategic tolerance" or controlled depreciation, viewing it as a tool to maintain export competitiveness while conserving reserves.

Measures to Strengthen the Rupee

Short-Term Measures –

Forex Interventions – The RBI can strategically sell dollars from its forex reserves to temporarily increase the supply of dollars and support the rupee.

Currency Swap Agreements – Entering into bilateral currency swap agreements with friendly nations like Japan or the UAE can provide an alternative source of foreign currency.

Monetary Policy Adjustments – The RBI could raise its repo rate (currently 6.5% as of August 2025) to make holding rupees more attractive for foreign investors.

Import Rationalization – The government could impose temporary restrictions on non-essential imports, such as luxury goods, to curb dollar demand.

Long-Term Measures –

Promote Rupee-Based Trade – Diversifying trade payments away from the US dollar by promoting international trade settled in rupees.

Boost Exports – Strengthening export-oriented schemes like the Production Linked Incentive (PLI) to make Indian manufacturing globally competitive.

Reduce Import Dependency – Vigorously pursuing initiatives like Make in India to expand domestic production of oil, electronics, and other critical imports.

Attract Stable FDI – Improving the ease of doing business to attract long-term Foreign Direct Investment (FDI) rather than volatile FPI flows.

The Way Forward

Strengthen Strategic Autonomy – India must carefully balance its relationships with major powers like the US, Russia, and the BRICS nations to protect its economic and strategic interests.

Diversify Trade Partners – Aggressively pursue Free Trade Agreements (FTAs) with new partners like the EU, UK, and ASEAN to reduce over-reliance on the US market.

Engage in Diplomacy – Proactively use diplomatic channels to resolve the ongoing trade and political tensions with the US while reinforcing commitments to multilateral forums like the Quad and G20.

Conclusion

The 2025 US-India crisis and the resulting rupee depreciation underscore the complex challenges India faces in balancing its economic stability with its strategic autonomy. While short-term measures by the RBI can help manage market volatility, India's long-term economic resilience will depend on fundamental structural reforms aimed at diversifying trade, boosting domestic manufacturing, and reducing critical import dependencies.

Source – https://www.reuters.com/world/india/indian-rupee-slips-record-low-likely-central-bank-intervention-caps-losses-2025-09-05/?utm_source=chatgpt.com

