



RUPEE APPRECIATION AND DEPRECIATION: IMPLICATIONS: ECONOMIC: GS - III



The value of a currency is not just a number on the exchange rate board; it's a reflection of a nation's economic health and a determinant of its global standing. The Indian rupee (INR), like any other currency, undergoes fluctuations – sometimes appreciating, and at other times, depreciating.

What is Rupee Appreciation and Depreciation?

- **Rupee Appreciation:** When the value of the rupee increases compared to other currencies, say the US dollar, it means you need fewer rupees to buy a dollar. For example, if the exchange rate moves from ₹80 per dollar to ₹75 per dollar, the rupee has appreciated.
- **Rupee Depreciation:** Conversely, depreciation occurs when the rupee's value falls against another currency. For instance, if the rate moves from ₹80 to ₹85 per dollar, the rupee has depreciated.

These movements are driven by factors like trade balances, inflation, foreign investments, and central bank policies.

Impact of Rupee Appreciation and Depreciation on Different Social Sections

1. Consumers:



- **Appreciation:** Imported goods like electronics, fuel, and luxury items become cheaper, benefitting middle- and upper-class consumers.
 - **Depreciation:** Imports become expensive, pushing up prices of essentials like fuel and affecting household budgets, especially for the lower-income groups.
2. **Businesses:**
- **Appreciation:** Export-driven industries like IT services and textiles suffer as their products become costlier in global markets. However, companies reliant on imports benefit due to lower costs.
 - **Depreciation:** Exporters gain a competitive edge, but importers face higher costs, affecting sectors like automobile manufacturing and electronics.
3. **Government:**
- **Appreciation:** Reduces the burden of external debt repayments in rupee terms.
 - **Depreciation:** Increases the cost of external debt and adds strain to fiscal accounts, especially due to higher oil import bills.
4. **Common Citizens:**
- Inflation spikes during depreciation, disproportionately impacting lower-income groups.
 - Travel, education, and medical expenses abroad become costlier during rupee depreciation, affecting those in the middle and upper classes.

A Brief History of Rupee Depreciation Since 2014

The rupee has witnessed significant fluctuations over the past decade, with major events influencing its value:

- **2014-2016:** The rupee experienced relative stability, trading in the range of ₹60-₹68 per dollar. However, global factors like the US Federal Reserve's tightening policies started to weigh on emerging market currencies, including the INR.
- **2018:** The rupee faced sharp depreciation due to rising crude oil prices and capital outflows, hitting ₹74 to the dollar.
- **2020:** During the COVID-19 pandemic, the rupee weakened further as global economic uncertainties led to a flight of capital from emerging markets.

2022-2024: The rupee depreciated significantly, crossing ₹80 to the dollar for the first time in August 2022, largely due to the US Federal Reserve's aggressive rate hikes and geopolitical tensions.

Reasons for the Current Rupee Depreciation

1. **Strengthening of the US Dollar:**
 - Since late 2024, the US dollar has strengthened against almost all global currencies due to higher interest rates and robust economic performance in the US.
2. **High Trade Deficit:**



- India's imports, especially of crude oil, have outpaced its exports, leading to a widening trade deficit that puts pressure on the rupee.
- 3. **Capital Outflows:**
 - Global investors have pulled money from emerging markets like India due to attractive returns in the US, further weakening the rupee.
- 4. **Geopolitical Uncertainty:**
 - Ongoing global tensions and conflicts have caused volatility in the forex market, affecting the rupee's performance.
- 5. **Inflationary Pressures:**
 - Higher domestic inflation relative to other countries erodes the rupee's value over time.

Impact of the Current Depreciation of the Rupee

1. **Higher Import Costs:**
 - Rising costs of crude oil have increased fuel prices, contributing to inflation. This has a cascading effect on transportation and essential goods.
2. **Export Boost:**
 - Exporters, particularly in sectors like IT and pharmaceuticals, benefit as their products become more competitive globally.
3. **Worsening External Debt:**
 - India's external debt servicing becomes costlier in rupee terms, adding strain to fiscal management.
4. **Pressure on Foreign Exchange Reserves:**
 - The RBI has intervened to stabilize the rupee by selling dollars, leading to a decline in forex reserves.

Critics' Arguments on Rupee Management

Critics argue that the RBI's approach to managing the rupee has been inconsistent. Some believe the central bank has intervened too aggressively in the forex market, straining liquidity, while others accuse it of allowing excessive depreciation to favor exporters. These contradictory perspectives reflect the complexity of currency management.

Positive Aspects of the Current Rupee Performance

1. **Moderate Depreciation:**
 - Despite global pressures, the rupee's depreciation has been relatively moderate compared to other currencies.
2. **Improved External Borrowings:**
 - The proportion of unhedged external borrowings has decreased, reducing the risk of financial instability.



3. Stronger Export Potential:

- A weaker rupee supports Indian exporters, potentially improving the trade balance in the long run.

4. Calibrated Interventions:

- The RBI's interventions have maintained stability without depleting forex reserves excessively.

Implications for the Upcoming Budget

1. Focus on Inflation Control:

- Policymakers are likely to prioritize measures to control inflation, especially through subsidies and targeted welfare programs.

2. Increased Allocations for Exports:

- Export-promotion initiatives may receive a boost to capitalize on the rupee's competitive value.

3. Management of External Debt:

- The government may explore ways to refinance or manage external debt in a way that minimizes the fiscal burden.

4. Energy Subsidies:

- To cushion the impact of higher fuel costs on the population, energy-related subsidies might see increased allocations.

Conclusion

Rupee depreciation is neither inherently good nor bad; its impact depends on the broader economic context and the balance of trade-offs. While the current depreciation has increased import costs and inflationary pressures, it also offers opportunities for export growth and greater economic competitiveness. The Reserve Bank of India's calibrated approach has helped maintain relative stability, and the upcoming budget will be an opportunity to address the challenges and leverage the benefits of the rupee's performance.

Ultimately, currency management is as much about long-term resilience as it is about short-term stability. With global uncertainties persisting, a pragmatic and balanced approach remains the best way forward for the Indian economy.

Main Practice Question

Discuss the implications of rupee depreciation on India's economic growth, inflation, and external trade, highlighting the measures taken by the Reserve Bank of India (RBI) to manage currency fluctuations. (250 words)



Answer Guidelines

Introduction (30-40 words):

- Define rupee depreciation and its significance in the global economic context.
- Briefly mention the recent trends in rupee depreciation and its primary causes, such as the strengthening of the US dollar and rising trade deficits.

Body (150-170 words):

1. Impact on Economic Growth:

- Positive: Boosts export competitiveness, supporting export-driven sectors like IT and pharmaceuticals.
- Negative: Higher import costs, particularly for crude oil, increase production costs and widen the fiscal deficit.

2. Impact on Inflation:

- Depreciation makes imports like crude oil, electronics, and raw materials more expensive, fueling inflationary pressures and impacting household budgets, especially for lower-income groups.

3. Impact on External Trade:

- Trade balance worsens initially due to costly imports, but export competitiveness may improve over time.
- Encourages hedging of external borrowings to mitigate risks.

4. RBI Measures:

- Calibrated interventions in forex and offshore non-deliverable forward (NDF) markets.
- Liquidity injections to ensure market stability and manage inflationary pressures.

Conclusion (30-40 words):

- Rupee depreciation poses challenges but also offers opportunities for economic restructuring.
- The RBI's balanced interventions aim to stabilize the currency while supporting growth and maintaining external trade competitiveness.



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