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The Decline of the Indian Rupee: Causes, Impact and Policy Response

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Abstract
In recent years, the Indian Rupee has declined significantly due to many domestic and international factors. This paper explores the causes of the decline, which include Capital Outflows, Trade and Current Account Deficits, etc. This paper also examines the impacts of the decline, such as Macroeconomic impacts, Sectoral impacts etc. In addition to causes and impacts, it also evaluates the policy measures adopted by several countries that contributed to the decline of the Indian Rupee such as rate hikes by the U.S. Federal Reserve, OPEC's oil price strategy, effects of the US-China Trade Wars etc.

Keywords: Indian Rupee Depreciation, Inflationary Pressures, Geopolitical Tensions, Capital Outflows, Competitive Devaluation.

1. INTRODUCTION

The fall of the Indian Rupee has become a major concern as it affects the Indian economy both within and outside the country. This paper looks at the diverse factors that have led to the fall of the rupee, its overall effect on inflation, the trade balance, the investment climate, and the range of measures taken by the Reserve Bank of India and the government. In providing what one might refer to as a complete picture of the economic dynamics, we will also look into the effectiveness of the steps employed to meet this challenge.

Year	USD (Avg.)	USD (Year-End)	Year	USD (Avg.)	USD (Year-End)
2000–01	45.6844	46.64	2011–12	47.9229	51.16
2001–02	47.6919	48.8	2012–13	53.2112	54.2323
2002–03	48.3953	47.505	2013–14	60.5019	60.0998
2003–04	45.9516	43.445	2014–15	61.1436	62.5908
2004–05	44.9315	43.755	2015–16	65.4685	66.3329
2005–06	44.2735	44.605	2016–17	67.072	64.8386
2006–07	45.2849	43.595	2017–18	64.4549	65.0441

2007–08	40.241	39.985	2018–19	69.9229	69.1713
2008–09	45.917	50.945	2019–20	74.5321	73.2365
2009–10	47.4166	45.135	2020–21	73.2256	74.5692
2010–11	45.5768	44.645	2021–22	82.44	82.76

2. CAUSES

On 30 July 2024, THE MINISTER OF STATE FOR FINANCE (SHRI PANKAJ CHAUDHARY) was Questioned about the reasons for the depreciation of Indian rupees against the US dollar. He replied "Various domestic and global factors influence the exchange rate of the Rupee (INR), such as movement of the Dollar index, trend in capital flows, level of interest rates, movement of crude oil prices, current account deficit, etc. One of the main reasons for the depreciation of INR against the US dollar during the current calendar year has been the strengthening of the US dollar. During the current calendar year, INR has been one of the best-performing Asian currencies, having depreciated by 0.6% against the US dollar (as of July 24, 2024). Other major Asian currencies like the Japanese Yen and South Korean Won have declined by 8.4% and 6.7% respectively against the US dollar (as of July 24, 2024). During the same period, the dollar index strengthened by nearly 3.0% while all G10 currencies except the British pound weakened by more than 1% against the US. Dollar. Further, Brent crude prices have risen more than 6% in 2024 (as of July 24, 2024), accentuating pressure on INR." [3]

I. Capital Outflows

A. Foreign Portfolio Investment (FPI): Global uncertainties often lead foreign investors to pull out investments from Indian markets, further depleting forex reserves and pressuring the currency.

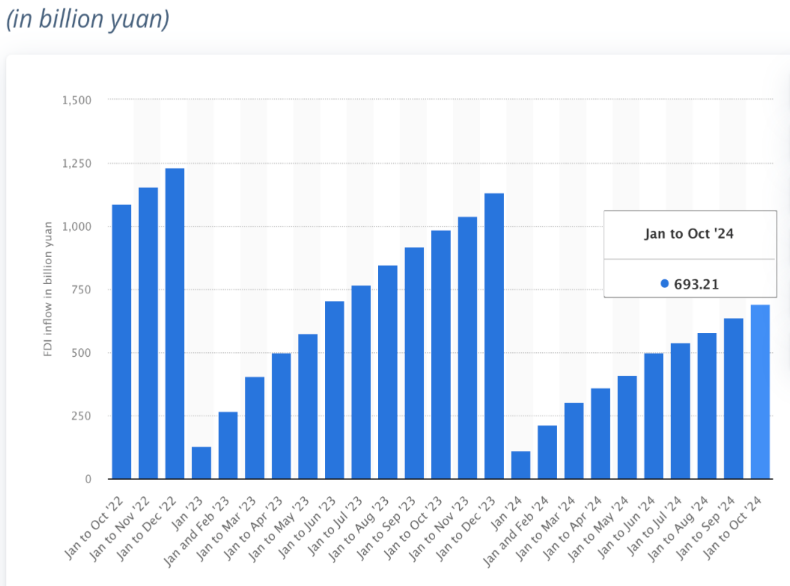


Fig Monthly cumulative value of inward foreign direct investment (FDI) flows to China from October 2022 to October 2024

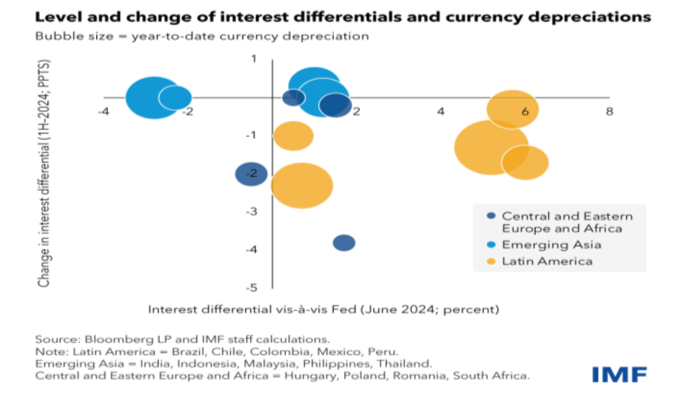
In October, after the government released pro-growth policies by the Government of China there was a major shift of foreign Direct Investment from India to China.

	INDIA				CHINA			
	Total Financial Commitment		**Total No. of Investments**		**Total Financial Commitment**		**Total No. of Investments**	
Year	in $*	**Percent change**	**Number**	**Percent change**	in $*	**Number**	#	**Percent change**
2011	0.16		118		6.29		14	
2012	0.1	18.8	265	124	2.5	-60.3	11	-21.4
2013	0.19	0.0	287	8.3	4.69	87.6	20	81.80
2014	0.08	-57.9	214	-25.4	6.68	42.40	21	5.00
2015	0.13	62.50	198	-7.50	27.11	305.8	23	9.50
2016	0.08	-38.5	212	7.10	14.7	-45.8	25	8.70
2017	0.23	187.5	371	75.00	8.35	-43.2	24	-4.00
2018	0.38	65.20	364	-1.90	14.65	75.40	26	8.30
2019	0.56	47.40	395	8.50	9.92	-32.3	18	-30.8
2020	0.22	-60.7	258	-34.7	7.28	-26.6	13	-27.8
2021	0.48	118.2	248	-3.90	3.73	-48.8	14	7.70
2022	0.35	-27.1	278	12.10	2.32	-37.8	12	-14.3

II. Trade and Current Account Deficits

A persistently high trade deficit, exacerbated by increased imports and slower export growth, puts downward pressure on the rupee The current account deficit widens due to greater import dependency, especially for energy and essential goods.

A key determinant of exchange rates is the difference in interest rates between a given country and the United States—the benchmark in global capital markets. At the beginning of this year, investors expected the Federal Reserve to cut interest rates significantly, widening or maintaining the interest differentials with emerging markets. With the US economy proving stronger than previously anticipated and inflation not yet reaching the Fed’s target, expectations for US interest rate cuts dissipated over the year, and the US dollar appreciated. As a result, major emerging markets’ interest rate differentials vis-à-vis the US narrowed.



A. Market Fluctuation

"Nifty earnings are projected to grow by just 5% in FY25, marking the first single-digit increase in five years due to moderated corporate earnings," as highlighted in the Economic Times [8]. This subdued growth reflects the challenges faced by Indian companies amid global economic headwinds and domestic economic adjustments.

B. Domestic Inflation

The year-on-year inflation rate in October 2024 was recorded at 6.21%, with rural inflation reaching 6.68% and urban inflation at 5.62%. These inflationary trends reflect rising prices, especially in rural areas, likely driven by higher food and commodity prices. Persistent inflation can have a significant impact on the Indian rupee. It diminishes the currency's purchasing power domestically and makes Indian exports less competitive on the global stage due to higher production costs, further widening the trade deficit.

A growing trade deficit increases the demand for foreign currencies to settle trade, contributing to the depreciation of the rupee. Additionally, inflation may compel the Reserve Bank of India (RBI) to increase interest rates to stabilize prices. While higher rates could attract foreign investments in the short term, the consequent slowdown in economic growth may weaken investor sentiment and exert further pressure on the rupee. Rising inflation also raises the cost of imports, particularly crude oil, amplifying the current account deficit and pushing the rupee lower against stronger currencies. This creates a challenging scenario for maintaining currency stability amidst global economic and geopolitical uncertainties.

		October 2024 (Prov.)			September 2024 (Final)			October 2023		
		Rural	Urban	Combd.	Rural	Urban	Combd.	Rural	Urban	Combd.
Inflation	CPI (General)	6.68	5.62	6.21	5.87	5.05	5.49	5.12	4.62	4.87
	CFPI	10.69	11.09	10.87	9.08	9.56	9.24	6.63	6.63	6.61
Index	CPI (General)	199.5	193.7	196.8	196.7	191.4	194.2	187	183.4	185.3
	CFPI	208.2	216.3	211.1	203	210.9	205.8	188.1	194.7	190.4

3. LITERATURE SURVEY

A. ECOWRAP, September 6, 2018, Issue No. 44, FY19

The report analyzes the depreciation of the Indian Rupee as a consequence of both global and domestic factors. Global pressures include the strengthening of the US dollar, geopolitical uncertainties, and the broader global economic environment. Domestically, increasing oil import bills, widening trade deficits, and interest rate hikes have amplified the problem. Key impacts include rising import costs, inflationary pressures, and higher debt servicing costs. Export-oriented sectors show slight gains, while higher consumption sectors face adverse effects.Policy responses highlighted include short-term measures like RBI forex market interventions and interest rate adjustments, medium-term trade policy reforms, and long-term structural reforms focusing on fiscal discipline and energy security. The report emphasizes the necessity of a balanced approach combining short-term actions with long-term reforms for sustainable rupee management. Additionally, empirical evidence underscores limited elasticity between exchange rates and export performance, along with asymmetric investor behavior during periods of depreciation.

B. US Presidential Election 2024: How Trump 2.0 Impacts India's and Global Economy (SBI, Issue #20, 2025, November 10, 2024)

This paper discusses the possible repercussions of Donald Trump's return to the US presidency on the Indian Rupee and global economies. It postulates that inflationary policies under Trump's administration could strengthen the US dollar, leading to further depreciation of the INR. Historical data reflects an 11% decline in the INR during Trump's previous term, highlighting the tangible risks associated with such economic policies.

The report correlates a 5% depreciation in the INR to a 25-30 basis point increase in inflation, noting that although fluctuations appear severe, their economic impact may be less dramatic than often perceived. It also delves into how Federal Reserve decisions—particularly in response to political pressures—could influence global monetary policies and, consequently, the rupee's valuation. The study underlines the need for India to prepare for indirect effects such as altered trade policies, tariffs, and global competitiveness shifts driven by US economic strategies.

C. Bhanotu, Venkateswara & Ravi, Jaladi. (2014), Rupee Value Decline - Reasons and Impact

This study provides an in-depth historical and economic analysis of the Indian Rupee's depreciation, tracing its evolution from a pegged system to a controlled floating regime. The paper identifies key factors contributing to the rupee's decline, including unfavorable global economic conditions, high inflation, and a widening current account deficit. It highlights that while depreciation can enhance India's trade competitiveness by making exports cheaper, it adversely impacts the domestic economy by increasing the cost of imports and reducing purchasing power. The authors propose several policy measures to mitigate the rupee's decline, such as liberalizing FDI policies, increasing caps on Foreign Institutional Investors (FIIs), and easing capital controls to attract foreign investments. These measures aim to stabilize the rupee and foster sustainable economic growth.

4. IMPACTS

A. Macroeconomic Impacts

Inflationary Pressures: A depreciating rupee increases the cost of imports, particularly crude oil, significantly impacting inflation rates. For instance, a 10% depreciation in the rupee could lead to a 50 basis point rise in inflation as estimated by the Reserve Bank of India (RBI). This inflationary pressure reduces the purchasing power of the general population, disproportionately affecting low-income households.

Fiscal Stress: The government faces higher fiscal costs due to increased borrowing pressures. For example, in FY18, depreciation led to an additional fee of ₹6,000-7,000 crores in government debt servicing. With rising oil import bills, fiscal deficits are further exacerbated, compelling the government to reallocate funds from social welfare to debt management.

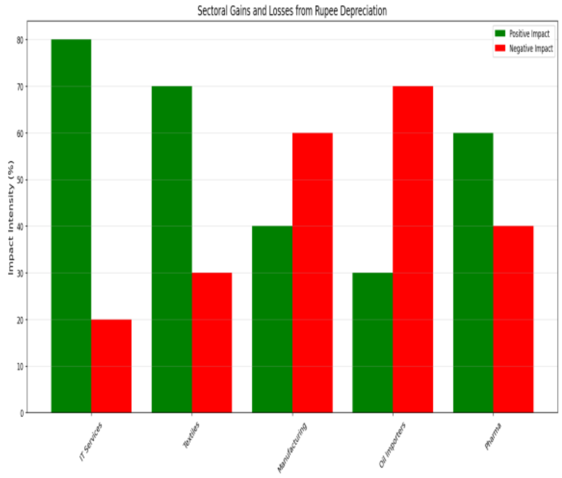
Trade Deficits: While a weaker rupee can theoretically boost exports, India's export basket, which includes more mechanized goods, is income elastic rather than price elastic. As a result, the expected trade deficit correction is limited, further burdening the balance of payments inside the country and indirectly affecting the economy.

B. Sectoral Impacts

IT and Services Sector: A weaker rupee helps export-oriented sectors like IT and BPO since it increases their realization per dollar. Dollars account for almost 75% of India's IT revenue. For instance, despite global economic challenges, IT titans were able to increase their profits due to a cheaper currency but the middle-class community will be deeply affected but this challenge.

SMEs and manufacturing: Profit margins are lowered for small and medium-sized businesses (SMEs) that depend on imported raw materials due to increased input costs. However, in global markets, industries like textiles enjoy competitive pricing benefits where the cost of each item increases significantly than the price at which the item was built which increases the revenue of that particular company, but at the same time, it is a huge burden to the society.

Dependency on Energy and Oil: Since more than 75% of India's needs for crude oil are imported, the industry is susceptible to changes in exchange rates. The cost of importing crude oil rose by ₹353 billion in 2018 due to a depreciation from ₹65 to ₹71 per dollar which impacts the economy as a whole.



C. Effects on Families

Living Expenses: Fuels and other necessities are immediately impacted by depreciation, which raises everyday costs. From luxury products to technology, imported goods become much more expensive, which lowers disposable income.

Travel and Education: Due to currency devaluation, education loans in rupees are insufficient, placing a financial strain on students studying overseas. In a similar vein, rising costs for international travel reduce outbound trips.

Case Study

The Currency Crisis of 2013: High current account deficits (CAD) and worldwide economic conditions caused the currency to weaken from ₹55 to ₹68.80 per dollar in 2013. While the manufacturing sector faced rising prices, the IT and textile industries profited from the depreciation (volume 3-issue 62-2014-22).

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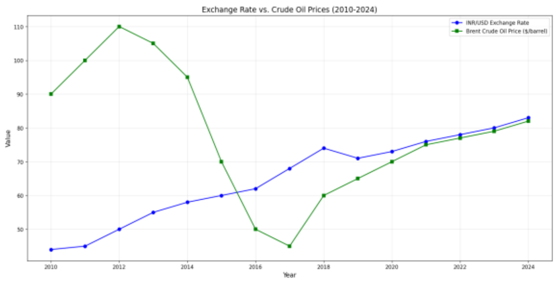


Impact of Depreciation in 2018: India's oil import bill increased by ₹353 billion in 2018 as a result of the rupee's 13% depreciation. The RBI had to raise interest rates three times in a short period due to a 56 basis point increase in inflation.

Quantitative Analysis: Impact of Rupee Depreciation

Year	Exchange Rate (₹/USD)	CAD (% of GDP)	Inflation Rate (%)	FDI Inflows (Billion $)
2013	68.80	4.8	10.1	27.4
2018	74.06	2.4	3.6	36.3
2024*	83.00	3.5	5.2	45.0

5. POLICY RESPONSES

Several countries have opted for various policy measures which led to the decline of the Indian Rupee and some of them are:

A. Implementation of a stricter and tighter Monetary Policy by the U.S. Federal Reserve

To combat inflation, the U.S. Federal Reserve eventually raised its benchmark interest rates. Global Investors who seek better returns on U.S. Treasury bonds and other debt instruments are attracted by the increase in U.S. interest rates. This results in capital outflows from markets like India, thus resulting in the decline of the Indian Rupee due to the decreased demand for Indian assets.

The dollar liquidity in the global market declines when the Fed tapers QE programs by reducing its bond purchases. Hence, it will lead to a rise in the value of the USD, and there will be growing pressure on currencies like the Indian Rupee as investors move capital to safer assets.

B. Trade Protectionism and Tariff Policies

Due to the U.S.-China trade war, many investors have shifted to the USD as a safer currency, thus reducing the demand for market currencies like the Indian Rupee and deteriorating its position in global markets.

The U.S. and EU have imposed tariffs on many Indian exports such as textiles, IT services, steel, etc. It erodes competitiveness, resulting in lesser export-revenue earnings in foreign currency while exerting downward pressure on INR.

C. Oil Production and Pricing Policies by OPEC

The global prices for crude oil have increased due to the decisions made by OPEC and its allies (OPEC+) in order to cut oil production. There is an increase in demand for USD and a reduction in the value of the Indian Rupee, due to the inflation of import bills caused by the increase in oil prices, as India is heavily reliant on oil imports.

The countries that take part in the oil trade with currencies other than the USD such as the Euro or Chinese Yuan, reduce dollar circulation, and due to India's high USD dependency on oil imports, there is increasing pressure on the Indian Rupee.

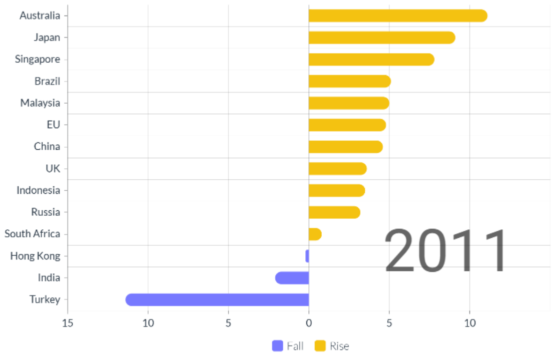
D.Competitive Devaluation and Currency Wars

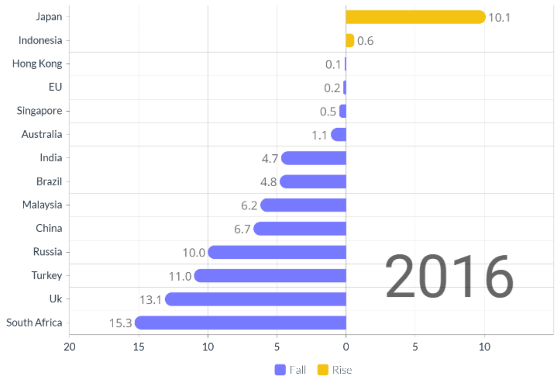
To make their exports cheaper and more competitive in global markets, countries like China or Japan have eventually reduced the value of their currencies, thus reducing India's export competitiveness and leading to a drop in foreign exchange inflows and further declining the rupee.

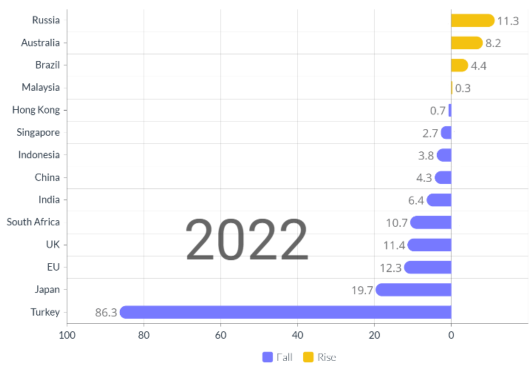
E. Geopolitical Tensions and Sanctions

The conflict between Russia and Ukraine has impacted the global supply chains and energy markets, leading to an increase in the price of commodities. India, being a major importer in the above two markets, faces higher import costs, resulting in a higher demand for foreign currency, especially USD, which weakens the Indian Rupee.

Western sanctions on countries such as Iran or Russia make it complicated for India. India's compulsion to avoid trading in local currency with those countries means more transactions in USD, which compels more demand for the rupee, thereby making the currency more vulnerable to an external shock.







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