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**THE FALLING INDIAN RUPEE**

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## THE FALLING INDIAN RUPEE

### In Context

- The Indian rupee recently crossed the 85-mark against the US dollar, continuing a long-term **trend of weakening relative to the dollar**. A decade ago, this rate was 61, and it was 83 earlier this year.

### Exchange Rate

- **Definition:** The exchange rate is the value of one currency relative to another. For instance, 85 per \$1 means 85 Indian rupees are required to buy one US dollar.
  - ♦ When the demand for the US dollar exceeds the demand for the rupee, the rupee weakens, and the dollar strengthens.
- **Function:** It determines how much of one currency is needed to trade for another, crucial for international trade and investments.

### Factors Responsible for Weakening Rupee

- **Trade Deficit:** India's trade deficit widened to \$26.83 billion in October 2024, indicating a higher demand for dollars to pay for imports. This contributes to the rupee's weakness.
- **Capital Outflows:** Foreign portfolio investors have pulled out a net amount of Rs 43,856 crore from Indian markets in 2024 so far (until December 20th), putting downward pressure on the rupee.
- **Stronger US Dollar:** The US dollar index, which measures the dollar against a basket of major currencies, has risen by about 15% this year, reflecting the dollar's strength and making other currencies, including the rupee, weaker in comparison.
- **High Inflation:** India's retail inflation has remained above the RBI's target range of 2-6% for most of this year, reaching 6.77% in October. This higher inflation compared to many trading partners can make Indian exports less competitive.
- **Trade in Services:** If Indians spend more on US services (like tourism) than Americans on Indian services, demand for dollars increases.

### Impacts of a Weaker Rupee

- **Costlier Imports:** Crude oil prices have risen by over 10% this year, and a weaker rupee further increases the cost of importing oil, contributing to inflation and impacting household budgets.
- **Debt Burden:** India's external debt stood at \$620.7 billion at the end of June 2024. A weaker rupee increases the cost of servicing this debt, putting pressure on government finances.
- **Outbound Travel:** The cost of traveling to the US has increased significantly. For example, a trip that cost Rs 5 lakh a year ago would now cost around Rs 5.75 lakh due to the rupee's depreciation.
- **Benefits for Exporters:** A weaker rupee can make Indian exports more competitive in the global market, potentially boosting export-oriented industries.

### Steps to Strengthen the Rupee

- **Boost Exports:** The government is aiming to boost exports through initiatives like Production Linked Incentive (PLI) schemes. India's merchandise exports grew by 10.3% year-on-year in November 2024, indicating some positive momentum.
- **Attract Foreign Investment:** The government has taken steps to improve the ease of doing business and attract FDI. India received \$46.1 billion in FDI between April and September 2024.
- **Control Inflation:** The RBI has been raising interest rates to combat inflation. However, inflation remains a challenge.
- **Diversification:** India is exploring rupee trade with several countries to reduce reliance on the US dollar.

**Conclusion**

- The weakening of the Indian rupee is a complex issue with multiple contributing factors. While it presents challenges, it also offers opportunities for export-oriented industries. The government needs to continue its efforts to address the underlying causes, manage the negative impacts, and leverage the potential benefits of a weaker rupee.

**Source: IE**

**Mains Practice Question**

Discuss the factors influencing exchange rate fluctuations in India with a focus on the recent depreciation of the Indian rupee against the US dollar. Analyze its implications on India's trade, inflation, and investment climate.

