Imported Inflation

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The **weakening of the domestic currency** in the past two months i.e. July and August 2019 may lead to **imported inflation** in the country.

- When the **general price level rises in a country because of the rise in prices of imported commodities,** inflation is termed as imported.
    - Two key contributors to India's imports are: **Crude Oil and Gold.** Rise in prices of these two products lead to rise in the import bill of the country.
    - It is expected that dull global growth prospects would keep crude prices benign. But, higher demand for gold can push prices higher.
- However, **inflation may also rise due to the depreciation of the domestic currency,** which pushes up the rupee cost of imported items.
    - For example, if the rupee depreciates by 20% against the US dollar in a particular period, the landed rupee cost of an imported product will also go up by the same proportion and will affect the price levels and inflation readings.
    - **Current Causes Behind Depreciation:**
        - Growing risk aversion amongst investors has resulted in broad losses in the currencies of the Emerging Markets (EM).
        - The rupee has been further impacted by escalating tensions in Kashmir and a slightly **larger-than-expected repo rate cut from the RBI.**

Depreciation of the Currency

- Depreciation of a country's currency refers to a **decrease in the value of that country's currency** with respect to **one or more foreign reference currencies,** typically in a floating **exchange rate system.**

    In a **floating exchange rate system,** market forces (based on demand and supply of a currency) determine the value of a currency.
- **Example:** $1 used to equal to Rs.60, now $1 is equal to Rs. 72, implying that the rupee has depreciated relative to the dollar i.e. it takes more rupees to purchase a dollar.
- It happens **due to supply and demand-side factors.**

- It makes **exports more competitive and imports more expensive.**
- It is **different from devaluation** wherein the **government of a country makes a conscious decision** to lower its exchange rate, basically in a fixed or semi-fixed exchange rate.
  - **Fixed exchange rate:** This occurs when the government seeks to keep the value of a currency fixed against another currency.
  - **Semi-Fixed Exchange Rate.** This occurs when the government seeks to keep the value of currency between a band of the exchange rate. In other words, the exchange rate can fluctuate within a narrow band.

Source: Mint