



Depreciation of Indian Rupee

For Prelims: Appreciation vs Depreciation of Currency, Depreciation of Indian Rupee.

For Mains: Reasons for Current Depreciation of Indian Rupee, Impact of Depreciation of Indian Rupee.

Why in News

The Indian currency **declined 2.2% in the Sep-Dec 2021 quarter**. This [depreciation of currency](#) is due to global funds worth \$4 billion having been pulled out of the country's stock market.

- This downfall of currency makes the **Indian rupee as Asia's worst-performing currency**.

Key Points

- **About Depreciation:**
 - Currency depreciation is a **fall in the value of a currency** in a floating exchange rate system.
 - Rupee depreciation means that the rupee has become less valuable with respect to the dollar.
 - It means that the rupee is now weaker than what it used to be earlier.
 - For example: **USD 1 used to equal to Rs. 70**, now **USD 1 is equal to Rs. 76**, implying that the rupee has depreciated relative to the dollar i.e. it takes more rupees to purchase a dollar.
- **Impact of Depreciation of Indian Rupee:**
 - Depreciation in rupee is a **double-edged sword** for the Reserve Bank of India.
 - **Positive:** While a weaker currency may support exports amid a nascent economic recovery from the pandemic.
 - **Negative:** It poses risk of imported inflation, and may make it difficult for the central bank to maintain interest rates at a record low for longer.

Appreciation vs Depreciation of Currency

- In a floating exchange rate system, **market forces** (based on demand and supply of a currency) determine the value of a currency.
- **Currency Appreciation:** It is an increase in the value of one currency in relation to another currency.
 - Currencies appreciate against each other for a variety of reasons, including government policy, interest rates, trade balances and business cycles.
 - Currency appreciation discourages a country's export activity as its products and services become costlier to buy.
- **Currency Depreciation:** It is a fall in the value of a currency in a floating exchange rate system.
 - Economic fundamentals, political instability, or risk aversion can cause currency depreciation.
 - Currency depreciation encourages a country's export activity as its products and services

become cheaper to buy.

Devaluation And Depreciation

- In general, devaluation and depreciation are often used interchangeably.
- They both have the same effect – a fall in the value of the currency which makes imports more expensive, and exports more competitive.
 - However, there is a difference in the way they are applied.
- A devaluation occurs when a country's central bank makes a conscious decision to lower its exchange rate in a fixed or semi-fixed exchange rate.
- A depreciation is when there is a fall in the value of a currency in a floating exchange rate.

- **Reasons for Current Depreciation of Indian Rupee:**
 - **Record-High Trade Deficit:** India's [trade deficit](#) widened to an all-time high of about \$23 billion in November amid higher imports.
 - This growing trade deficit is driven by a [rebound in oil prices](#).
 - **Policy divergence Between RBI and Federal Reserve:** The strengthening of USD in line with expectations of better growth in the US economy and favorable interest offered by the **Federal Reserve (US' Central bank)**.
 - The RBI has been continuously buying dollars to build its reserves and prepare itself for any volatility.
 - **Outflow of Capital:** Foreign capital exodus from stocks have led to the benchmark [S&P BSE Sensex Index](#) falling by about 10% below an all-time high touched in October 2021.
 - **Omicron Concerns:** When concerns about the [omicron virus variant](#) are roiling the global markets.

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