



Depreciation of Indian Rupee

For Prelims: Depreciation of Indian Rupee, Currency depreciation, inflation, Depreciation Vs Devaluation, Appreciation Vs Depreciation

For Mains: Impact of Depreciation of Indian Rupee on economy

Why in News?

The **Indian Rupee depreciated** by around 10% against the US dollar and the rupee was the **worst-performing Asian currency** in 2022.

- This decline was mainly on account of appreciation in the US currency on safe haven appeal amid fears of [recession](#) and [inflation](#) across many parts of the world and [Russia-Ukraine war](#).

How did the Rupee Perform in 2022?

- During the year, the rupee fell to a lifetime low of 83.2 against the dollar. Compared to rupee, **depreciation of other Asian currencies was to a lesser extent**.
 - During the year, the Chinese Yuan, Philippine Peso and Indonesian Rupiah fell around 9%. South Korean Won and Malaysian Ringgit declined by nearly 7% and 6%, respectively.
- However, the [Reserve Bank of India \(RBI\)](#) heavily **intervened in the forex market to defend rupee**. Since the beginning of 2022, the country's foreign exchange reserves have fallen by USD 70 billion. It stood at USD 562.81 billion as of 23rd December 2022.
- Reserves have witnessed a bit of erosion but the central bank is now starting to again build up its reserves and that would act as a buffer in times of uncertainty.

What was the Reason for Capital Outflows?

- The US Fed aggressively raised interest rates by 425 basis point (bps) in 2022 in its **fight against inflation**. This led to a **higher interest rate differential between the US and India**, and investors pulled out money from the domestic market and started **investing in the US market to take advantage of higher rates**.
- In 2022, [Foreign Portfolio Investors \(FPIs\)](#) pulled out **Rs 1.34 lakh crore from the Indian markets** – the highest-ever yearly net outflow.
 - They withdrew Rs 1.21 lakh crore from the stock markets and Rs 16,682 crore from the debt market in 2022, **putting pressure on the rupee**.
- Russian invasion of **Ukraine accentuated the FPI withdrawals with the global economic slowdown** making inflows tougher.

What may be the Impact of Depreciation on the Indian Economy?

- **Positive:**
 - Weaker rupee should theoretically **give a boost to India's exports**, but in an environment of uncertainty and weak global demand, a fall in the external value of rupee

may not translate into higher exports.

▪ **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.
- India meets more than two-thirds of its domestic oil requirements through imports.
- India is **also one of the top importers of edible oils**. A weaker currency will further escalate imported edible oil prices and lead to a higher food inflation.

What is the Outlook on Rupee for 2023?

- Even though the outlook on the rupee remains weak in the near future, the **depreciation in local currency may not continue for a longer period** as India remains the fastest-growing economy.
- The terminal interest rate for the US Fed was anticipated, **but it cannot be the case that their monetary policy will be tightened endlessly**.
- When the (US Fed) tightening is over, **the tide will surely turn**.

What is 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.

What are 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.**

UPSC Civil Services Examination Previous Year Question (PYQ)

Prelims

Q1. Which one of the following is not the most likely measure the Government/RBI takes to stop the slide of Indian rupee? (2019)

- (a) Curbing imports of non-essential goods and promoting exports
- (b) Encouraging Indian borrowers to issue rupee denominated Masala Bonds
- (c) Easing conditions relating to external commercial borrowing
- (d) Following an expansionary monetary policy

Ans: (d)

Q2. Consider the following statements:

The effect of devaluation of a currency is that it necessarily

1. improves the competitiveness of the domestic exports in the foreign markets
2. increases the foreign value of domestic currency
3. improves the trade balance

Which of the above statements is/are correct?

- (a) 1 only
- (b) 1 and 2
- (c) 3 only
- (d) 2 and 3

Ans: (a)

Mains

Q. How would the recent phenomena of protectionism and currency manipulations in world trade affect macroeconomic stability of India? **(2018)**

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