



## 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 23<sup>rd</sup> 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)**

**Source: IE**

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