

Falling of Indian Rupee

Mains: GS-III - Economy

Why in News?

The rupee-to-dollar exchange rate, or the rupees needed to purchase a U.S. dollar, crossed 96 in May this year; the graph of the Indian rupee has been snaking sharply downward.

What is the Exchange Rate?

- **Exchange Rate** - It is the value of one nation's currency vs the currency of another nation or economic zone.
- Typically, exchange rates can be *free-floating or fixed*.
- **Free-Floating Exchange Rate** - It rises and falls due to changes in the foreign exchange market.
- **Fixed Exchange Rate** - It is pegged to the value of another currency.
- The rupee's exchange rate vis-à-vis a particular currency, say the US dollar, tells us how many rupees are required to buy a US dollar.

To know more about **Exchange Rates**, click [here](#)

What is the impact of trade deficits on the rupee's value?

- **Demand** - The demand for the rupee rises with India's exports and falls with imports.
- **Impact of Increased Export** - When firms in Ludhiana export garments, the dollars or euros they receive from foreign buyers are exchanged for rupees to pay workers and suppliers, thereby *increasing demand for the rupee*.
- **Impact of Reduced Imports** - On the other hand, Indian companies import oil by exchanging rupees for dollars, thereby *reducing the demand for the rupee*.
- Even *individuals travelling abroad* exchange rupees for foreign currency (destination country), further reducing rupee demand.
- **Balance of Payments Link** - Overall, if India's *imports exceed exports*, the foreign currency payments it must make to the rest of the world exceed the foreign currency payments it receives.
- That implies more rupees are exchanged for dollars, leading to declines in the demand for, and the value of the rupee (requiring more rupees to purchase one dollar).
- Thus, a currency's exchange rate is closely tied to the country's balance of (foreign currency) payments (to and from the rest of the world).
- **India's Trade Deficit** - India has consistently run a *merchandise trade deficit*, with imports of goods (especially oil) exceeding exports.

- Oil imports are a major contributor.
- This deficit is partly offset by a surplus in India's invisibles -
 - Service exports (especially IT/software).
 - Remittances from migrant workers in West Asia.
- **Current Account Deficit** - Overall, India's current account, which is the sum of merchandise trade and the invisibles accounts, has been in deficit.
- To bridge the current account gap, India relies on capital inflows, mainly
 - Foreign investment.
 - External loans.
- **Role of Forex Reserves** - If capital inflows exceed the current account deficit, the surplus adds to India's forex reserves.
- These reserves act as a buffer to stabilise the rupee during volatility.

Mounting strain Amid ongoing geopolitical tensions, the rupee has weakened sharply against the dollar. Global uncertainty, volatile capital flows and rising import costs have intensified pressure on India's balance of payments and forex reserves

Table 1: India's balance of payments, in billion U.S. dollars

	2023-24	2024-25
A. Current account	-26.1	-23.1
A1. Merchandise trade	-244.9	-286.9
A2. Invisibles	218.8	263.9
B. Capital account	89.4	16.6
B1. Foreign investment	54.2	4.52
B2. Loans	6.5	29.3
B3. Others	28.7	-17.2
C. Forex reserves (increase -/decrease+)	-63.7	5

The Table shows the net values of the respective items. The merchandise trade balance is exports minus imports of goods; similarly, inflows minus outflows of foreign investment and other items.

Source: Database on Indian Economy (DBIE), The Reserve Bank of India.

How do capital outflows weaken the rupee?

- **Forex Reserves as a Safety Net** - A country's forex reserves are as valuable as a family's treasure trove.
- The reserves are tapped to pay for critical imports during periods of insufficient foreign currency inflows, and to defend the currency's value when capital outflows are too large.
- **FDI vs FPI**
- **Foreign Direct Investment (FDI)** - It is mostly in new or existing factories and businesses and, as a result, has some ties binding it to the host country.
- **Foreign Portfolio Investment (FPI)** - It involves purchases of stocks or bonds, is highly volatile and driven by speculation.
- Portfolio investors enter a country seeking quick financial returns and exit at the first sign of risk or when higher returns are offered elsewhere.
- **Impact of FPI Flows** - When FPI surges in, the stock markets are on a roll; when it flows out, it leaves a trail of destruction.
- This leads to
 - Falling demand for the rupee &
 - Depreciation of the exchange rate (more rupees needed per dollar).

- **Capital Outflows & Rupee Weakness** - Capital outflows imply that investors withdraw their investments in rupee assets and exchange them for dollar assets, leading to a tumble in demand for the rupee and in its exchange rate.
- **The Periods of Rupee Depreciation**

Period	Rupee/USD	Cause
Apr–Sep 2013	54.4 → 63.8	Trade deficit + FPI outflows
Jan–Oct 2018	63.6 → 73.6	Oil prices + capital flight
Feb–Apr 2020	71.5 → 76.2	Pandemic shock
Jan–Oct 2022	74.4 → 82.3	Global tightening
Sep 2024–Feb 2025	83.3 → 87.1	Oil + geopolitics
May 2025–May 2026	85.2 → 96	FPI retreat + U.S. rate hikes

- It has each been characterised by worsening of the trade account, FPI outflows, or both.
- **Investors Retreat** - The rupee's recent fall is mainly because foreign investors are pulling money out of India, choosing safer markets due to rising U.S. interest rates and global tensions.
- **Rising Import Costs** - The depreciation of the rupee imposes a high cost on the Indian economy.
- To purchase a barrel of oil at \$100, Indian companies now must pay Rs. 9,600, compared to Rs. 8,500, had the exchange rate remained at Rs. 85 per dollar.
- **Export Advantage** - However, a depressed rupee can help boost exports: a shirt costing Rs. 1,200 can be sold in the U.S. market at \$12.5 now; if the exchange rate were Rs. 80 per dollar, the price would have been \$15.
- **Limitations** - But rupee depreciation alone may not help much, given the range of supply and demand constraints weighing on Indian manufacturing.
- Structural reforms are needed to fully leverage currency depreciation.

What is the role of the RBI?

- **RBI's Intervention** - The Reserve Bank of India (RBI) intervenes to prevent the exchange rate from falling to very low levels.
- When foreign investors rush out by selling their rupee assets for dollars, the RBI props up the rupee by selling some of the dollars (or treasury bonds) from its reserves.
- This raises the demand for rupee and slows its decline (as it did during October 2024-January 2025 and August-December 2025).
- **Strength of Forex Reserves** - India's forex reserves remain sufficiently large.
- They stood at around USD 691.11 billion at the end of March 2026, enough to cover 10.8 months' worth of the country's imports (as of the end of December 2025).
- These reserves are a powerful shield against speculative attacks on the rupee.

What lies ahead?

- The ongoing geopolitical tensions and the threat of further oil price increases pose severe challenges.
- India could be at risk of paying more dollars per barrel of oil and more rupees per dollar.
- The country must take steps to regulate speculative capital outflows and reduce its dependence on oil imports.

Reference

[The Hindu | Why is the Indian Rupee falling?](#)

