Rupee’s Depreciation

Why in news?

The Indian rupee is experiencing its worst slump in four years. Since the start of 2022, the currency has depreciated by more than 7% against the U.S. dollar, weakening past a historic low of 80 to a dollar mark earlier this week.

Is India alone in this?

- The Indian currency is not alone in faring poorly against the dollar bill (greenback).
- Even the historically strong euro and the British pound are taking a hammering and weakening by more than the rupee has.
- The fact that other currencies too have appreciably lost value against the dollar can only offer cold comfort to India’s real economy.

What are the impacts of the depreciation?

- Domestic manufacturers and services providers must now cope with higher dollar prices for the raw materials, equipment or other supplies.
- They may also need to procure from overseas, in the wake of the supply disruptions caused by the pandemic and the war in Ukraine.
- But they also face mounting import bills - the slide means they have to fork out more rupees for the same dollar price from even just a few months ago.

How will different sectors be impacted by the depreciation?

- **IT Sector** - IT companies are the biggest gainers as they bill most clients in US dollars. Americas, including the US, contribute about 50-60% of revenue.
- Their rupee earnings rise as the Indian currency falls.
- **Pharma Sector** - A net gainer sector as it’s a big exporter though raw materials are substantial imports.
- In FY22, India exported $24.62 b worth of products, of which about 30% is to the US. Raw material imports were about $4-5 billion**.**
- **Garments Sector** to benefit given the significant exports and most input costs are locally sourced.
- **Oil & Gas Sector** - The most adversely impacted sector as India imports over 85% of oil and half of the gas it consumes.
- **Renewable energy** - Indian solar plants depend heavily on imported solar cells and modules. So, project costs would rise.
- **Steel** - India exports 10-15% of its steel. The depreciation will make Indian steel more competitive globally.
- Balances the impact of the recent export duty on steel
- **Auto** - About 10-20% of a car’s total raw materials by value are imported but firms

also export vehicles. The depreciation will make cars, in general, more expensive
- Exact impact will depend on inputs purchased and level of exports.
- **FMCG** - Raw material imports account for nearly half of input cost.
- The depreciation will make prices hike to offset higher input costs.
- Margins may be impacted as full pass-through hasn't happened.
- **Consumer Electronics** - 40-60% of total input cost on imports; in smartphones, 70-80% of input costs on imports.
- Re fall has been largely offset by recent drop in component costs Companies not likely to drop prices since they want to improve their margins after 2 yrs.
- **Aviation** - About 60% of costs in dollar terms.
- The depreciation will raised cost burden when fuel prices are at record highs
- It will impact profitability. It will make overseas tickets more expensive.
- **Telecom Services** - A falling rupee makes gear imports more costly.
- Weaker rupee could push up capex bill by 5% in FY23 Drag on profits, unless telcos increase tariffs.

What are the reasons for depreciation?

- It has been said that the rupee may be in a **'free fall'** scenario.
- A 'free fall' is a scenario that could ultimately prove rather damaging for macro-economic stability by spurring imported inflation at a time when both fiscal and monetary authorities are battling to tame runaway inflation.
- The following factors as the major drivers of the rupee's depreciation,
    1. Russia-Ukraine conflict,
    2. Soaring crude oil prices, and
    3. **Foreign Portfolio Investors Were Selling Off Assets** and fleeing to safe haven in the wake of global monetary policy tightening.

So far, in 2022, FPIs have dumped $29.6 billion in Indian equity and debt after 3 years of net investments, with the prospect of more, sharp interest rate increases by the Federal Reserve to tame 4-decade-high U.S. inflation likely to do little to staunch the outflows.

What does the US dollar index indicate?

- The US dollar index, a measure of the greenback's value against a basket of six major currencies, too offers little reassurance to the rupee.
- The index is just shy of a 20-year high hit in the month of June 2022 indicating that investors are betting strongly on dollar-backed assets.
- To know more about the US dollar index, click here.

What does the REER of Rupee say?

- The rupee's real effective exchange rate (REER) provides a weighted average value in relation to a basket of currencies of its major trading partners.
- It is also signalling that the Indian currency is still overvalued and has room to depreciate further.

- The RBI will need to judiciously utilise every dollar in its foreign exchange reserves to ensure that a likely slowdown in exports and sticky imports do not add more undue pressure on the rupee.

Reference

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