



Depreciation of Indian Rupee

Context:

The Indian rupee fell to an all-time low of 77.44 against the U.S. Dollar.

Relevance:

GS-III: Indian Economy (Capital Market, Fiscal Policy and Monetary Policy)

Dimensions of the Article:

1. What is Currency Depreciation and what are its causes
2. Impact of the drop
3. Reasons for Current Depreciation of Indian Rupee

https://www.youtube.com/watch?v=h0asl4KhypE&ab_channel=LegacyIASAcademy

What is Currency Depreciation and what are its causes?

- Currency depreciation is a fall in the value of a currency in terms of its exchange rate versus other currencies.
- Economic fundamentals, interest rate differentials, political instability, or risk aversion can cause currency depreciation.
- Orderly currency depreciation can increase a country's export activity as its products and services become cheaper to buy.
- Currency depreciation in one country can spread to other countries.
- Countries with weak economic fundamentals, such as chronic current account deficits and high rates of inflation, generally have depreciating currencies. Currency depreciation, if orderly and gradual, improves a nation's export competitiveness and may improve its trade deficit over time. But an abrupt and sizable currency depreciation may scare foreign investors who fear the currency may fall further, leading them to pull portfolio investments out of the country. These actions will put further downward pressure on the currency.
- Easy monetary policy and high inflation are two of the leading causes of currency depreciation. When interest rates are low, hundreds of billions of dollars chase the highest yield. Expected interest rate differentials can trigger a bout of currency depreciation.



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- Central banks will increase interest rates to combat inflation as too much inflation can lead to currency depreciation.
 - Additionally, inflation can lead to higher input costs for exports, which then makes a nation's exports less competitive in the global markets. This will widen the trade deficit and cause the currency to depreciate

Impact of the drop

- Depreciation in rupee is a double-edged sword for the Reserve Bank of India.
- While a weaker currency may support exports amid a nascent economic recovery from the pandemic, 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.

Reasons for Current Depreciation of Indian Rupee

- The rupee depreciated due to a sell-off in global equity markets sparked by the US Federal Reserve's (central bank) interest rate hike, the war in Europe, and growth fears in China because to the Covid-19 surge.
- The outflow of dollars is a result of rising crude prices, and the stock market correction is also contributing to the negative flow of dollars.
- The RBI's actions to tighten monetary policy in response to growing inflation have resulted in depreciation.

-Source: The Hindu