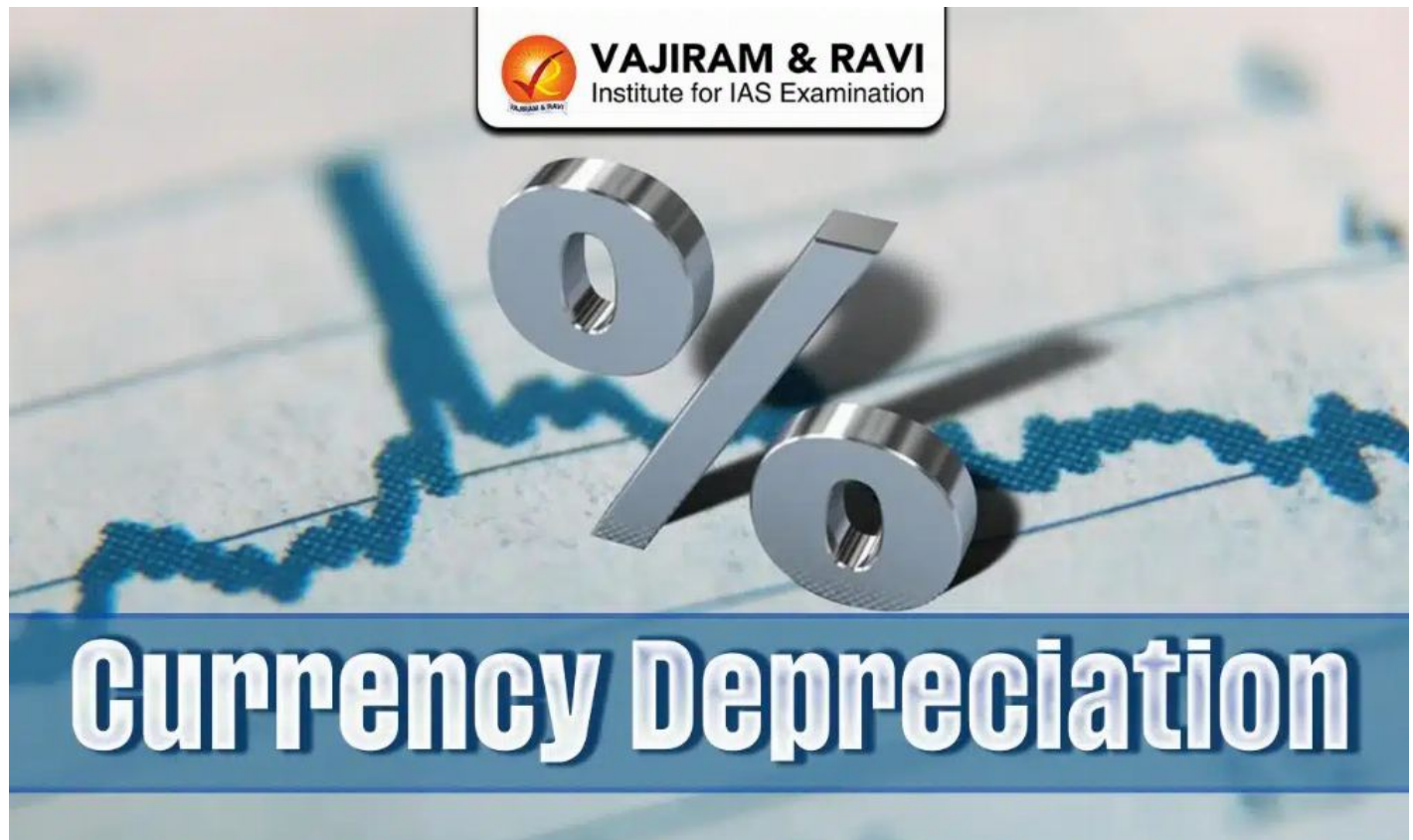


Currency Depreciation Amid the Crisis in West Asia - Explained

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Currency Depreciation Latest News

- The Indian rupee has breached the 96-per-dollar mark, hitting a record low amid the West Asia crisis, with policymakers concerned about the possibility of it crossing the psychological barrier of 100.

Understanding Currency Depreciation

- Currency depreciation refers to the decline in the value of a country's currency relative to another currency, typically the US dollar in India's case.
- It occurs due to market forces such as demand and supply of foreign exchange, capital flows, trade balances, and interest rate differentials.
- A depreciating currency makes imports costlier and exports cheaper, affecting inflation, trade balance, and overall economic stability.

- For a heavily import-dependent country like India, especially for crude oil and gold, a weakening rupee has significant macroeconomic implications.

Understanding Balance of Payments

- The **Balance of Payments** (BoP) is a comprehensive record of all economic transactions between residents of a country and the rest of the world over a specific period. It comprises two main accounts:
 - **Current Account:** Records trade in goods and services, primary income, and secondary income (remittances).
 - **Capital and Financial Account:** Records foreign investments, loans, and other capital flows.
- A BoP surplus occurs when foreign fund inflows exceed the trade deficit, strengthening the rupee. A BoP deficit weakens the currency.

Historical Context: The Phase of Artificial Stabilisation

- The current rupee crisis must be understood in the context of the Reserve Bank of India's (RBI) intervention patterns over the past three years.
- **Rupee Movement Timeline**
 - September 2022: Rupee breached the 81-per-dollar mark for the first time.
 - 2023-2024: Rupee moved in a narrow range of 81-83 per dollar for nearly two years.
 - October 2024: Broke past 84 per dollar.
 - December 2024: Crossed 85 per dollar.
 - Since January 2025: Rupee has fallen by 11%.
 - May 2026: Breached 96 per dollar, hitting a record low.
- **The Stabilisation Years**
 - According to policymakers, the rupee was artificially held back between 2023 and 2024 through significant RBI interventions in the foreign exchange market. Key data points include:
 - 2022-23: BoP deficit of \$9 billion; rupee weakened by 7.6%; RBI sold a record \$213 billion; forex reserves declined by \$29 billion.
 - 2023-24: BoP surplus of \$64 billion; RBI bought \$41 billion net; forex reserves increased by \$68 billion; rupee declined only by 1.4%.
 - 2024-25: BoP deficit of \$5 billion; rupee fell by 2.5%; RBI's gross dollar sales jumped to a record \$399 billion.
 - The RBI's stated policy is that it does not target any specific exchange rate level and only intervenes to prevent excessive volatility. However, the data suggests significant interventions were made to maintain rupee stability.

Current Crisis: West Asia Conflict and Capital Outflows

- The ongoing West Asia crisis has put significant pressure on India's capital account, leading to substantial foreign capital outflows.
- Since the war began in late February 2026, the rupee has fallen by 5.2% against the dollar.
- **Key Factors Driving Depreciation**

- Rising Crude Oil Prices: Higher import bills widen the current account deficit.
- Foreign Institutional Investor (FII) Outflows: Sustained capital outflows of ₹1.97 lakh crore in the January-May period.
- Global Uncertainty: Geopolitical tensions affecting investor sentiment.
- Pent-up Depreciation: Markets pricing in depreciation that may have occurred during the earlier phase of artificial stability.

• Why Past Stabilisation Matters Now

- Policymakers are increasingly recognising that the prolonged stability of the rupee at 82-83 per dollar during 2023 and 2024 may have created pent-up depreciation pressure. According to internal deliberations:
- The forex market is now pricing in the depreciation that may have occurred earlier.
- The current fall appears steeper because of the earlier artificial stability.
- Effects of long, artificial stabilisation are being felt now.
- The ability of interventions to defend any particular level is increasingly seen as limited.

Economic Implications of Rupee Depreciation

• Impact on Inflation

- A weaker rupee increases the cost of imports, particularly crude oil, leading to higher fuel prices and broader inflationary pressures.
- According to State Bank of India's Group Chief Economic Advisor, the rupee has reached a "**critical depreciation threshold**" beyond which further weakness could erode the benefits of recent domestic fuel price hikes.

• Impact on Current Account

- Higher import costs widen the current account deficit, putting further pressure on the rupee in a self-reinforcing cycle.

• Impact on Investor Sentiment

- A rapidly depreciating currency can hurt investor confidence, accelerating capital outflows and creating further pressure on the rupee.

• Impact on External Debt

- A weaker rupee increases the cost of servicing external debt in rupee terms, raising the financial burden on Indian companies and the government.

Comparison with the 2013 Taper Tantrum

- The current situation has drawn comparisons with the 2013 Taper Tantrum, when India was labelled among the "Fragile Five" economies. However, key differences include:
 - India's forex reserves are significantly higher today.
 - The macroeconomic fundamentals are stronger in many respects.
 - The policy response toolkit has evolved, including options like swap lines and targeted interventions.
- Nevertheless, structural vulnerabilities remain, including high import dependence on crude oil and gold, and exposure to global monetary policy shifts.

Policy Responses

- **RBI Interventions**

- Dollar sales to defend the rupee.
- Forward market interventions to manage volatility.
- Restrictions on certain derivative contracts to curb speculation.

- **Government Measures**

- Higher import duties on gold to reduce non-essential imports.
- Considering cuts in withholding tax to attract foreign investors.
- Fuel price hikes to manage the burden of higher crude oil costs.
- PM's austerity appeal urging citizens to reduce gold and petrol consumption.

Way Forward

- **Short-Term Measures**

- Targeted RBI interventions to prevent disorderly depreciation.
- Attracting NRI deposits through schemes like FCNR(B) deposits.
- Diversifying crude oil sources to reduce dependence on West Asia.
- Promoting gold monetisation to channel idle gold into the economy.

- **Long-Term Structural Reforms**

- Boosting manufacturing exports through PLI and Make in India.
- Deepening financial markets to attract stable long-term capital.
- Strengthening forex reserves as a buffer against external shocks.
- Accelerating the renewable energy transition to reduce crude oil dependence.
- Enhancing competitiveness through labour, land, and capital market reforms.

Source: IE

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