

Rupee Depreciation, RBI Intervention and India's External Sector Challenges

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Rupee Depreciation Latest News

- The Indian rupee has witnessed a sharp depreciation, sliding close to **₹97 per US dollar** amid rising oil prices, geopolitical tensions in West Asia, foreign capital outflows, and global financial uncertainty.
- The debate has intensified over whether the Reserve Bank of India should actively intervene or allow the rupee to “find its market level”.

Why is the Rupee Falling?

- **Pressure from the capital account:**
 - Contrary to conventional explanations, the recent depreciation is not primarily due to weak macroeconomic fundamentals.
 - India continues to record relatively **strong GDP growth**, manageable inflation, and fiscal consolidation.

- The core issue lies in the capital account:
 - Persistent Foreign Institutional Investor (**FII**) outflows since mid-2025.
 - Negative net Foreign Direct Investment (**FDI**) inflows during several months.
 - Rising **US interest rates** making dollar assets more attractive.
 - Heightened global risk aversion due to the West Asia crisis.
- This has reduced dollar inflows into India while increasing demand for foreign currency.
- **Role of balance of payments (BoP):**
 - India traditionally runs a **Current Account Deficit (CAD)** because imports exceed exports.
 - This is usually financed through the FDI, portfolio investments, remittances, and external borrowing.
 - When capital inflows exceed the CAD, the BoP remains in surplus and supports the rupee.
 - However,
 - 2023-24 saw a large BoP surplus, allowing RBI to accumulate reserves.
 - 2024-25 moved back into deficit.
 - Capital outflows in 2025-26 intensified depreciation pressures.
 - Thus, the rupee **weakened** despite **stable** domestic **fundamentals**.

Debate on RBI Intervention

- **Argument for a market-determined rupee:**
 - Economists argue that excessive intervention distorts markets.
 - A weaker rupee theoretically discourages imports, boosts exports, and **restores** external balance **naturally**.
 - They caution that defending a currency level can deplete forex reserves, delay necessary adjustments, and create future instability.
- **Argument for RBI intervention:**
 - Some economists argue that uncontrolled depreciation, especially when driven by speculative finance rather than fundamentals, can become dangerous.
- **Risks of unchecked depreciation:**
 - **Imported inflation**, especially through crude oil.
 - Higher production costs due to import dependence.
 - Rising inflation expectations.
 - Panic-driven capital flight.
 - Adverse investor sentiment.
- The RBI therefore intervenes not to target a fixed exchange rate, but to prevent “excessive and disruptive volatility.”

Did Artificial Stabilisation Backfire?

- A major policy debate concerns RBI actions during 2023-24, when the rupee was held largely within the ₹81-83 range.
- RBI sold or bought dollars aggressively to smooth movements. Critics argue this created an “**artificial plateau**”.

- As global pressures intensified later, the rupee saw a sharper fall because the depreciation that had been delayed earlier was eventually reflected quickly in the exchange rate.

Exchange Rate Dynamics and Market Psychology

- Exchange rates are heavily influenced by **sentiment**.
- If investors expect further depreciation foreign investors withdraw funds, exporters delay dollar conversions, importers rush to buy dollars, and speculators intensify pressure.
- This creates a **vicious cycle** where expectations themselves accelerate depreciation.
- Economists explained such “**overshooting**” behaviour, where currencies move beyond equilibrium values in the short run.

Why Does Depreciation May Not Boost Exports Much?

- The **textbook assumption** that a weak currency automatically boosts exports is limited in India’s case because:
 - Indian exports are highly **import-intensive**.
 - Inputs such as crude oil, intermediate goods, and machinery become costlier.
 - **Inflation** erodes competitiveness gains.
- Moreover, if many emerging market currencies weaken simultaneously against the dollar, relative export competitiveness changes little.
- Thus, depreciation imposes immediate costs on households and firms without guaranteeing export gains.

RBI’s Policy Approach

- The RBI maintains that exchange rates should remain market-determined, intervention is only to **smooth volatility**, and no fixed exchange rate target exists.
- India still possesses substantial forex reserves, credible monetary institutions, and relatively stable macroeconomic indicators.
- The IMF’s Integrated Policy Framework (**IPF**) also recognises forex intervention as a legitimate tool for emerging market economies during periods of excessive volatility.

Way Forward for India

- **Allow**: Gradual market-driven adjustment while preventing speculative volatility.
- **Strengthen**: Long-term capital inflows through manufacturing and technology reforms (globally attractive AI and advanced-tech investment opportunities).
- **Reduce**: Import dependence, particularly in energy and critical intermediates.
- **Expand**: Export diversification and competitiveness under initiatives like “Make in India”.
- **Deepen**: Domestic financial markets to reduce vulnerability to external shocks.
- **Maintain**: Adequate forex reserves as a buffer against global uncertainty.

Conclusion

- India should avoid both extremes — neither rigidly defending the rupee nor allowing disorderly depreciation. A **calibrated strategy** is essential.
- Ultimately, exchange-rate stability cannot rest solely on RBI intervention. Sustainable rupee strength will depend on improving India's structural competitiveness, external resilience, and investor confidence in the long run.

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