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The Solution to the Falling Rupee Lies in Diplomacy

Context

- The recent **decline in the value of the Indian rupee** has caused considerable concern among market participants and the general public.
- What makes this episode particularly puzzling is that it has occurred despite strong macroeconomic fundamentals.
- India currently enjoys robust economic growth, historically low inflation, and a manageable current account deficit, conditions that typically support currency stability.
- The depreciation of the rupee, therefore, cannot be adequately explained through conventional economic indicators.
- Instead, it reflects the growing **influence of geopolitical tensions** and capital flow volatility, especially arising from strained trade relations with the United States.

Strong Macroeconomic Fundamentals

- India's **macroeconomic performance** remains strong by both domestic and international standards.
- Economic growth is estimated at **4% for the current year**, reinforcing India's position as one of the fastest-growing major economies.
- Inflation has been remarkably subdued, with consumer price inflation falling to 1.33% by the end of 2025, well below the Reserve Bank of India's lower tolerance band for several consecutive months.
- The external sector also appears stable, with the current account deficit amounting to only 0.76% of GDP in the first half of 2025–26, a significant improvement over the previous year.
- Despite these favourable indicators, the rupee has depreciated by around 6% since April 2025.

Reason Behind Rupee Depreciation

- **Capital Outflows as the Primary Cause**
    - A closer examination shows that the primary driver of the rupee's decline is not the trade deficit but capital outflows.
    - Although India's merchandise and services trade deficit widened modestly during April-December 2025, it remains within **manageable limits** and does not justify the magnitude of the currency's fall.

- In contrast, capital flows have undergone a sharp reversal. Net capital inflows of over $10 billion during April–December 2024 turned into net outflows of nearly $4 billion in the corresponding period of 2025.
- This reversal has **exerted significant downward** pressure on the rupee and reflects deteriorating investor sentiment rather than economic weakness.

- **Geopolitical Tensions and U.S. Trade Policy**

  - These capital outflows are closely linked to **geopolitical developments**, particularly the increasingly adverse trade stance of the United States toward India.
  - The imposition of a cumulative **50% tariff** on Indian exports, initially on a reciprocal basis and later due to India's import of Russian crude oil, has heightened uncertainty among investors.
  - Additional threats of tariffs on countries trading with Iran, despite India's limited trade exposure, have further intensified fears.
  - As tariffs are increasingly weaponised for geopolitical objectives, economic fundamentals have taken a back seat in shaping investment decisions.

Shift from Economic to Diplomatic Determinants and the Role of the Reserve Bank of India

- **Shift from Economic to Diplomatic Determinants**

  - This episode marks a departure from earlier instances of rupee depreciation.
  - In 2022, for example, the rupee's fall could be explained by global economic factors such as aggressive interest rate hikes by the U.S. Federal Reserve.
  - The present depreciation, however, lacks a clear economic rationale and is driven largely by non-economic pressures.
  - Consequently, the challenge has moved from the economic arena to the diplomatic sphere, implying that **conventional macroeconomic tools** alone are insufficient to address the problem.

- **Role of the Reserve Bank of India**

  - In this context, the role of the Reserve Bank of India is important but constrained.
  - Since the adoption of a market-determined exchange rate regime in 1993, the RBI has intervened in foreign exchange markets primarily to reduce volatility rather than to fix the rupee's value.
  - Although volatility has never been formally defined, RBI actions indicate that it includes moderating sharp and disruptive depreciations.
  - Such intervention seeks to minimise the costs of sudden exchange rate shocks while allowing the currency to adjust gradually.

Why Rupee Depreciation Is Not a Solution

- The argument that rupee depreciation could stimulate exports is weak under present conditions.

- India’s exports increasingly depend on imported inputs, reducing the **competitive advantage** gained from a weaker currency.
- Moreover, high tariffs in the U.S. market significantly limit export growth. On the import side, India relies heavily on essential commodities, particularly crude oil, which accounts for a large share of total imports.
- A **weaker rupee would raise import costs** and risk fuelling inflation, undermining price stability.

Conclusion

- The recent decline in the value of the rupee is primarily the **result of capital outflows** driven by geopolitical tensions rather than weak economic fundamentals.
- As long as uncertainty over trade relations with the United States persists, downward pressure on the rupee is likely to continue, with **potential spillover** effects on financial markets.
- While the Reserve Bank of India can smoothen volatility, a lasting solution lies in diplomatic engagement.
- An **early and credible understanding between India and the United States** is essential to restore investor confidence, stabilise capital flows, and ensure long-term currency stability.

The Solution to the Falling Rupee Lies in Diplomacy FAQs

Q1. Why is the recent fall in the rupee considered unusual?
Ans. The recent fall in the rupee is unusual because it has occurred despite strong economic growth, low inflation, and a modest current account deficit.

Q2. What is the main factor behind the rupee’s depreciation?
Ans. The main factor behind the rupee’s depreciation is capital outflows driven by geopolitical tensions rather than economic fundamentals.

Q3. How have U.S. trade policies affected the rupee?
Ans. U.S. trade policies have increased investor uncertainty through high tariffs on Indian exports, leading to capital outflows and pressure on the rupee.

Q4. What role does the Reserve Bank of India play in this situation?
Ans. The Reserve Bank of India intervenes in the foreign exchange market to reduce volatility and smoothen sharp movements in the rupee.

Q5. Why is currency devaluation not a suitable solution for India?
Ans. Currency devaluation is not suitable for India because it would raise import costs, fuel inflation, and offer limited export benefits under current trade conditions.

Source: **The Hindu**

A Spark to Drive India’s e-LCV Transition

Context

- **India’s** logistics ecosystem has been transformed by the rapid expansion of **Light Commercial Vehicles**, which underpin last-mile delivery in the **e-commerce**
- These vehicles operate intensively and travel long daily distances, yet for years they existed in a **regulatory blind spot**.
- While passenger cars were brought under fuel economy rules, LCVs remained outside mandatory limits.
- This changed in July 2025, when the **Bureau** of **Energy Efficiency** proposed **fuel efficiency** standards for LCVs for the 2027–2032 period, marking a decisive shift in clean transport policy.

The significance of LCVs in India’s emissions landscape

- LCVs accounted for 48% of India’s commercial goods vehicle fleet in 2024, making them central to freight movement and urban air quality.
- Despite this dominance, **electrification** remains minimal at just 2%.
- The climate implications are substantial: average LCV fleet **emissions** stood at 147.5 g **CO2**/km in 2024, and without even this small electric share, emissions would rise to 150 g CO_2/km.
- This demonstrates that limited electrification can still produce measurable gains, reinforcing the importance of regulating this segment within India’s broader decarbonisation strategy.

Industry resistance and government resolve

- Automakers initially lobbied for exemptions, arguing that the LCV market is highly price-sensitive and that compliance would require costly upgrades.
- These concerns mirror earlier industry resistance in the passenger car segment.
- However, the government’s refusal to dilute the proposal signals a clear policy commitment to **decarbonisation**.
- The experience with passenger vehicles, where electric adoption remains around 3% after years of regulation, illustrates that exemptions and weak targets can significantly blunt the impact of otherwise well-intentioned rules.

Fuel efficiency standards and the economics of electrification

- The effectiveness of fuel economy regulation depends largely on its stringency.
- Weak **standards** encourage incremental improvements to **ICE** vehicles rather than a shift to electric powertrains.
- Research shows that at 116.5 g CO_2/km, further reductions become cheaper through electric vehicles than through ICE optimisation.
- The proposed target of 115 g CO_2/km marginally crosses this threshold, making electric LCVs technically viable but not compelling enough to trigger large-scale transition.
- Market dynamics further complicate adoption. Conventional LCVs typically cost under ₹1 million, while electric equivalents remain more expensive.
- Although battery-powered vehicles offer lower lifetime operating costs, inconsistent policy support undermines demand.

- National schemes exclude LCVs, leaving adoption dependent on uneven state-level **incentives**, which weakens investor confidence and slows scale-up.

Super credits, hybrids, and the risk of regulatory dilution

- To address early barriers, the proposal introduces **super credits** for electric LCVs and assigns them a zero CO_2 value for compliance, making them attractive for **manufacturers** seeking cost-effective compliance.
- This approach aligns with international practices and can accelerate early market entry. However, the policy also extends similar benefits to **hybrids** and offers offset factors for select ICE technologies.
- While intended as transitional measures, these provisions risk delaying full electrification.
- If manufacturers can comply through partial solutions rather than committing to **BEVs**, investment in dedicated electric platforms may be postponed.
- The plan to phase out super credits for electric LCVs while retaining support for hybrids and ICE technologies could entrench conventional powertrains rather than displace them.

Conclusion

- India has taken a necessary step by bringing LCVs under fuel efficiency regulation, recognising their scale and environmental impact.
- Yet regulation alone is insufficient without careful design. Strong targets that make electrification economically attractive, combined with time-bound incentives that clearly prioritise BEVs, are essential for meaningful transformation.
- Without this alignment, India **risks repeating the passenger car experience**, where cautious standards have slowed the transition to clean mobility rather than accelerating it.

A Spark to Drive India’s e-LCV Transition FAQs

Q1. Why are light commercial vehicles important for India’s transport emissions?
Ans. Light commercial vehicles form nearly half of commercial goods vehicles and are heavily used, making them a major source of transport emissions.

Q2. What policy change addresses the regulatory gap for LCVs?
Ans. The Bureau of Energy Efficiency has proposed fuel efficiency standards for LCVs for the 2027–2032 period.

Q3. Why is electrification of LCVs still limited in India?
Ans. Electrification remains low due to high upfront costs, limited models, and inconsistent incentive policies.

Q4. How do super credits influence manufacturer compliance?
Ans. Super credits make electric LCVs more attractive by allowing manufacturers to meet emission targets more easily.

Q5. What risk arises from supporting hybrids and ICE technologies?
Ans. Supporting hybrids and ICE technologies can delay full electrification by reducing incentives to invest in battery electric vehicles.

Source: **The Hindu**