

# Understanding the Structural Reasons Behind the Rupee's Fall

The Indian rupee has depreciated significantly against the US dollar, reaching an all-time low. This trend is intertwined with the global economic landscape and domestic factors. Let's delve deeper into the structural reasons behind this depreciation.

 by OJAANK IAS



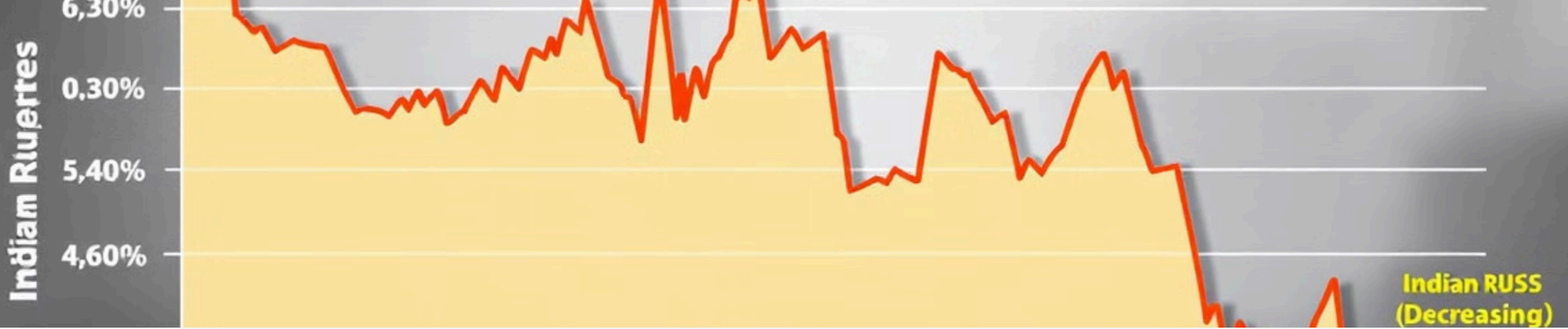
# Currency Inflexibility and the Mercantilist Approach

## RBI's Interventionist Policy

The Reserve Bank of India (RBI) has been intervening to suppress the rupee's depreciation, but this has created an artificial inflexibility.

## Mercantilist Approach

The RBI's interventionist policy has been likened to a mercantilist approach, which aims to manage the currency's value for economic benefits.



# The US Dollar's Strength

1

## US Economic Strength

The US economy is performing stronger than expected, leading to the US Federal Reserve (Fed) to maintain a hawkish stance.

2

## Widening Growth Divergences

The US economy's strength is further accentuated by widening growth divergences with the Eurozone.

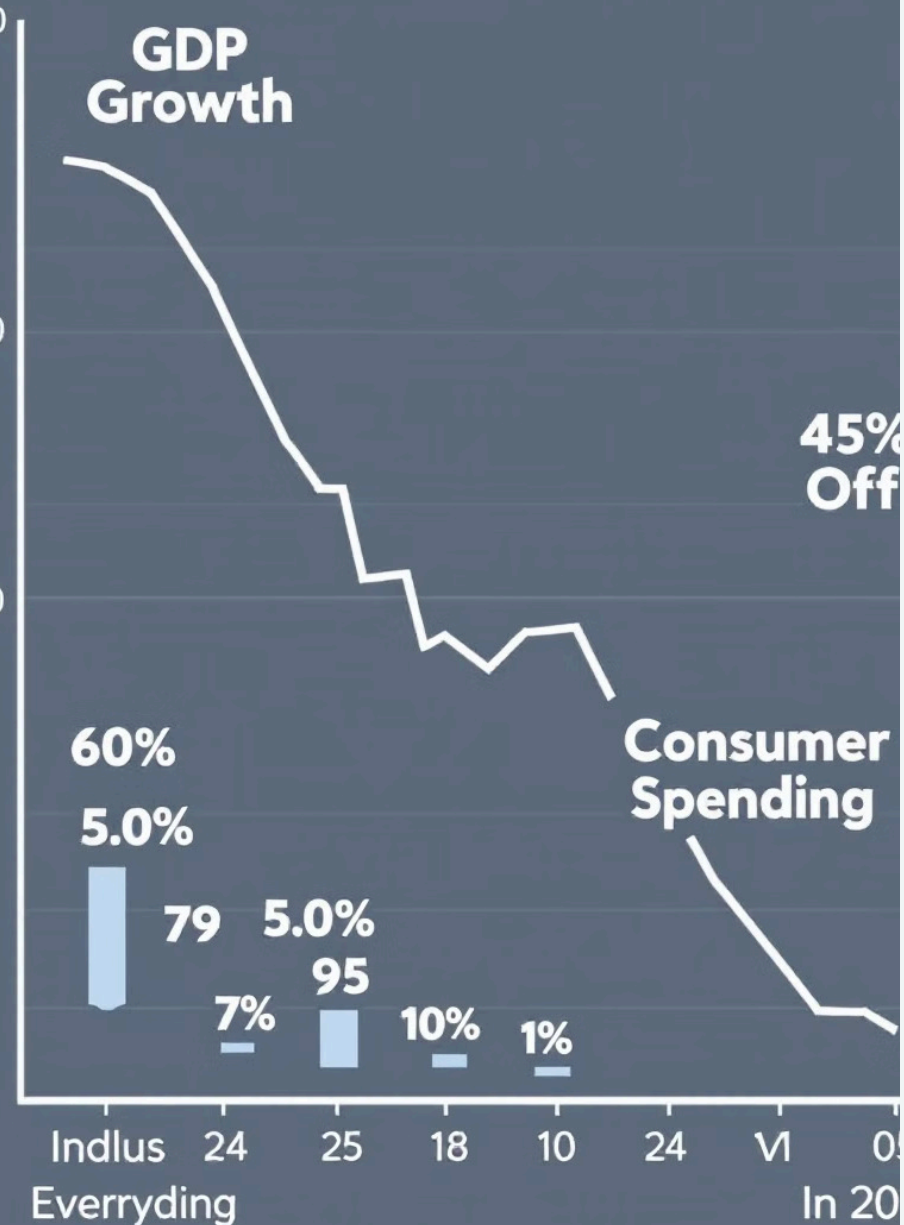
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## China's Currency Flexibility

China is counteracting its economic slowdown by adopting greater currency flexibility, putting pressure on the dollar emerging markets (EM) index.

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## Domestic Factors: Growth Concerns and Demand Slackness

### Growth Projections Downscaling

The RBI and Central Statistical Office have downscaled India's GDP growth projections, reflecting concerns about actual growth.

### Rural Demand Weakness

Prolonged weakness in rural demand has been a major factor, alongside a truncated urban demand rebound and household fragility.

### Receding Productivity

Rising ruralisation, contracting real income per worker, and eroding household savings are indicators of declining productivity.

# Capital Flows Volatility and Investment Implications



## Capital Flows Volatility

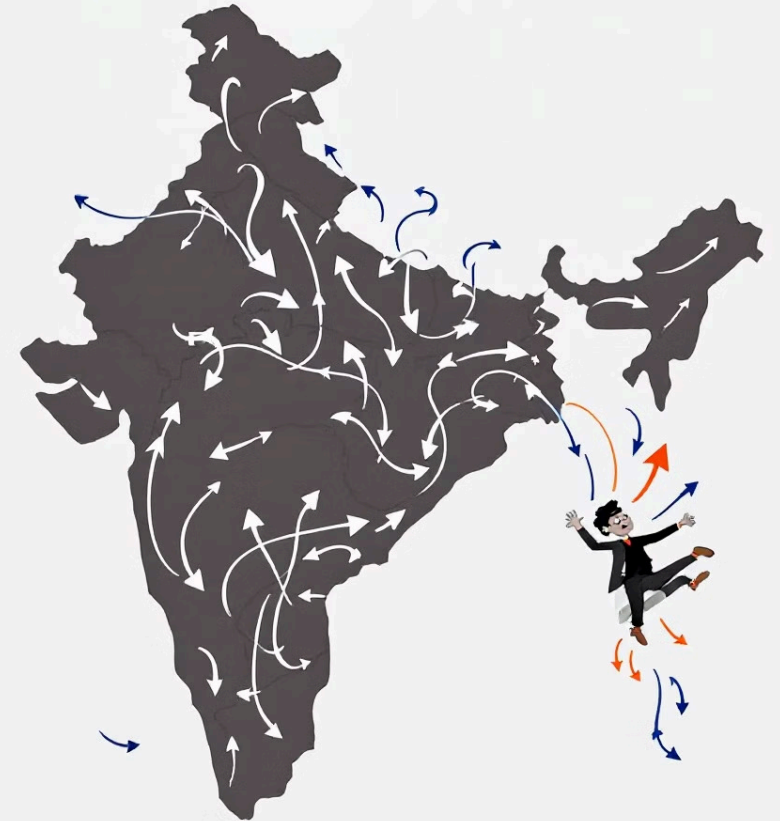
Capital flows into India are becoming increasingly volatile, affecting portfolio flows, FDI, and external commercial borrowings.



## Underperformance of Indian Equities

Indian equity indices are showing modest returns compared to the US S&P 500, further impacting foreign institutional investor flows.

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# Policy Options and Constraints

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## Limited Policy Options

The RBI and government face multiple constraints in managing the rupee's depreciation, including monetary policy and fiscal headroom.

2

## Monetary Easing

The RBI's window for easing policy rates is narrow due to the negative real policy rate differential with the US Fed.

3

## NRI Deposit Scheme

The RBI could resort to an NRI deposit scheme to mitigate the impact of depreciation, as seen during the 2013 Taper Tantrum.



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# The Need for Currency Flexibility



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## Currency Inflexibility and Growth

The RBI's currency inflexibility has hampered economic growth and placed pressure on the economy.

2

## Easing Liquidity Tightness

Allowing greater depreciation can ease liquidity tightness and help address concerns about excessive retail lending.



# Global Trends and Their Impact on the Rupee



# Understanding the Dynamics of the Indian Economy

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## Rural Demand Weakness

Persistent weakness in rural demand continues to be a challenge for the Indian economy.

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2

## Household Fragility

Household fragility persists, reflecting the impact of the pandemic and economic slowdowns.

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3

## Declining Productivity

Declining productivity, including in the unorganized sector, is a significant concern.

# India's Growth Outlook and the Rupee's Trajectory

## 1

### Growth Concerns

The downscaling of India's GDP growth projections reflects concerns about the economy's underlying health.

## 2

### Dollar's Strength

The US dollar's strength is expected to persist in the near term, putting pressure on the rupee.

## 3

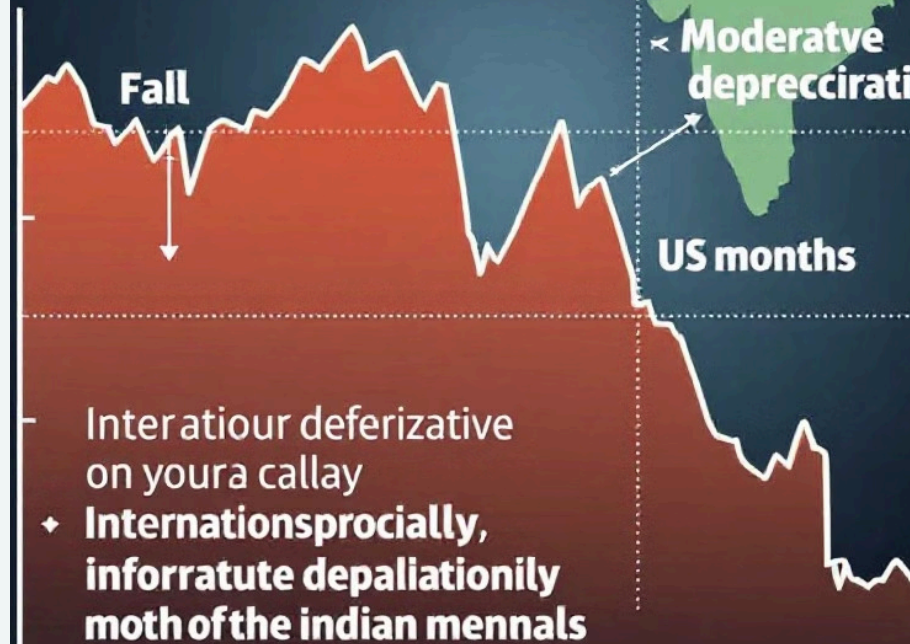
### Capital Flows Volatility

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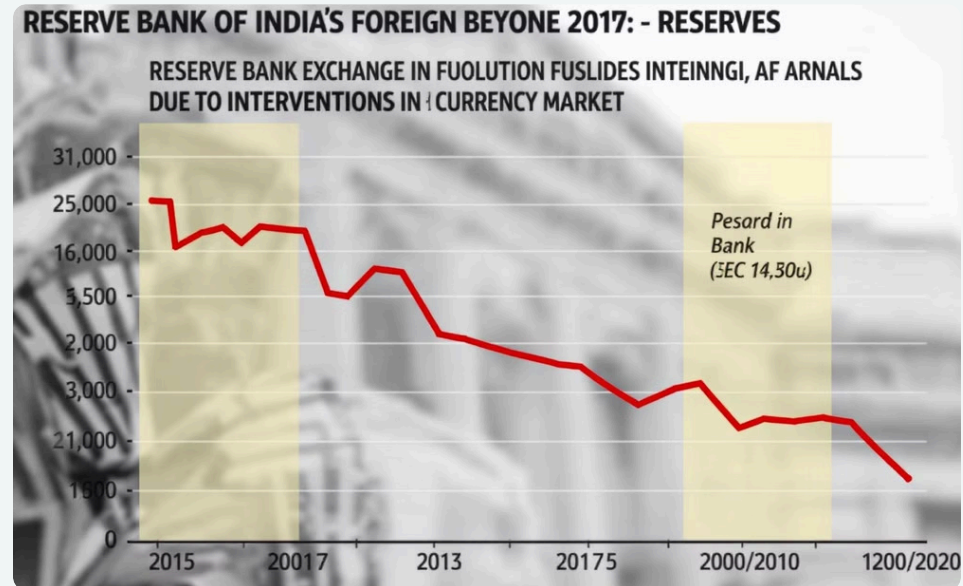
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# The RBI's Role in Managing Currency Volatility



## Managing Currency Volatility

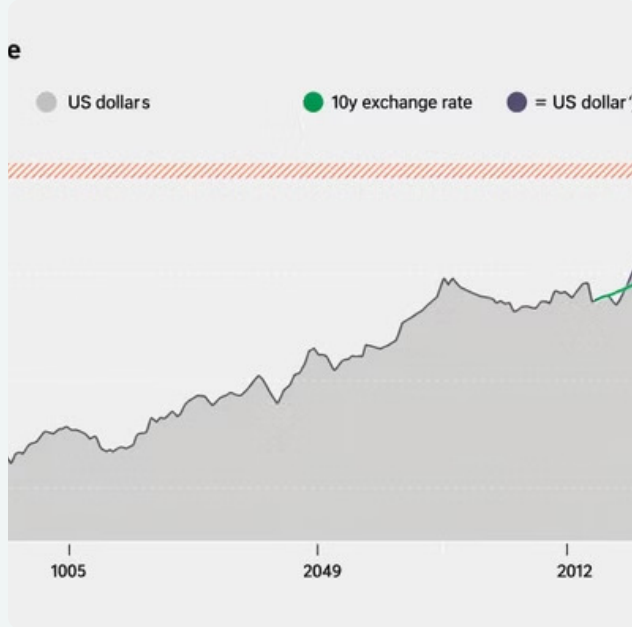
The RBI's ability to manage currency volatility will be tested as the US dollar strengthens and global uncertainty persists.



## Foreign Exchange Reserves

The RBI's foreign exchange reserves could be depleted as it continues to intervene in the currency market.

# Navigating Economic Challenges and the Rupee's Future





## **Key Takeaways and Looking Ahead**

**The rupee's depreciation is driven by a complex interplay of global and domestic factors. While the RBI faces constraints in managing currency volatility, addressing domestic challenges and adopting a more flexible currency policy will be crucial for fostering economic growth and stability.**

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