

# Rupee and Dollar

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## Rupee and Dollar: The Changing Landscape

**Context:** The Indian rupee has weakened against the US dollar, crossing the 85 mark. In April, the exchange rate was around 83, and a decade ago, it stood at approximately 61. This steady decline in the rupee's value relative to the dollar highlights persistent economic challenges and shifts in global financial dynamics.

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## Understanding Exchange Rates

### 1. What Are Exchange Rates?

- The exchange rate determines how many rupees are needed to buy one unit of a foreign currency.
- For international transactions—such as purchasing an American car or booking a Swiss vacation—Indian rupees must be exchanged for foreign currencies like the US dollar or euro.

### 2. How Are Exchange Rates Determined?

- Exchange rates are influenced by the demand and supply of currencies in global markets.
  - When demand for the US dollar exceeds demand for the Indian rupee, the dollar strengthens, making it costlier.
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## Factors Influencing Exchange Rates

### 1. Trade in Goods

- Higher imports from the US than exports to the US create greater demand for dollars, leading to the rupee's weakening.

### 2. Trade in Services

- Increased purchases of US services (e.g., tourism) by Indians also drive up dollar demand, contributing to rupee depreciation.

### 3. Investments

- **If Americans invest more in India than Indians invest in the US**, the rupee strengthens due to higher demand.
  - Conversely, reduced foreign investments in India weaken the rupee.
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### **Key Factors Impacting the Rupee's Demand**

- **Trade Restrictions:** Tariffs or bans on Indian goods reduce the demand for rupees, weakening its value.
  - **Inflation Differences:** High inflation in India compared to the US erodes the rupee's purchasing power and deters investors.
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### **Current Developments: The Falling Rupee**

- **Recent Decline:** The rupee has slid to **85.11** against the US dollar, driven more by a strengthening dollar than by a weakening rupee.
- **Mixed Performance:** While the rupee has depreciated against the dollar, it has appreciated against other major currencies like the **euro, pound, and yen**.

### **Global Factors Driving Dollar Strength**

- **US policies** such as potential **import tariffs, deportations, and tax cuts** have boosted inflation expectations.
  - The **US Federal Reserve's tight monetary policies** have resulted in **higher bond yields**, further strengthening the dollar.
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### **Impact of the Falling Rupee**

#### **Negative Effects**

#### **1. Rising Inflation**

- **India imports nearly 80%** of its **crude oil** needs, and a weaker rupee makes imports costlier.
- These higher costs cascade through the **value chain**, increasing input costs across industries.

#### **2. Widening Current Account Deficit (CAD)**

- Costlier imports exacerbate the **trade deficit**, putting additional pressure on the exchange rate.

#### **Positive Effects**

#### **1. Boost to Remittances**

- A weaker rupee makes **remittances** from overseas more attractive for recipients in India.

## 2. Export Competitiveness

- **Indian exporters** benefit from a weaker rupee, as their goods become cheaper internationally, provided they do not heavily rely on imported raw materials.

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## Policy Recommendations for India

1. Focus on the rupee's **effective exchange rate** against a basket of currencies, rather than solely against the **US dollar**.
2. **Avoid defending the rupee through interest rate adjustments**; instead, base rate decisions on domestic inflation trends.
3. Address **fiscal** and **current account deficits**, adhere to **inflation targets**, and reinforce confidence in India's **growth potential** to ensure macroeconomic stability.

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## Conclusion

The rupee's depreciation against the dollar is a multifaceted challenge influenced by global and domestic factors. **While it brings certain advantages like increased remittances and export competitiveness**, the negative impacts on **inflation** and **trade deficits** cannot be ignored. By focusing on sound macroeconomic policies and strengthening structural fundamentals, India can mitigate the adverse effects and build a more resilient economy.

