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EDITORIAL ANALYSIS

Where Will the Rupee Go From Here? — Currency Outlook Amid West Asia Tensions

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INTERVIEW ANGLE

"With the rupee depreciating on West Asia oil shock and capital outflows, what tools does RBI have — and what are the limits of intervention when the shock is external? Is a managed float the right framework?"

THE CORE ARGUMENT

The Indian rupee has depreciated approximately **4-5% against the U.S. dollar** in the April-May 2025 period following the West Asia conflict escalation — driven by a deteriorating current account (oil import bill spike), foreign portfolio investor (FPI) outflows from emerging markets, and dollar strengthening as a safe-haven asset. The editorial examines the RBI's options under its **"managed float"** exchange rate regime, the structural factors determining long-term rupee direction, and warns against excessive RBI intervention that depletes foreign exchange reserves without addressing the underlying current account deficit.

RUPEE MOVEMENT — RECENT HISTORY

PERIOD	INR/USD	DRIVER
FY2022-23	81-83	Post-Ukraine commodity shock
FY2023-24	82-84	Stable; FPI inflows, services exports
FY2024-25	83-86	Fed rate hold, FPI outflows
April-May 2025	86-89	West Asia oil shock, FPI exit
April 2026	85-87 (recovering)	Partial ceasefire; FPI returning

Context: The rupee's long-term depreciation trend reflects India's **chronic current account deficit (CAD)** — India is structurally an import-heavy economy that runs CAD in most years.

WHAT DRIVES THE RUPEE?

Current Account (Trade in Goods and Services)

COMPONENT	FY2025-26 (ESTIMATED)
Merchandise exports	~$420 billion
Merchandise imports	~$680 billion
Trade deficit	~$260 billion
Services exports (IT, travel, finance)	~$380 billion
Services imports	~$190 billion
Services surplus	~$190 billion
Current Account Balance	**~-$70 billion (CAD ~2% of GDP)**

Oil is the dominant driver of CAD: India's oil import bill constitutes ~35-40% of total merchandise imports. A $10/barrel rise in oil prices adds ~$10-15 billion to the annual import bill.

Capital Account (Investment Flows)

COMPONENT	TYPICAL ANNUAL FLOW
FDI inflows	$50-70 billion
FPI equity inflows/outflows	Volatile; ±$20-30 billion
FPI debt	More stable; ±$5-10 billion
NRI remittances	~$120+ billion (world's largest)
External Commercial Borrowings (ECB)	~$20-30 billion

NRI remittances — India is the world's largest recipient — are a crucial dollar earner that cushions CAD. In crisis years (West Asia conflict), remittances from Gulf actually spike as NRIs send more home.

Dollar Strength / Federal Reserve Policy

The rupee is also moved by **global dollar index (DXY):**

- When Fed raises rates → dollar strengthens globally → all emerging market currencies (including rupee) weaken
- **April 2025 trigger:** Fed held rates; but risk-off sentiment from West Asia caused FPI exit from EM
- **April 2026:** Fed started cutting (25 bps in March 2026); dollar weakened → rupee partially recovered

RBI'S TOOLS AND THEIR LIMITS

India's Foreign Exchange Reserves

INDICATOR	FIGURE (APRIL 2026)
Total forex reserves	~$670-690 billion
Gold reserves	~$65 billion
SDR (IMF)	~$18 billion
IMF reserve tranche	~$5 billion
Import cover	~11-12 months

India's forex reserves are the **4th largest globally** (after China, Japan, Switzerland).

RBI Intervention Mechanisms

TOOL	MECHANISM	LIMIT
Dollar selling (spot)	RBI sells USD from reserves to increase dollar supply	Depletes reserves
Forward market operations	RBI buys USD forward to manage future rate expectations	Creates future obligations
MSS (Market Stabilisation Scheme)	Sterilise excess liquidity from dollar operations	Budget capped
Repo rate	Higher rates → attract capital inflows	Inflation constraint
Capital flow management	FPI investment norms, ECB guidelines	Limits market efficiency

The Managed Float — India's Official Regime

India officially operates a **managed float** (also called "dirty float"):

- Exchange rate is market-determined
- RBI intervenes to **reduce volatility** — not to target a specific rate
- RBI does NOT announce an exchange rate target or band

Criticism: During the 2025 rupee slide, RBI's dollar selling stabilised the rate at 87-88, but critics argued this depleted reserves to defend an overvalued rupee — better to let it depreciate and adjust.

Structural Policy Recommendation

The editorial argues:

1. **Don't deplete reserves** defending an artificial rate — let market determine fair value
2. **Address the CAD structurally:** Diversify export basket beyond IT services; reduce oil import dependency through EVs + renewables
3. **Rupee internationalisation:** Expand rupee-denominated trade settlement to reduce dollar dependency (already piloted)
4. **NRI deposit schemes:** Attract NRI capital during crisis (as in 1991, 2013, 2022)

RUPEE INTERNATIONALISATION — RBI'S ONGOING INITIATIVE

INITIATIVE	STATUS
Rupee trade settlement framework (2022)	18 countries opened rupee accounts with Indian banks
Bilateral currency swap	India-UAE (dirham-rupee), India-Japan (yen-rupee), others
Rupee-denominated bonds (Masala Bonds)	Listed on London Stock Exchange; limited traction
GIFT City offshore rupee market	Developing; financial centre for offshore INR products

Rupee internationalisation reduces dollar demand for India's trade — but requires **capital account convertibility** progress, which India has pursued cautiously.

HISTORICAL PARALLEL — 1991 AND 2013 CRISES

CRISIS	TRIGGER	RBI RESPONSE	OUTCOME
1991	BoP crisis; reserves down to 2 weeks import	Gold pledged; IMF loan; devaluation	Reform trigger; structural adjustment
2013	Taper Tantrum; ₹ hit 68/USD	FCNR(B) scheme attracted $26B NRI deposits	Rate stabilised; reserves rebuilt
2022	Ukraine shock; ₹ hit 83/USD	Gradual depreciation allowed; forex intervention	Managed decline
2025-26	West Asia shock; ₹ hit 88/USD	Reserve buffer used; partial rate cuts	Partial recovery

India's external vulnerability is significantly lower than in 1991 — reserves cover 11 months of imports — but structural CAD remains the long-term pressure.

UPSC ANGLE

PAPER	ANGLE
GS3 — Economy	Exchange rate regimes, current account deficit, forex reserves, NRI remittances
GS3 — Economy	RBI tools, managed float, capital account, rupee internationalisation
GS2 — IR	India-West Asia economic links, energy price transmission

Mains Keywords: Managed float, current account deficit, RBI intervention, forex reserves, FPI, NRI remittances, rupee internationalisation, FCNR deposits, Masala Bonds, GIFT City, taper tantrum, capital account convertibility

Probable Question: "India's managed float exchange rate regime faces limits when external shocks are structural rather than transient. Analyse." (GS3 Mains)

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