

Boon or bane? What a falling rupee means for Indian exports.



BY

Nilanjan Banik

6 MINS READ

Jan 09, 2025, 05:55:00 AM IST

Gift This Story **i**



FONT SIZE



SAVE



PRINT



COMMENT

Boon or bane? What a falling rupee means for Indian exports.

Between 2000 and 2014, as the Indian currency depreciated, trade balance also improved. However, this relationship is becoming increasingly irrelevant now due to the shift in Indian exports from price-sensitive to income-sensitive items.

By Nilanjan Banik

All's well that ends well.

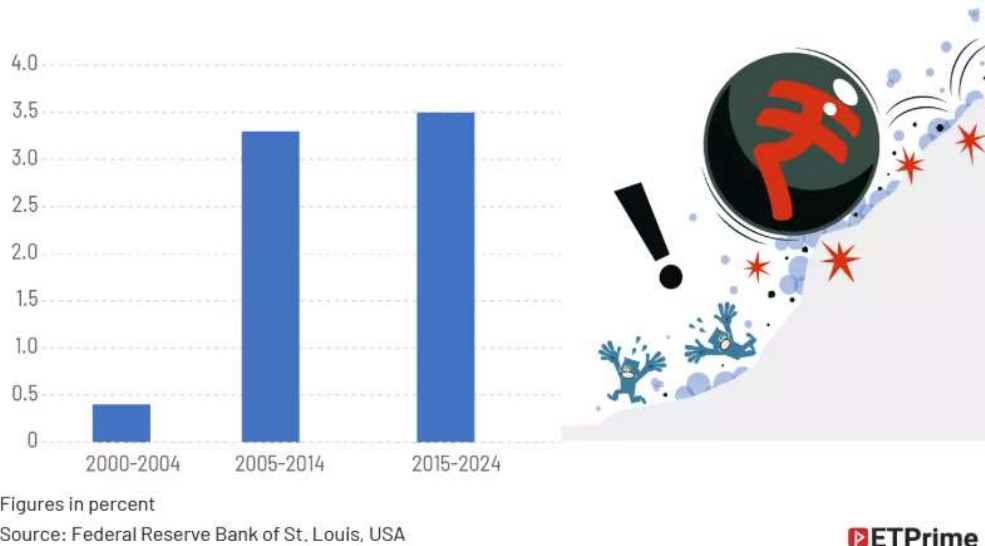
For rupee, that's not quite what's happening. The year 2024 didn't end well for the Indian currency. It [hit an all-time](#) low on December 27, 2024, breaching the 85.65 mark against the US dollar. Numerous commentaries in popular media are expressing concern that a weakened rupee could spell tough times for the Indian economy.

So, what exactly a depreciating rupee means for the Indian economy and its trade balance? Does it help exports?

To be sure, a weaker rupee implies higher import costs, which could lead to a widening current account deficit (CAD). India's overall trade deficit increased to [3.4% of the GDP in Q2 FY25](#), up from 2.9% in the same period last year. The merchandise trade deficit rose to 8.2% of the GDP from 7.5%. Basic macroeconomic theory suggests that a widening CAD [will fuel domestic inflation](#) by raising the price of imported crude oil. This could have secondary effects, including a decline in foreign exchange (forex) reserves and foreign institutional investors (FIIs) pulling out of the Indian stock market.

Interestingly, the depreciation of the rupee against the dollar is not a recent phenomenon. Between 2005 and 2024, the rupee had, on average, depreciated by around 3.5% annually.

Average depreciation of the rupee against the dollar over the specified period

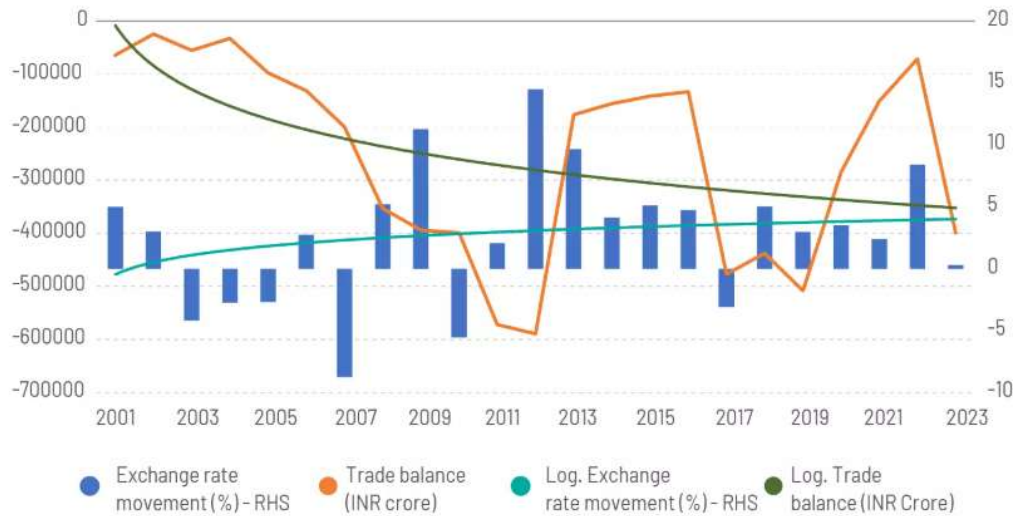


Boon or bane for exports?

Contrary to popular belief, a weaker rupee may not necessarily boost India's exports. A look at our major export items suggests these are income elastic, that is, they tend to perform well when there is an upsurge in foreign income. In case of India, there is a change in the composition of exports from price-sensitive items such as leather footwear, dairy products, beverages, textiles and apparel products to more [income-sensitive items](#) such as refined petroleum products, iron and steel, chemicals, machinery and transport equipment (engineering goods), and pearls and precious stones such as diamonds.

For example, the share of refined petroleum products (high-speed diesel, motor spirit, aviation turbine fuel, naphtha, etc.) in India's export basket increased dramatically from around [2% in 1993 to around 21% in 2023](#). In fact, India is now the second-largest exporter of refined petroleum, with exports valued at USD85 billion and a global market share of 12.6%. Other major exports from India include insecticides and fungicides (10.5%), steel (12.7%), beet sugar (12.21%), rubber tyres (3.31%), and gemstones (36%), with the global market share figures indicated in parentheses.

Trade balance and exchange rate movement



Source: Federal Reserve Bank of St. Louis, USA

ETPrime

As illustrated above, a weakening rupee initially helped improve the trade balance between 2000 and 2014 – as the Indian currency depreciated, trade balance also improved. However, this relationship is becoming increasingly irrelevant due to the shift in Indian exports from price-sensitive to income-sensitive items. A prolonged Russia-Ukraine war and the onset of weak global economic growth, especially in the Euro zone, led to lower demand for income-elastic items, which make up for a significant portion of India's export basket. In China, India's another major trading partner, GDP growth rate is likely to slow down from 8.1% in 2021 [to below 5%](#) in 2025. The US is also experiencing a surge in inflation, around the 3% mark, which is still higher than the long-term average of 2%. Additionally, Trump's tariffs could pose a challenge for India's exports.

Why the rupee fall may continue

There are two ways to determine the value of the exchange rate. First is the goods market approach, which seeks to determine the value of the exchange rate based on the 'law of one price' (LOOP), using the concept of purchasing power parity (PPP). LOOP states that in the absence of transport and other costs such as tariffs, identical (similar) goods will sell for the same price. If LOOP holds true, then the real exchange rate is one. Therefore, if domestic inflation is higher than the US inflation, the rupee is

expected to depreciate against the dollar. Second is the asset-market approach, where the value of exchange rate is conditional upon the inflow and outflow of capital into and from the domestic economy.

Historically, the US has a lower inflation rate than India. Much of the differential in inflation rates between the US and India can be explained by labour productivity alone, with more productive labour generating more 'real' goods and services, thereby leading to lower inflation. According to [ILO estimates](#) for 2025, India is producing an output of USD25,431 per worker, significantly below America's average of USD153,446 per worker.

Additionally, with Trump's promise of making the US economy great again, fund managers are pulling out of the Indian market, hoping that American assets and the dollar will strengthen and yield greater returns. Foreign fund managers sold equities worth [INR113,858 crore](#) through exchanges in October, with an additional INR41,872 crore of equities sold through exchanges in November 2024. Therefore, the depreciation of the rupee is likely to continue, and one should not be overly concerned unless the annual rate of depreciation exceeds 4%.

The government on its part has undertaken a series of interventions to make Indian industry and products competitive. Some of the key initiatives include establishment of the National Manufacturing Competitiveness Council (NMCC) in 2004, launch of the National Manufacturing Policy in 2011, introduction of the Make-in-India scheme in 2014 and Atmanirbhar Bharat Abhiyan in 2020. However, the impact of these initiatives in making our exports competitive is yet to bear fruit. On the contrary, India's CAD is likely to increase further as crude oil, precious metals, and coal still contribute to bulk of our imports, and are necessary items for a growing economy like India.

Some good news

Despite the concerning outcomes associated with a falling rupee, there is also some good news. A weaker rupee makes India an attractive destination for setting up businesses, as cost of labour, land, and capital become relatively cheaper in India. The rapid growth of global capability centres (GCCs) in India is a testament to this, with around [1,700 GCCs](#) now operating in the country.

The GCC market in the country is projected to grow to USD100 billion in 2030, with the number of GCCs reaching to around 2,200 and employing between 2.5 and 2.8 million Indians. Another significant beneficiary of a falling rupee is the remittances from Indians working and settled abroad. India received over [USD111 billion](#) in remittances in 2022, becoming the first country to ever reach that milestone. This figure is nearly 2.2 times higher than the USD49 billion in FDI inflows India received in 2022.

Finally, India's software exports are likely to get benefitted from a weakening Rupee. In fact, while examining the largest component of India's imports — mineral fuels, oils, and bituminous substances (HS Code 27) — the deficit in this category [is offset by the proceeds](#) from total services exports. That's what makes India distinct from its South Asian peers, where their declining currencies are posing significant challenges to their long-term growth prospects.

(For a more comprehensive and theoretical exploration of this topic, please refer to [The 'What,' 'Why,' and 'How' of a Widening Current Account Deficit](#)).

(The author is professor, Mahindra University. Views expressed are personal.)

(Graphics by Sadhana Saxena)