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The Rupee Dilemma

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The exchange rate and its impact on trade are consequential policy considerations. One of the foundational relationships introduced in economics is that depreciation of currency makes exports cheaper, leading to increased export competitiveness. In contrast, an appreciation of the currency makes exports expensive, hence a fall in export competitiveness.

However, on the flip side, a depreciating currency can also fuel inflationary pressures, as the cost of imported goods rises. To substantiate this, one of the extreme examples of complete decimation of the exchange rate is Argentina's 2018–2020 crisis, where a collapsing peso sharply increased import prices, pushing inflation above 50% despite weak domestic demand.

Another fundamental concept covered in introductory economics is the J-curve effect. According to it, a depreciation in the exchange rate leads to a short-term deterioration of the current account balance (due to a relatively inelastic demand). However, in the long run, the current account improves (since demand becomes more price elastic).

Recent developments in China have reignited global discussions about the role of exchange rates in shaping export competitiveness. Despite widespread belief that Beijing has been supporting its currency, new evidence suggests that China may have been resisting appreciation of the yuan against the U.S. dollar. Through its state-owned banks, China has been accumulating large foreign assets, nearly \$70 billion in the second quarter of 2025 alone to keep the yuan from strengthening¹. At the same time, its real effective exchange rate has declined by nearly 10–12 percent over the past three years making Chinese exports significantly cheaper in global markets. This has boosted China's trade surplus and given its exporters a competitive edge at a time when global demand is weakening.

A weaker yuan effectively makes Chinese goods more price-competitive in global markets, reviving debates over the role of exchange rates in shaping export performance. This

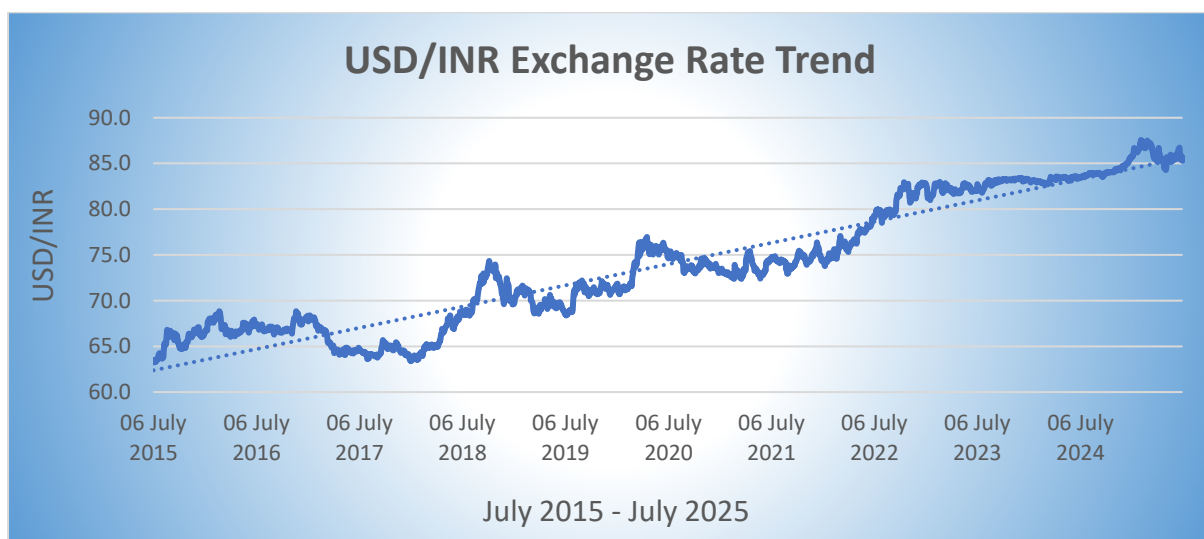
¹ **Setser, Brad W. (2025, October).** *Follow the Money: China's Currency Management and the Shifting Direction of Pressure on the Yuan.* Council on Foreign Relations. Retrieved from <https://www.cfr.org/blog>

development raises a broader question- Does a weaker currency still significantly enhance export competitiveness in today's trade environment? For India, which faces similar global pressures and structural shifts in its export composition, it becomes essential to examine whether allowing the rupee to depreciate meaningfully benefits exports or whether the relationship between exchange rate movements and export performance has weakened over time.

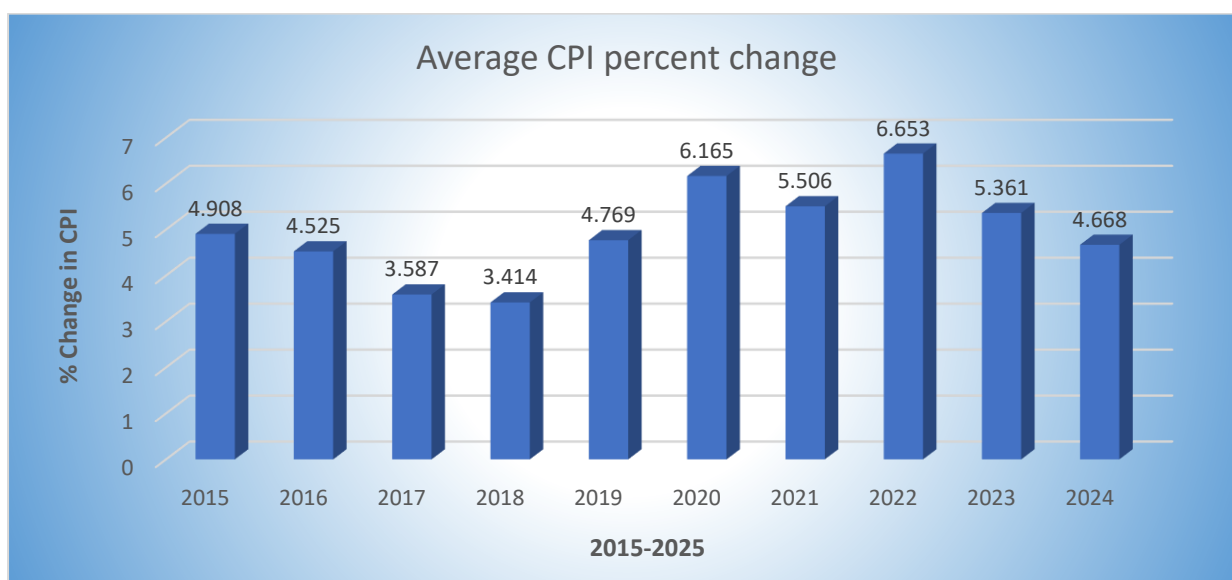
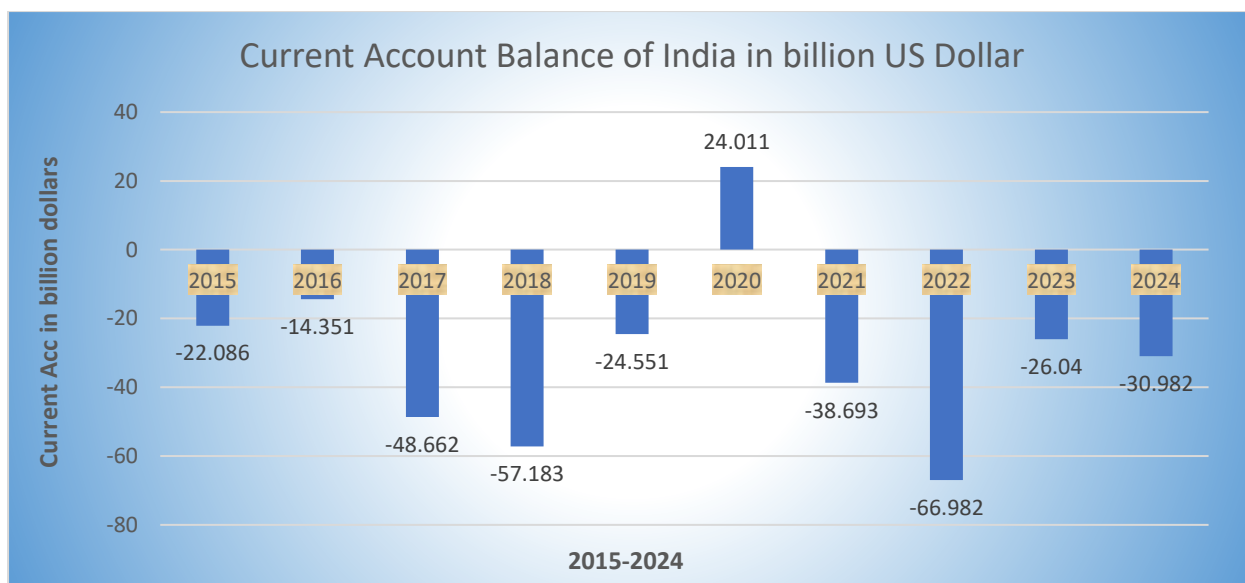
To explore this, we attempt to examine the relationship between the exchange rate and India's trade performance. It revisits key economic ideas such as currency depreciation, the J-curve effect, and price elasticity of exports. Using recent empirical findings, it evaluates whether the Indian rupee's depreciation still meaningfully boosts exports or whether structural changes in India's export basket and rising import dependence have altered the outcome.

This leads to the quintessential debate of whether to let the currency fall in value, to what extent, and whether it significantly impacts export competitiveness – a debate faced by India now more than ever.

To start with, 1 US Dollar = 86.58 Rupees as of June 2025. The 10-year trend of the USD/INR exchange rate shows a perpetual decline. The rupee hit its 10-year low of 87.57 rupees per dollar in February 2025 (due to US tariff policy uncertainty). The trade-weighted real effective exchange rate (REER) was 108 in November 2024, an 8% overvaluation of the Indian rupee reflecting reduced export competitiveness.



The current account deficit of India in 2024 was 30.98 billion dollars, which is 0.78 percent of the GDP, almost half as compared to 2022. The percentage change in the average consumer price index in 2024 was 4.66 percent.



Looking at the trend of USD/INR exchange rate from late 2021, we arrive at some interesting interlinkages mentioned previously as essential and elementary concepts of economics. As the depreciation of the rupee increases from about 73 rupees per dollar in late 2021 to 82.5 rupees per dollar by 2022 end, we note the inflation rising in tandem with it by jumping from 5.5% in 2021 to 6.6% in 2022. We also see a J-curve-like phenomenon manifesting in the current account balance. We observe the current account deficit worsen in the short run to a negative 66 billion dollars in 2022, but then gradually improve for the following two consecutive years.

Building upon these concepts, we now aim to assess the magnitude of the impact of rupee depreciation on India's exports. Furthermore, we provide a sectoral overview. To estimate the impact, we use the Real Effective Exchange Rate (REER) as a comprehensive measure of exchange rate competitiveness. We have referred to the trade elasticity values to calculate the change in export volume from the "Office of the Chief Economic Adviser, Ministry of Finance,

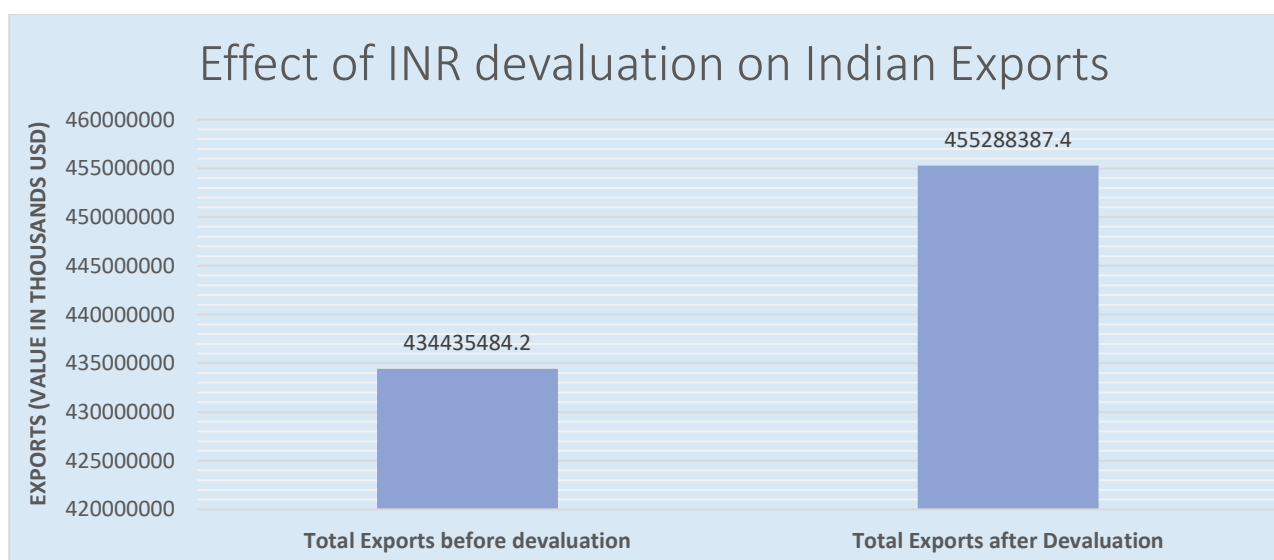
Government of India. (2023, December). *Re-examining narratives: A collection of essays*. Government of India and Chinoy & Jain (2019)". Following is an excerpt from the essay, Chapter 3 –

“The exchange rate acts as a price for the goods exported. The real effective exchange rate (REER) looks at the inflation-adjusted movement of exchange rates between India and its major trading partners. The price elasticity of exports shows a more drastic decline from (-) 2.7 to (-) 0.4 over this time frame. The fall in income elasticity of exports means that India’s exports are becoming less vulnerable to changes in world demand and to changes in relative prices. A decline in elasticities is favourable in the presence of downside risks (such as a decline in global demand and an appreciation of exchange rates).”

Empirical evidence suggests that a 10% currency devaluation, ceteris paribus, should increase export volumes by 4.8% , given the current price elasticity of –0.48. This result is robust across different REER indices, proxies for export performance, and periods. Accordingly, the impact of INR depreciation is estimated using the following relationship:

$$\% \text{ Change in exports} = e_{ex} \times \% \text{ change in REER}$$

Export data at the HS-6-digit level (HS 2022) from the WITS database is used to apply this elasticity and estimate the potential export gain from INR depreciation.



Source: WITS FY2023-24

The results indicate that the devaluation of the Indian Rupee led to a noticeable increase in total exports, rising from 434.44 billion before devaluation to 455.29 billion afterward, reflecting a growth of approximately 4.8%. This suggests that the weaker rupee enhanced the price

competitiveness of Indian goods in international markets resulting in higher foreign demand and boosting export volumes.

TABLE 1: SECTORAL ANALYSIS OF INDIAN EXPORTS (FY2023-2024)

CATEGORY	Exports from India to the world before devaluation (Billion USD)	Exports from India to the world after devaluation (Billion USD)
MINERAL ORES	79.25	83.06
CHEMICALS	62.97	65.99
AGRICULTURE	49.92	52.32
ELECTRICAL MACHINERY & EQUIPMENT	39.36	41.25
TEXTILES	36.14	37.87
GEMS AND JEWELLERY	29.25	30.65
AUTOMOBILES AND AUTOMOBILE PARTS	21.75	22.79
IRON AND STEEL PARTS	20.11	21.08
ALUMINIUM	7.25	7.59

Furthermore, the sectoral analysis in Table 1 shows that exports from India to the world after devaluation are highest for mineral ores, followed by chemicals and agriculture. The change in exports is calculated taking REER elasticity as -0.48.

Taken together, the data suggest that rupee depreciation leads to a measurable increase in India's export volumes. A 10 percent fall in the REER, *ceteris paribus*, corresponds to an estimated 4.8 percent rise in total exports. Sectorally, the largest gains are observed in mineral ores, chemicals, and agricultural products, reflecting their higher price sensitivity. Overall, the results confirm that a weaker rupee does enhance India's export performance by improving price competitiveness in global markets, even though the magnitude of the effect remains moderate.

Why Currency Devaluation Isn't the Best Solution

As we saw in the above section, a weaker rupee can make Indian exports cheaper and more competitive. However, it is not a perfect or sustainable strategy for boosting exports every time. Several factors limit its effectiveness and even create economic risks:

1. **Weaker price elasticity of exports** : Recent literature points out on the fact that impact of exchange rate movements on India's exports has weakened over time. The price elasticity of exports which measures how much exports respond to changes in prices or the exchange rate has fallen sharply from -2.7 before 2008 to just -0.4 in recent years².

² Office of the Chief Economic Adviser, *Re-examining Narratives: A Collection of Essays* (New Delhi: Ministry of Finance, Government of India, December 2023).

This indicates that while a weaker rupee still makes Indian exports more competitive, the effect is now smaller than before.

One major reason for this change is the structural shift in India's export basket. Today India not only deals in traditional, price-sensitive goods like textiles and gems but also in new age sectors such as pharmaceuticals, chemicals, and electronics. These sectors rely more on technology, quality, and global value chain integration than on price advantages. As a result, India's exports have become more stable and less dependent on exchange rate fluctuations. In short, rupee depreciation still helps boost exports, but the overall export performance now depends more on innovation and global linkages than on price changes alone.

2. **Rise in Import Bill** : A weaker rupee makes imports such as crude oil, fertilizers, and industrial components more expensive. Since these items are essential to production and consumption, the overall price level in the economy rises. This can fuel inflation, reduce consumers' purchasing power, and raise the cost of living.
3. **Rising input costs for exporters**: In the Indian context, many export-oriented industries depend heavily on imported raw materials, components, and intermediate goods. Sectors such as petroleum refining, electronics, pharmaceuticals, automobiles, and engineering goods rely on inputs like crude oil, electronic chips, active pharmaceutical ingredients (APIs), and specialized machinery. So, if the rupee depreciates, the cost of these imported inputs increases in INR terms, raising production costs for exporters. For instance, India imports nearly 70 percent of its electronic components and over 60 percent of its pharmaceutical bulk drugs and APIs, mainly from China. A weaker rupee makes these imports costlier, which in turn squeezes the profit margins of exporters in these sectors, even though their goods may appear cheaper in global markets

This phenomenon is also supported in the broader economic literature. Rajan and Subramanian (2011)³ explain that in developing countries, both currency appreciation and depreciation can distort the balance between tradable and non-tradable sectors. They note that if an industry rely too much on imported intermediates, a weaker currency can actually make them less competitive because of higher input costs.

The Reserve Bank of India's *Report on Currency and Finance (2018–19)*⁴ also highlights a similar concern. It observes that the export benefits from rupee depreciation in India are often limited because several major sectors including petroleum products, electronics, and pharmaceuticals have high import intensity. As a result, any gain in

³ Rajan, R., & Subramanian, A. (2011). *Aid, Dutch Disease, and Manufacturing Growth*. *Journal of Development Economics*, 94(1), 106–118.

⁴ Reserve Bank of India (2019). *Report on Currency and Finance 2018–19: Changing Dynamics of India's External Sector*. Mumbai: Reserve Bank of India.

price competitiveness from a weaker rupee is partly offset by higher costs of imported inputs.

Apart from these, a continuously weakening rupee can also hurt the economy in several ways. It often shakes investor confidence, leading to capital outflows and making it costlier for the government and companies to borrow abroad. At the same time, a weaker currency increases the burden of repaying foreign debt and can strain India's external finances if the fall continues for too long. Over time, relying on devaluation to boost exports can do more harm than good. It may discourage firms from improving efficiency or product quality, and for sectors that depend on imported inputs like electronics, petroleum refining, and high-end manufacturing, the higher costs can wipe out any export gains. In short, a cheaper rupee may help in the short term, but lasting competitiveness depends more on innovation and reducing import dependence than on currency depreciation.

To sum it up, currency devaluation results in cheaper exports and expensive imports. Cheaper exports imply an increase in export quantity, which in turn improves the current account balance of the country. Increasing export quantity also leads to a rise in aggregate demand, which causes demand-pull inflation. On the imports side, expensive imports increase the import bill, which also pushes inflation upwards. Other manifestations are reduced real wages and purchasing power. Investor confidence is also very closely correlated to exchange rate movements. Large and rapid currency devaluation may lead to heavy capital outflow, also known as capital flight, due to reduced investor confidence.

Differential Impact of Currency Depreciation on Goods and Services Exports

As highlighted earlier in the context of merchandise exports, currency depreciation generally enhances export competitiveness, though the actual benefit varies with the imported input share across sectors. We also saw that merchandise exports (like petroleum, electronics, machinery, and chemicals) are often import-intensive meaning they rely on imported raw materials, energy, or components. When the rupee weakens, the cost of these imported inputs rises and hence offsetting the price advantage from the weaker currency.

However, if we look at services exports, in contrast, it depend mainly on domestic labor and skills, not on imported physical inputs. So, when the rupee depreciates, costs remain largely domestic while foreign earnings increase in rupee terms, directly improving profitability and competitiveness. This is particularly true for India's IT, business process outsourcing (BPO), consulting, and financial services, where the main cost is salaries paid in rupees, but revenue is earned in dollars.

The Reserve Bank of India (RBI) in its *Report on Currency and Finance 2018–19* and later *Handbook of Statistics on Indian Economy* notes that India's services exports show a stronger positive correlation with rupee depreciation compared to goods exports. For example, in FY 2022–23, when the rupee depreciated by about 8%, India's IT and business services exports grew by nearly 10%, whereas merchandise exports rose only 6%.

This shows that the impact of currency depreciation on India's exports is uneven across sectors. The overall gains are now driven more by the services sector, highlighting how India's export strength increasingly lies in knowledge and skill-based industries rather than price-driven manufacturing.

Going forward, India's trade policy should focus on strengthening domestic supply chains, enhancing technological capability, and improving productivity across sectors. A stable and competitive rupee supported by sound macroeconomic fundamentals and resilient export structures will serve India far better than a deliberate policy of devaluation. In an increasingly interconnected and competitive global economy, long-term export success will depend not on how low the rupee falls, but on how high the value of India's products rises.

About the Authors



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Her work focuses on areas related to Trade in Services, Trade in Goods, and Technical Barriers to Trade (TBT).



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About CRIT

India's Foreign Trade Policy (FTP) Statement 2015-20 suggested a need to create an institution at the global level that can provide a counter-narrative on key trade and investment issues from the perspective of developing countries like India. To fill this vacuum, a new institute, namely the Centre for Research on International Trade (CRIT), was set up in 2016. The vision and the objective of the CRIT were to significantly deepen existing research capabilities and widen them to encompass new and specialised areas amidst the growing complexity of the process of globalization and its spill-over effects in domestic policymaking. Secondly, enhancing the capacity of government officers and other stakeholders in India and other developing countries to deepen their understanding of trade and investment agreements.

About CWS

The Centre for WTO Studies which is a constituent Centre of CRIT, pre-dates the CRIT since it was created in 1999 to be a permanent repository of WTO negotiations-related knowledge and documentation. Over the years, the Centre has conducted a robust research program with a series of papers in all spheres of interest at the WTO. It has been regularly called upon by the Government of India to undertake research and provide independent analytical inputs to help it develop positions in its various trade negotiations, both at the WTO and other forums such as Free and Preferential Trade Agreements and Comprehensive Economic Cooperation Agreements. Additionally, the Centre has been actively interfacing with industry and Government units as well as other stakeholders through its Outreach and capacity-building programs by organizing seminars, workshops, subject-specific meetings, etc. The Centre thus also acts as a platform for consensus-building between stakeholders and policymakers. Furthermore, the inputs of the Centre have been sought after by various international institutions to conduct training and studies.

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