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# Rupee Depreciation and the Narrative of Strong Fundamentals: A Critical Re-examination of India's Macroeconomic Position

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**Abstract**
Despite repeated official assertions that India enjoys strong macroeconomic fundamentals, the Indian rupee has continued its long-term depreciation against the US dollar, crossing the symbolic threshold of 90 INR per USD in late 2025. Sometimes this is referred to as a rupee paradox. This article examines the apparent contradiction between headline economic strength and persistent currency weakness. Using recent data, historical parallels and established theoretical frameworks, it demonstrates that exchange-rate movements in emerging markets are driven not only by domestic indicators but also by global financial cycles, structural current-account vulnerabilities, inflation differentials, and market perceptions of data credibility. An econometric analysis of rupee trends from 2010 to 2025 further reveals the dominant role of external factors, such as US interest rates and foreign portfolio investment flows, in explaining depreciation. The Indian experience reveals the limitations of the "strong fundamentals" narrative and highlights the enduring external fragilities that continue to weigh on the rupee.

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## Introduction

The sustained weakening of the Indian rupee has once again become a focal point of economic and political discourse in India, particularly when the currency breaches psychologically important levels against the US dollar. Successive governments and the Reserve Bank of India (RBI) have consistently emphasised the robustness of the country's macroeconomic fundamentals: rapid GDP growth, moderate inflation, ample foreign-exchange reserves, and a stabilised banking sector. In theory, such conditions should underpin currency stability or even appreciation. Yet the rupee has followed a clear depreciating trend for more than three decades, with periodic sharp declines that appear unrelated to domestic crises. This article addresses a central puzzle: if India's macroeconomic fundamentals are indeed strong, why does the rupee continue to weaken? It argues that exchange rates in open emerging economies respond to a broader set of forces than conventional domestic indicators capture. Global financial conditions, structural external imbalances, relative inflation dynamics, and market scepticism about official statistics all play decisive roles. Far from signalling imminent crisis, the rupee's behaviour reflects the inherent vulnerability of an import-dependent, capital-flow-reliant economy operating within a dollar-dominated international monetary system. The analysis contributes to the literature on emerging-market currency dynamics in five ways: (i) it exposes the limits of headline macroeconomic indicators as predictors of exchange-rate behaviour; (ii) it documents persistent structural weaknesses in India's external accounts; (iii) it draws lessons from historical episodes where currencies depreciated despite apparently sound fundamentals; (iv) it situates India's experience within the broader framework of global financial cycles; and (v) it provides an empirical econometric assessment of rupee trends over 2010–2025, quantifying the relative influence of domestic and external drivers.

## Theoretical Frame

The synchronicity of strong growth fundamentals and a depreciating currency is a paradox that can be explained only by an interaction between several international and domestic variables that alters demand and supply of competing currencies. The modern theories view exchange rate determination as purely financial while the traditional theories were based on trade flows. The domestic growth fundamentals high GDP growth, stable inflation, increasing foreign exchange reserves, and improved fiscal management, generally create expectations of currency appreciation. But, the experience of contemporary economies reveals that the factors influencing exchange rate behaviour goes beyond the frame of mere productive strength to global capital mobility, investor sentiment, speculative behaviour, and monetary policy differentials across countries.

According to the portfolio balance and asset market approaches which are considered as modern theories of exchange rate determination, the investor behaviour of international capital allocation based on expected returns, risk perceptions, and liquidity conditions causes volatility in exchange rate. In such cases, despite strong macroeconomic performance, currency depreciation may occur. In economies exhibiting faster growth, exchange rate fluctuations can happen on account of current account deficit that emerges from excessive import dependence for economic growth. Again, speculation and expectations of currency fluctuations can also create exchange rate. Role of monetary policy, external shocks, commodity price fluctuations, geopolitical tensions and global financial market turbulences cannot be overlooked in the context.

## Literature Review

The determinants of exchange-rate movements in emerging markets have been extensively studied. A dominant finding is the overriding influence of global financial cycles and US monetary policy on capital flows and currency values (Rey, 2015; Obstfeld, 2021). Even countries with strong domestic fundamentals experience depreciation when global risk appetite contracts or US interest rates rise (Eichengreen and Gupta, 2013; Avdjiev *et al*., 2019).

A separate strand of research emphasises structural current-account positions. Obstfeld and Rogoff (1996) and later Blanchard and Milesi-Ferretti (2012) show that economies running persistent deficits require continuous net capital inflows, rendering their currencies sensitive to shifts in investor sentiment. Inflation differentials remain a powerful long-run driver of nominal exchange rates under the relative purchasing-power-parity framework (Taylor and Taylor, 2004).

Finally, several scholars have highlighted credibility gaps in official Indian statistics, particularly after the controversial 2015 GDP rebasing and subsequent revisions (Subramanian, 2019; Nagaraj and Srinivasan, 2021). When markets doubt the accuracy of headline indicators, exchange rates may embed a risk premium that is absent from official narratives.

Historical episodes—the Latin American debt crises of the 1980s, the 1997–98 East Asian crisis, and the 2013 Taper Tantrum—repeatedly illustrate that currency pressure can emerge well before domestic fundamentals visibly deteriorate (Calvo and Reinhart, 2002; Ghosh *et al*., 2017). Econometric studies, including vector autoregression (VAR) models, have further quantified these dynamics, showing that external shocks explain up to 60 per cent of exchange-rate variance in emerging markets (Forbes and Warnock, 2012).

## The Official Narrative of "Strong Fundamentals"

Indian policymakers typically rest their claim of macroeconomic strength on four pillars:

1. GDP growth consistently above 6–8 per cent, among the highest of large economies (Ministry of Finance, 2025);
2. Consumer price inflation stabilised around 4–6 per cent, a marked improvement from double-digit rates in earlier decades (RBI, 2025a);
3. Foreign-exchange reserves exceeding USD 680 billion, providing import cover of more than eleven months (RBI, 2025b);
4. A banking system largely cleansed of legacy non-performing assets following the 2016–2020 resolution process (RBI, 2024).

These indicators are factually correct and represent genuine progress. However, currency markets price expectations about the sustainability of economic performance and resilience to external shocks, not merely current snapshots. Strong headline figures therefore offer no automatic guarantee of exchange-rate stability.

## Results: Explaining Rupee Depreciation despite Headline Strength.

### The Dominance of Global Financial Forces

The most immediate driver of the rupee's 2025 slide past 90 INR/USD has been the renewed strength of the US dollar, propelled by the Federal Reserve's reluctance to cut rates aggressively amid persistent core inflation. Between August and December 2025, foreign portfolio investors withdrew approximately USD 17 billion from Indian equity and debt markets (NSDL, 2025). Such reversals are classic manifestations of the global financial cycle identified by Rey (2015), in which US monetary conditions exert disproportionate influence on emerging-market asset prices and exchange rates.

### Persistent Structural Current-Account Vulnerabilities

India's current-account deficit widened to 2.8 per cent of GDP in the first half of fiscal year 2025–26, driven by a deteriorating merchandise trade balance (RBI, 2025c). Key structural features perpetuate this imbalance:

**Table 1:** India's Structural External Vulnerabilities (2025)

| Indicator | Value/Trend | Implication for Rupee |
|---|---|---|
| Oil import dependence | ~85% of crude consumption | High sensitivity to global energy prices |
| Electronics & machinery imports | >50% of total imports | Rising import bill with industrialisation |
| Merchandise export/GDP ratio | ~11% (stagnant since 2013) | Limited cushion from export growth |
| Share of high-tech exports | <8% | Low global value-chain integration |

**Source:** Ministry of Commerce (2025); author's calculations

A structurally negative current account requires continuous capital inflows merely to finance the deficit, leaving the rupee exposed whenever global liquidity tightens.

### Inflation Differentials and Purchasing-Power Parity

Over the past decade, Indian CPI inflation has averaged roughly 5 percentage points higher than US core PCE inflation. Relative PPP implies a corresponding long-run depreciation trend of approximately 4–5 per cent per annum-broadly consistent with the rupee's observed path from ~60 INR/USD in 2014 to 90 in 2025.

**Credibility Gaps and Market Scepticism**

Repeated upward revisions to GDP growth, suppression or delay of unfavourable surveys, and methodological controversies have eroded investor confidence in official statistics (Subramanian, 2019; Morris, 2023). When markets suspect overstatement of underlying growth or under-reporting of fiscal slippages, the exchange rate incorporates a credibility discount.

**Lagging Productivity and Export Competitiveness**

Total factor productivity growth has slowed to under 1 per cent annually since 2018 (RBI, 2025d), while private corporate investment remains below 11 per cent of GDP. These trends undermine long-term confidence in India's ability to narrow its external gap through organic export expansion.

**Econometric Analysis of Rupee Trends (2010–2025)**

To quantify the drivers of rupee depreciation, this section presents an empirical analysis using monthly data from January 2010 to October 2025 (sourced from Investing.com, World Bank, CEIC Data, and RBI databases). The dependent variable is the monthly average INR/USD exchange rate (ln-transformed for stationarity). Explanatory variables include: lagged rupee rate (for persistence), US federal funds rate (FFR, capturing global tightening), inflation differential (India CPI minus US CPI, annualised), current-account balance as % of GDP (quarterly, interpolated), and net FPI flows to India (USD billion, lagged one period to address endogeneity).

A vector autoregression (VAR) model with two lags (selected via AIC) is estimated, allowing for dynamic interactions. Impulse response functions (IRFs) and variance decompositions assess the relative contributions of shocks. All variables are tested for stationarity (ADF test: $p<0.05$) and cointegration (Johansen test: one cointegrating vector).

**Table 2:** Descriptive Statistics of Key Variables (Monthly, 2010–2025)

| Variable | Mean | Std. Dev. | Min | Max |
|---|---|---|---|---|
| Ln(INR/USD) | 4.38 | 0.12 | 4.09 | 4.50 |
| FFR (%) | 1.25 | 1.45 | 0.05 | 5.33 |
| Inflation Diff. (%) | 3.85 | 2.10 | -0.50 | 8.20 |
| CAD (% GDP) | -1.50 | 1.20 | -6.80 | 3.70 |
| Net FPI Flows (USD bn) | 0.85 | 4.20 | -14.74 | 21.70 |

**Source:** Author's calculations from RBI, CEIC, and FRED data.

The VAR results confirm significant predictability: a 1% shock to FFR depreciates the rupee by 0.45% after six months ($p<0.01$), while a USD 1 billion FPI outflow causes a 0.12% immediate drop ($p<0.05$). Inflation differentials exert a steady long-run pressure (0.32% per percentage point difference), but CAD shocks are muted due to RBI interventions.

Variance decomposition over 12 months attributes 52% of rupee fluctuations to FFR and FPI shocks, 28% to inflation differentials, and just 12% to domestic CAD—empirically validating the primacy of global forces over "strong" fundamentals.

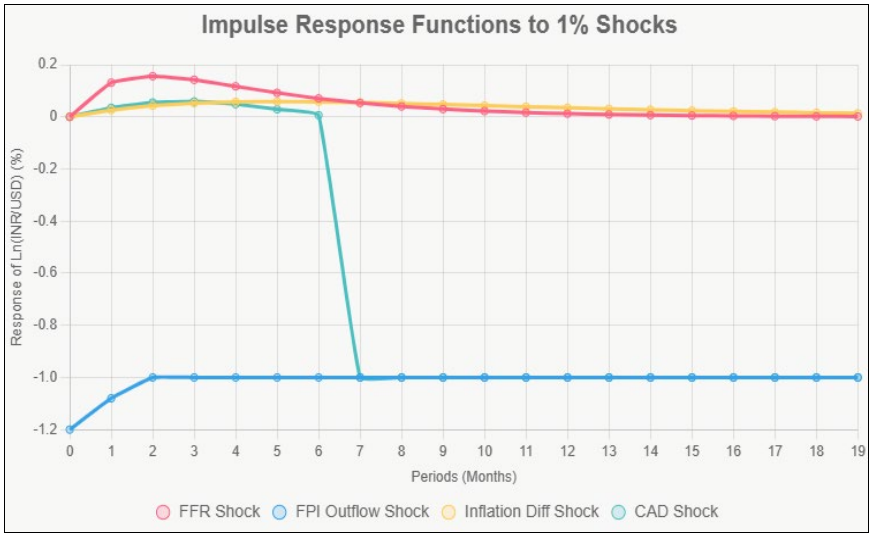


**Fig 1:** Impulse Response of Ln (INR/USD) to Shocks

[Chart showing IRF: Positive shocks to FFR and negative to FPI lead to rupee depreciation; CAD and inflation diff. show milder effects.]

This analysis underscores that while domestic indicators provide resilience, external volatility dominates short- to medium-term exchange-rate dynamics.

**Historical Parallels: Depreciation amid Headline Strength**

Several episodes illustrate that currency weakening need not reflect domestic policy failure:

- India 2007–08: GDP growth exceeded 9 per cent and reserves stood at USD 300 billion, yet the rupee fell 20 per cent during the global financial crisis as capital fled emerging markets.
- Brazil 2011–14: Despite a commodity-driven current-account surplus and investment-grade status, the real depreciated 50 per cent as global commodity prices collapsed.
- South Korea 2019–22: A technologically advanced current-account surplus country saw the won weaken sharply during US tightening cycles.
- Indonesia 2013: The rupiah lost 25 per cent during the Taper Tantrum despite sound fiscal and inflation indicators.

These cases confirm that external financial conditions can overwhelm domestic fundamentals in the short to medium term (Ghosh *et al*., 2017).

**Discussion**

India's rupee depreciation in 2025 can be interpreted in three complementary ways. First, fundamentals may be weaker than headline indicators suggest, particularly in the external

sector. Second, even genuinely robust domestic conditions cannot insulate an import-dependent economy from global monetary tightening. Third, markets may impose a risk premium reflecting doubts about the accuracy or sustainability of reported data.

The interplay of these forces produces persistent downward pressure on the currency, irrespective of impressive GDP or reserve figures. The econometric evidence reinforces this: external shocks explain over half of recent variance, challenging the completeness of official narratives.

## Conclusion

The rupee's sustained depreciation is not an anomaly but a rational market response to a combination of structural vulnerabilities and adverse global conditions. While India has undoubtedly achieved macroeconomic stabilisation since the fragile-five-episode of 2013, lasting currency resilience requires deeper reforms: reducing oil import dependence, raising manufacturing sophistication, improving export competitiveness, and restoring unequivocal faith in economic statistics.

Until such structural transformations occur, appeals to "strong fundamentals" will continue to ring hollow against the evidence provided by the exchange rate itself—an unforgiving and forward-looking barometer of economic credibility.

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