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WHAT DOES THE FALLING RUPEE MEAN FOR YOU AND ECONOMY?

Relevant for: Indian Economy | Topic: Issues relating to Growth & Development - Inflation & Monetary Policy

With the rupee recently weakening past Rs. 70 to a dollar and hovering about that level since, concerns over the impact of the devaluation on economic indicators are intensifying. Here is what happens when the rupee falls:

What happens to inflation?

One of the first visible effects of currency depreciation is the country's imports become more expensive and exports cheaper. The reason is simple. It takes more rupees to pay for the same quantum of imports and fewer dollars for a buyer to pay for the same quantity of exports.

More expensive imports are likely to drive inflation upward, especially in India where input products constitute a large part of our imports. In addition, a depreciating rupee also impacts the oil import bill since it costs more rupees per barrel of oil, which plays its own part in pushing inflation up.

What happens to GDP growth?

This is a more complex question given the number of factors that affect GDP growth. On the one hand, costlier inputs and the subsequent increase in the prices of finished goods should have a positive impact on GDP. But the consequent decrease in demand due to higher prices could nullify this.

This is best explained using the textbook formula of aggregate demand equalling the sum of household consumption of goods and services, investment, government expenditure on goods and services, and exports minus imports.

A depreciating rupee certainly affects the exports and imports, since exports are likely to receive a boost while imports could flag somewhat. It remains to be seen what impact a reduction in household consumption would have on demand, especially when the festive season is nearing.

What does this mean for you?

A depreciating rupee means higher prices of goods and services, costlier petrol and trips abroad turning more expensive. On the flip side, the domestic tourism could grow as more tourists visit India since their currency now buys more here. In the medium term, export-oriented industries may also create more jobs.

A depreciating rupee also impacts the oil bill since it costs more rupees per barrel

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