

Why India cannot let the rupee float

Imported inflation, fragile manufacturing and unequal burdens complicate textbook arguments supporting unrestricted currency depreciation across India.

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By **Deepanshu Mohan**

India's exchange-rate debates often proceed as though the price of the *rupee* were merely another financial price best left to market correction and macroeconomic adjustment. In theory, a weakening currency performs a useful balancing function.

Imports become costlier, domestic demand adjusts, exports become more competitive, and external imbalances gradually stabilise. It is a clean textbook mechanism, elegant in abstraction, and widely accepted within orthodox macroeconomics.

But, economies, especially emerging market economies, do not experience exchange-rate depreciation in abstraction. They experience it through speculative attacks, fuel prices, transport costs, electricity bills, food inflation and falling real wages.

What often disappears in these debates is that currencies do not depreciate uniformly across society. Their effects travel unevenly through economies, across classes, sectors and regions.

India imports nearly [88.6 percent](#) of its crude oil requirements, close to half of its natural gas consumption, substantial fertiliser inputs, edible oils, electronics components and industrial intermediates.

These are not discretionary imports that households or firms can easily reduce in response to a weaker currency. Their demand remains structurally inelastic in the short run.

This distinction matters enormously. In economies dependent on essential imports, depreciation rarely produces an immediate compression in import demand.

Instead, it first raises domestic costs. Fuel prices rise, freight becomes costlier, fertiliser prices feed into agriculture, electricity generation absorbs higher input costs and food inflation gradually intensifies through transport and supply-chain effects.

The burden of that adjustment is not distributed evenly. Inflation acts asymmetrically across households.

The latest [Household Consumption Expenditure Survey](#) reports that the bottom rural deciles continue to spend disproportionately on food, fuel, conveyance and basic consumption.

Inflation burden

Food alone accounts for [nearly 47 percent of rural consumption expenditure](#), while fuel, light and transport absorb another significant share. Informal workers and fixed-income households [possess far weaker bargaining power](#) to protect real wages against inflationary shocks.

In such contexts, currency depreciation becomes more than a macroeconomic adjustment mechanism. It becomes a regressive transfer of purchasing power.

This is precisely why the Indian central bank or the government has never behaved as though the rupee were a purely market-determined variable, despite official claims of a “[market-determined exchange-rate regime](#)”.

The Reserve Bank of India has [intervened repeatedly](#) and aggressively in currency markets across episodes of volatility. Policymakers themselves recognise that abrupt exchange-rate movements carry fiscal, political and social consequences extending far beyond textbook macroeconomics.

Recent empirical analysis of India's exchange-rate management suggests that the country has, at various points, operated across multiple implicit currency regimes despite formally maintaining a market-determined framework.

Between late 2023 and late 2024, India effectively operated under what amounted to a near de-facto peg, with annualised rupee-dollar volatility falling to just 1.5 percent, the lowest level in nearly 25 years. The IMF itself subsequently reclassified India's exchange-rate arrangement as "stabilised."

This creates an important contradiction within the orthodox "let the rupee float" argument. If clean market adjustment were genuinely sufficient, the RBI would not repeatedly intervene through spot-market operations, forward-book positions and reserve management to smooth volatility.

The scale of these interventions has become increasingly difficult to ignore. India's foreign-exchange reserves declined from roughly \$728 billion at their peak to closer to \$690 billion amid sustained intervention pressures.

Simultaneously, the RBI's net short dollar forward position reportedly crossed \$100 billion, indicating that intervention has increasingly shifted into forward markets rather than disappeared altogether.

This is not evidence of irrational policymaking. It reflects a recognition that emerging-market currencies operate under conditions fundamentally different from advanced economies.

In financially open but structurally vulnerable economies, exchange-rate depreciation can quickly feed into capital flight, imported inflation, corporate balance-sheet stress and self-reinforcing expectations of instability.

Export myth

The textbook assumption that weaker currencies naturally boost exports is equally overstated in the Indian context. That logic emerged from an earlier era of industrial production where export sectors relied overwhelmingly on domestic inputs.

Modern manufacturing operates very differently. Large parts of India's export economy remain deeply dependent on imported intermediate goods, components, machinery and energy inputs.

A weakening rupee therefore does not automatically generate an export boom. It often raises production costs simultaneously.

Electronics, pharmaceuticals, chemicals, renewable-energy equipment and auto-component manufacturing remain heavily reliant on imported supply chains.

For many Micro, Small, and Medium Enterprises (MSMEs) already operating under compressed margins and expensive credit conditions, depreciation raises input costs faster than export competitiveness improves.

Recent evidence on India's export responsiveness further complicates the textbook assumption that currency weakness automatically boosts competitiveness. Indian exports appear far more responsive to changes in global demand conditions than to exchange-rate movements themselves.

External demand matters more than currency weakness. India is not constrained primarily by an overvalued exchange rate. It is constrained by manufacturing depth, logistics, productivity, scale and integration into higher-value global supply chains.

This is where the larger policy debate often becomes misleadingly binary. The choice is not between an unsustainable currency peg and a completely unmanaged float. Emerging economies have historically relied on calibrated intervention precisely because external markets are not always self-stabilising.

Foreign-exchange reserves in countries such as India do not merely exist to "defend" currencies in a mercantilist sense. They perform insurance functions against external shocks, oil-price volatility, sudden capital outflows, and geopolitical disruptions.

The Asian financial crisis left deep institutional memories across emerging markets about the dangers of excessive dependence on clean-market adjustment.

Even critics of intervention increasingly acknowledge that volatility management matters. The more relevant question is not whether intervention should exist, but how it should be designed.

Strategic and transparent intervention mechanisms, including forward guidance, calibrated reserve deployment, and targeted external financing windows, may ultimately prove less destabilising than either rigid pegs or abrupt market-driven depreciations.

In advanced economies, exchange-rate flexibility may primarily operate as macroeconomic adjustment. In economies such as India, however, it also functions as inflation transmission, distributional redistribution, and political-economy shock.

And that is precisely why the rupee cannot be treated as just another market price of a commodity that can be allowed to freely depreciate in value-and given up entirely to market forces alone.

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