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# In calibrated move, RBI loosens grip, lets rupee depreciate against US dollar

Since December 10, rupee has depreciated 2.12% against US dollar to touch 86.62

Written by [George Mathew](#) , [Hitesh Vyas](#)  
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The rupee logged its steepest single-day fall in nearly two years and ended the January 13 session 66 paise down at its historic low of 86.70 against the US dollar. (File image)

In what appears to be a shift in strategy, the Reserve Bank of India (RBI) has seemingly relaxed its control over the rupee, allowing it to depreciate against the US dollar over the past month.

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The apparent change in stance marks a departure from the RBI's previous defence mechanisms, which were more rigid. In fact, it had tightly managed the rupee's movement to prevent sharp depreciation since September 2024 till about a month ago.

The rupee, which was moving in the range of 84-85 for quite some time, logged its steepest single-day fall in nearly two years and ended the January 13 session 66 paise down at its historic low of 86.70 against the US dollar. Since November 1, 2024, the rupee has depreciated by 2.6 per cent.

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"The RBI's new approach is a prudent one. If you bind the rupee to a very tight range, you also end up spending a lot of energy and resources. I think by letting the rupee go a wider range seems to be a good idea," an analyst noted.

However, market experts believe it's too early to attribute this change to the new RBI Governor, Sanjay Malhotra, who took charge on December 11. "The RBI, as an institution, was aligned with former Governor Shaktikanta Das's views on currency management, and suddenly changing that strategy isn't easy," said a money market analyst.

The rupee's fall in the last a few weeks has led to the conclusion in the market that the RBI tried something and they probably had anticipated that holding it beyond a point makes no sense. "I would say that there is a change in the RBI's strategy for sure but I wouldn't give it to the new governor," he said.

The depreciation came at a time when Malhotra had been involved in a series of meetings with officials to get a grip of the functioning of the central bank.

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Rupee traders have been keen to assess the new RBI Governor's view on the currency since he assumed office last month. "Recent rupee price action points to a higher tolerance for a weaker exchange rate, demonstrated in the -2.1 per cent fall in the rupee vs dollar in Q4 of FY24, compared to nearly flat Q1-Q3. The weakening bias continues into the new year, with overvaluation of the broad real effective exchange rate (REER) also weighing on exchange rate (Nov REER was at a record high)," said Radhika Rao, Senior Economist and Executive Director, DBS Bank.

"We had a situation where the RBI was fully supporting the rupee. However, in the last one month, it has reduced, which has led to the rupee depreciation," said an analyst from a leading securities firm. Since the dollar index has strengthened

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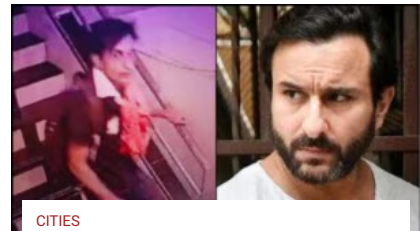
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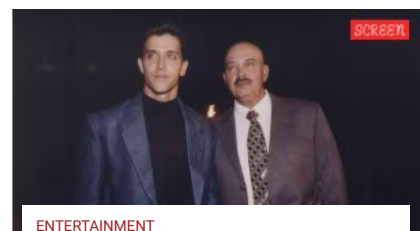
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significantly, the RBI may have thought that some amount of rupee depreciation to align with dollar strength may not be bad. So, they allowed the [rupee to depreciate](#) to the levels closer to 86.5 in the recent period, he said.

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### **Jump in forward dollar sales, fall in forex kitty**

The RBI had made dollar sales of \$49.18 billion in the forward market and \$9.27 billion in the spot market as of October 2024. When compared to this, the RBI made spot purchases of \$ 13.24 billion and forward sales of just \$ 541 million in April 2024. The RBI sells dollars when the dollar strengthens and the rupee declines, and vice versa. It uses the foreign exchange kitty to manage the rupee movement.

Dollar sales in the forward market, which won't impact forex reserves, could have gone up further in November and December, but figures are yet to be released by the RBI.

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The RBI did not respond to the mail from [The Indian Express](#) about its intervention in the currency market and the impact of rupee depreciation.

**India's foreign exchange reserves plummeted by \$ 79 billion since September 2024 to \$ 625.87 billion as of January 10, this year. This decline was mainly attributed to dollar sales to prevent the rupee fall and capital outflows, mainly withdrawals of over Rs 1,43,000 crore by foreign investors since October 2024. Had the RBI not sold forward dollars, forex kitty would have fallen by another \$50-75 billion.**

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The rupee is the only currency which has not depreciated much while all other currencies have depreciated against the dollar.

Strong intervention presence since Q4 of FY24 has led to a drain in domestic liquidity, pushing the balance to a deficit (accentuated by seasonal drivers), notwithstanding the 50 basis points cut in the cash reserve ratio as well as bond purchases by the RBI. This position had also become unsustainable as a rapid appreciation in the dollar magnified the misalignment, increasing the need to ease grip on the rupee, Rao said.

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### **Prudent stance**

**Compared to a nearly flat Re-\$ exchange rate till November, the rupee price action in the last 4-5 weeks points to a higher tolerance for a weaker exchange rate. From fully supporting the rupee, RBI's intervention has reduced leading to a depreciation.**

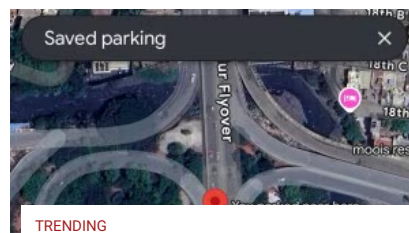
**The liquidity in the system is in deficit.** When the RBI intervenes in the market, it sells dollars and buys rupee. If the RBI is buying rupee, it's taking more rupee out of the system, resulting in a liquidity deficit. The liquidity deficit is hampering money

says he 'wanted to quit'



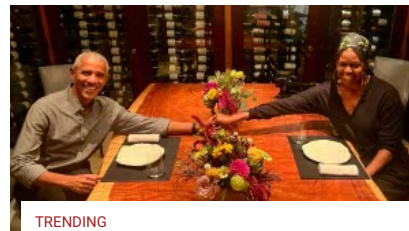
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markets, which means the cost of money becomes very expensive even when interest rates are going higher. The RBI would not be desirous of that.

While the projection for **inflation** for Q4 of the RBI is 4.5 per cent, the present depreciation in the rupee will be an additional concern as this can lead to higher imported inflation especially on oil products, said Madan Sabnavis, Chief Economist, Bank of Baroda.

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The future course of the rupee depends upon whether the dollar remains here or goes higher or its scales back. The event which is going to be looked at closely is **Donald Trump taking over as the US President** seat on January 20, and how he delivers on the election promises he had made in terms of immigration, tax and tariffs. There's an expectation that the currency can fall to 87 against the US dollar in March this year.

Assuming the nature of announcements is as strong as Trump had promised, the dollar will strengthen significantly. However, expectation is that the action is going to be slightly muted compared to what he had promised. If that would be the situation, the dollar may remain strong and may not go significantly higher from here immediately.

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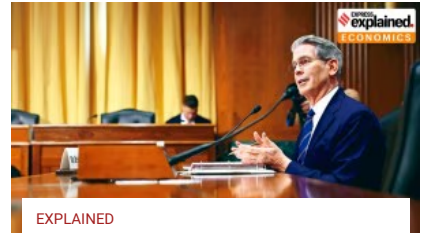
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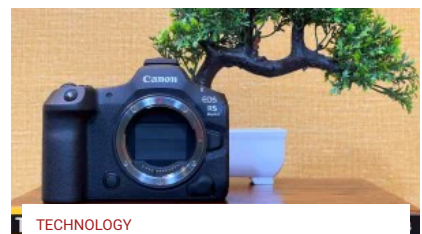
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