

Devaluation of Rupee on India's Fiscal Deficit

Atharv Mittal

ABSTRACT

The devaluation of the Indian rupee has significant implications for India's fiscal position, particularly through its effects on government expenditure, public debt, inflation, trade, and overall macroeconomic stability. This study examines the relationship between rupee depreciation and India's fiscal deficit, focusing on the channels through which exchange-rate movements influence government revenues and expenditures. A weaker rupee increases the domestic currency cost of imported commodities, especially crude oil, fertilizers, machinery, and other essential inputs, thereby raising subsidy requirements and government expenditure. Depreciation may also increase the servicing burden of external debt denominated in foreign currencies and create inflationary pressures that affect public spending and fiscal planning. At the same time, a weaker rupee can improve export competitiveness, potentially supporting economic activity, corporate profitability, tax revenues, and foreign exchange earnings. However, these benefits depend upon global demand, import dependence, domestic productive capacity, and the responsiveness of exports to exchange-rate changes. The study adopts an analytical approach to assess how rupee devaluation interacts with major determinants of India's fiscal deficit, including import costs, inflation, government borrowing, revenue mobilisation, and economic growth. It argues that persistent and sharp depreciation can intensify fiscal pressures when higher import bills and expenditure obligations outweigh gains from exports and revenues. The study concludes that maintaining fiscal sustainability requires coordinated monetary, exchange-rate, trade, energy, and fiscal policies. Strengthening domestic production, reducing dependence on critical imports, improving revenue mobilisation, and maintaining prudent debt management can reduce the vulnerability of India's fiscal deficit to fluctuations in the value of the rupee.

Keywords: Rupee Devaluation; Fiscal Deficit; Exchange Rate; Public Debt; Indian Economy.

INTRODUCTION

Exchange-rate movements constitute an important component of macroeconomic management because they influence international trade, domestic prices, investment decisions, external debt, capital flows, and government finances. In India, the value of the rupee against major international currencies, particularly the U.S. dollar, has undergone substantial changes since the transition toward a market-determined exchange-rate regime following the economic reforms of the early 1990s. While the terms devaluation and depreciation are sometimes used interchangeably, devaluation technically refers to an official downward adjustment of a currency under a fixed or managed exchange-rate system, whereas depreciation refers to a market-driven decline in its value under a flexible exchange-rate regime. In the contemporary Indian context, therefore, sustained rupee depreciation is generally the more accurate description, although the broader concept of rupee devaluation remains relevant for analysing the fiscal consequences of currency weakness.

The exchange rate of the Indian rupee is influenced by several domestic and international factors, including inflation differentials, interest rates, crude oil prices, trade and current-account balances, foreign portfolio investment, foreign direct investment, monetary policy, global risk perceptions, and movements in the U.S. dollar. India's relatively high dependence on imported energy makes the economy particularly sensitive to exchange-rate fluctuations. When the rupee depreciates, a given quantity of imports priced in foreign currencies requires a larger amount of domestic currency. This can increase the cost of crude oil, natural gas, fertilizers, machinery, electronics, and industrial inputs and may subsequently transmit to domestic prices. Exchange-rate pass-through literature demonstrates that changes in exchange rates can influence import and consumer prices, although the extent of transmission varies across countries, commodities, market structures, and macroeconomic conditions (Campa & Goldberg, 2005; Gopinath et al., 2010).

The Reserve Bank of India (RBI) manages excessive exchange-rate volatility while allowing the exchange rate to respond to market conditions. Exchange-rate management is closely connected with monetary stability because significant depreciation can generate imported inflation, alter capital-flow conditions, and affect liquidity. In an economy integrated with global financial markets, exchange-rate movements may therefore influence both monetary and fiscal policy choices.

The International Monetary Fund (IMF) has similarly emphasized that India's macroeconomic policy framework must balance growth, price stability, fiscal consolidation, and resilience against external shocks.

The economic consequences of rupee depreciation are not necessarily negative in every circumstance. A weaker currency can improve the price competitiveness of Indian exports and increase the rupee value of foreign-currency earnings. Export-oriented industries such as information technology services, pharmaceuticals, textiles, and other internationally traded sectors may benefit when foreign revenues are converted into rupees. However, these gains may be partly offset when production depends heavily upon imported energy, components, technology, or capital goods. Consequently, the net macroeconomic effect of depreciation depends on the structural characteristics of the economy, the composition of trade, global demand, commodity prices, and the causes underlying the exchange-rate movement.

Fiscal Deficit and Channels of Exchange-Rate Impact

Fiscal deficit represents the excess of the government's total expenditure over its total receipts excluding borrowings. It is an important indicator of the government's borrowing requirement and overall fiscal position. Persistent fiscal deficits may increase public debt and interest obligations, while excessively rapid fiscal consolidation may constrain productive public expenditure. India has therefore pursued fiscal consolidation while attempting to maintain expenditure on infrastructure, social welfare, capital formation, and development priorities. Recent assessments of the Indian economy have continued to identify prudent fiscal management and fiscal consolidation as important components of macroeconomic resilience (World Bank, 2026).

Rupee depreciation can affect the fiscal deficit through several interconnected channels. The first is the import-cost channel. India imports substantial quantities of crude oil and other strategically important commodities. When the rupee depreciates against the dollar, the domestic currency cost of such imports increases even if international commodity prices remain unchanged. Higher fuel and energy costs can affect transportation, electricity generation, industrial production, and agricultural inputs. Depending on prevailing taxation and subsidy arrangements, the government may face pressure either to absorb part of the price increase through reduced taxes or increased subsidies or allow the higher costs to be transferred to consumers. Either response may have fiscal consequences.

The second channel is inflation. Currency depreciation can increase domestic prices through exchange-rate pass-through. Campa and Goldberg (2005) explain that imported inputs can transmit exchange-rate changes beyond directly imported consumer goods into broader domestic production costs. Gopinath et al. (2010) further demonstrate the importance of currency invoicing and price-setting behaviour in determining the extent of exchange-rate pass-through. For India, higher imported inflation may increase government expenditure through subsidies, welfare programmes, indexed payments, procurement costs, and operating expenditure. Inflation may also raise nominal tax revenues, but the resulting revenue gains do not necessarily compensate for higher expenditure and macroeconomic instability.

A third mechanism concerns public and external debt. When government or public-sector liabilities are denominated in foreign currencies, depreciation increases their rupee value and may raise the domestic currency cost of debt servicing. The magnitude of this effect depends on the composition and maturity structure of external debt and the degree of foreign-currency exposure. Prudent external debt management is consequently important for limiting the fiscal vulnerability associated with currency fluctuations.

The fourth channel operates through economic growth and tax revenues. A depreciation-induced rise in imported input costs can reduce profit margins and investment in import-dependent industries. Slower economic activity can weaken corporate tax, income tax, and goods and services tax collections. Conversely, export-oriented sectors may gain from improved competitiveness and stronger rupee-denominated export earnings, potentially supporting employment, income, investment, and government revenues. Thus, the relationship between currency depreciation and the fiscal deficit is not linear; it depends on the relative strength of expenditure, revenue, trade, inflation, and growth effects.

Significance of Studying Rupee Devaluation and Fiscal Deficit

Understanding the relationship between rupee depreciation and India's fiscal deficit has become increasingly important in an environment characterised by geopolitical uncertainty, commodity-price volatility, changing global interest rates, and fluctuating international capital flows. External shocks can simultaneously affect exchange rates, oil prices, inflation, borrowing conditions, and economic growth, creating complex challenges for fiscal management. The World Bank (2026), for example, highlights the importance of energy diversification and prudent fiscal management in strengthening India's resilience to external risks.

Exchange-rate movements also interact with monetary and fiscal policies. Measures designed to contain inflation, manage liquidity, stabilise financial markets, and maintain sustainable public finances can influence one another. A substantial depreciation may increase imported inflation and complicate monetary-policy decisions, while fiscal measures intended to protect households and firms from rising commodity prices may increase expenditure or reduce government revenues. Conversely, credible fiscal consolidation can strengthen macroeconomic confidence and contribute to resilience against external volatility.

The study of the devaluation of the rupee and India's fiscal deficit is therefore significant because it provides an integrated framework for understanding how external-sector developments affect government finances. Rather than treating the exchange rate and fiscal deficit as isolated macroeconomic indicators, the study examines their relationship through import costs, subsidies, inflation, debt servicing, trade performance, revenue mobilisation, capital flows, and economic growth. Such analysis can contribute to the formulation of policies aimed at maintaining exchange-rate stability without compromising growth and fiscal sustainability. It also highlights the importance of reducing excessive dependence on critical imports, expanding competitive exports, strengthening domestic productive capacity, maintaining adequate foreign-exchange buffers, improving revenue mobilisation, and managing public debt prudently. In this context, analysing the fiscal consequences of rupee depreciation is essential for understanding India's broader macroeconomic stability and its capacity to respond effectively to domestic and global economic shocks.

Objectives

1. To examine the impact of rupee devaluation on India's fiscal deficit through changes in import costs, inflation, government expenditure, and external debt obligations.
2. To analyze the relationship between exchange-rate fluctuations and India's fiscal performance and suggest measures for maintaining fiscal stability.

RESEARCH METHODOLOGY

The present study adopts a descriptive and analytical research design to examine the impact of rupee devaluation on India's fiscal deficit. The study is primarily based on secondary data collected from reliable sources such as the Reserve Bank of India (RBI), Ministry of Finance, Economic Survey of India, Union Budget documents, International Monetary Fund (IMF), World Bank, and other published reports and research studies. Key variables considered include the INR–USD exchange rate, fiscal deficit, inflation rate, import expenditure, government expenditure, external debt, and economic growth. Annual time-series data are analyzed to understand trends and relationships between rupee depreciation and fiscal performance. Statistical techniques such as descriptive statistics, correlation analysis, and regression analysis are employed, wherever appropriate, to assess the direction and magnitude of relationships among the selected variables. The findings are interpreted in the context of India's macroeconomic conditions to evaluate the fiscal implications of rupee depreciation and identify suitable policy measures.

Data Analysis

The present analysis examines the relationship between the depreciation of the Indian rupee and India's fiscal deficit through exchange-rate movements, fiscal indicators, government borrowing, external debt, inflationary pressures, and import-related fiscal exposure. In accordance with the methodology, secondary data have been drawn principally from the Reserve Bank of India (RBI), Ministry of Finance, Economic Survey, Union Budget documents, Department of Economic Affairs (DEA), International Monetary Fund (IMF), and World Bank. The analysis is directed toward the two objectives of the study: first, to examine the impact of rupee devaluation on India's fiscal deficit through changes in import costs, inflation, government expenditure, and external debt obligations; and second, to analyse the relationship between exchange-rate fluctuations and fiscal performance and identify implications for fiscal stability.

Table 1: Long-Term Trend in Central Government Fiscal Deficit

Financial Year	Fiscal Deficit (% of GDP)	Broad Fiscal Position
2014–15	4.1	Consolidation
2015–16	3.9	Consolidation
2016–17	3.5	Improved

Financial Year	Fiscal Deficit (% of GDP)	Broad Fiscal Position
2017–18	3.5	Stable
2018–19	3.4	Improved
2019–20	4.6	Deterioration
2020–21	9.2	Exceptional pandemic expansion
2021–22	6.8	Post-pandemic consolidation
2022–23	6.4	Consolidation
2023–24	5.6	Consolidation
2024–25 RE	4.8	Further consolidation
2025–26 BE	4.4	Consolidation target

Note: RE = Revised Estimates, BE = Budget Estimates.

Source: Government of India, Ministry of Finance, *Economic Survey* and Union Budget documents; 2024–25 RE and 2025–26 BE from *Budget at a Glance 2025–26*. Earlier Economic Survey fiscal tables report, among other observations, 3.9% in 2015–16, 3.5% in 2016–17 and 2017–18, 3.4% in 2018–19, 4.6% in 2019–20, and 9.2% in 2020–21.

Table 1 demonstrates that India’s fiscal deficit cannot be explained by rupee depreciation alone. Between 2014–15 and 2018–19, the Central Government deficit declined from 4.1% to 3.4% of GDP, reflecting a sustained process of fiscal consolidation. The deficit subsequently increased to 4.6% in 2019–20 and reached an exceptional 9.2% during 2020–21, principally because of the fiscal and economic consequences of the COVID-19 pandemic rather than an exchange-rate shock in isolation. Thereafter, the deficit declined as economic activity normalised and fiscal consolidation resumed. Budget documents report an actual deficit of 5.6% of GDP in 2023–24, a revised estimate of 4.8% in 2024–25 and a budget estimate of 4.4% for 2025–26. This indicates that the fiscal position improved even during a period in which the rupee remained considerably weaker against the U.S. dollar than a decade earlier. Consequently, the descriptive evidence does not establish a simple one-to-one positive relationship between depreciation and fiscal deficit. Exchange-rate depreciation should instead be treated as one fiscal risk factor operating alongside economic growth, revenue collection, expenditure policy, subsidies, interest payments, external shocks and government consolidation strategies.

Table 2: Recent Central Government Deficit Indicators and Financing Requirements

Indicator	2023–24 Actual	2024–25 BE	2024–25 RE	2025–26 BE
Fiscal Deficit (₹ crore)	16,54,643	16,13,312	15,69,527	15,68,936
Fiscal Deficit (% GDP)	5.6	4.9	4.8	4.4
Revenue Deficit (% GDP)	2.6	1.8	1.9	1.5
Primary Deficit (% GDP)	2.0	1.4	1.3	0.8
Market Borrowings/G-Secs (₹	11,77,754	11,63,182	11,62,678	11,53,834

Indicator	2023–24 Actual	2024–25 BE	2024–25 RE	2025–26 BE
crore)				
External Debt Financing (₹ crore)	55,121	15,952	31,992	23,490

Key: BE = Budget Estimates, RE = Revised Estimates.

Source: Government of India, Ministry of Finance, *Budget at a Glance 2025–26: Deficit Statistics*.

Table 2 provides important evidence concerning the structure of India's recent fiscal position. The fiscal deficit declined from 5.6% of GDP in 2023–24 to a revised 4.8% in 2024–25, with a further reduction to 4.4% budgeted for 2025–26. Revenue and primary deficits also show declining trajectories. Of particular relevance to exchange-rate analysis is the composition of fiscal-deficit financing. Market borrowing through government securities is far larger than external debt financing. For example, market borrowing amounted to approximately ₹11.78 lakh crore in 2023–24 compared with external debt financing of ₹55,121 crore. In the 2025–26 Budget Estimate, market borrowing remains above ₹11.5 lakh crore, while external debt financing is ₹23,490 crore. This structure reduces the direct sensitivity of the Central Government's deficit financing to exchange-rate depreciation because the overwhelming portion of borrowing is domestic rather than foreign-currency borrowing. Nevertheless, depreciation can influence fiscal conditions indirectly through inflation, interest rates, commodity imports, subsidy expenditure and the rupee valuation of external liabilities. The table therefore supports the proposition that currency depreciation creates fiscal pressures primarily through indirect macroeconomic transmission channels rather than through direct foreign borrowing alone.

Table 3: External Debt and Exchange-Rate Valuation Exposure, 2023–24 and 2024–25

Indicator	End-March 2024	End-March 2025	Notes / Impact
External Debt (US\$ billion)	668.8	736.3	—
Increase during 2024–25	—	US\$ 67.5 billion	Absolute change
Growth in External Debt	—	10.1%	Year-on-year growth
External Debt (₹ lakh crore)	Approx. 55.7	63.0	—
Increase in Rupee Terms	—	Approx. ₹7.3 lakh crore	Absolute change in INR
Growth in Rupee Terms	—	13.0%	Year-on-year growth in INR
External Debt / GDP	18.5%	19.1%	Share of GDP
Forex Reserves / External Debt	—	90.8%	Coverage ratio
Valuation Effect	—	US\$ 5.3 billion	Valuation gain

Source: Department of Economic Affairs, Ministry of Finance, *India's External Debt: A Status Report 2024–25*.

Table 3 reveals an important mechanism through which exchange-rate changes interact with India's external financial position. India's external debt increased from US\$668.8 billion at end-March 2024 to US\$736.3 billion at end-March 2025, representing an increase of 10.1%. In rupee terms, however, the stock reached approximately ₹63 lakh crore and increased by about 13%, demonstrating that domestic-currency valuation can move differently from the dollar value of external liabilities. The DEA specifically reports a valuation gain of US\$5.3 billion at end-March 2025 arising from the appreciation of the U.S. dollar against the Indian rupee and other major currencies. Excluding valuation effects, the increase in external

debt would have been US\$72.9 billion rather than US\$67.5 billion. Thus, currency composition matters: dollar appreciation may increase the rupee cost of dollar-denominated obligations while simultaneously reducing the dollar value of liabilities denominated in other currencies. The external-debt-to-GDP ratio increased from 18.5% to 19.1%, although foreign-exchange reserves remained equivalent to 90.8% of external debt. The findings suggest that depreciation creates valuation and servicing risks, but India's reserve position and debt structure provide important buffers against such risks.

Table 4: Fiscal Consolidation in the Recent Period

Indicator (% of GDP)	FY2022–23	FY2023–24	FY2024–25
Total Revenue	9.4	9.6	9.7
Total Expenditure	16.1	15.3	14.6
Current Expenditure	13.2	12.1	11.3
Interest Payments	3.6	3.7	3.5
Capital Expenditure	2.8	3.3	3.3
Fiscal Deficit	6.7*	5.7*	4.9*
Primary Deficit	3.1	2.0	1.4
Total Liabilities	59.8	59.8	58.6

*Figures in this table follow the World Bank's April 2026 presentation based on the rebased GDP series and may therefore differ slightly from fiscal ratios reported in earlier Union Budget documents.

Source: World Bank, *India Development Update, April 2026*, Table 2.3, based on CEIC, MoSPI and World Bank staff calculations.

Table 4 shows that India achieved substantial fiscal consolidation over FY2022–23 to FY2024–25. On the World Bank's rebased GDP series, the Central Government fiscal deficit fell from 6.7% to 4.9% of GDP, while the primary deficit declined from 3.1% to 1.4%. Total expenditure decreased from 16.1% to 14.6% of GDP, mainly because current expenditure declined, while capital expenditure was preserved at around 3.3% in the latter two years. This is significant for the present study because exchange-rate weakness did not prevent improvement in headline fiscal indicators. It suggests that the fiscal effect of rupee depreciation can be counterbalanced by expenditure management, revenue mobilisation, nominal GDP growth and other policy measures. Interest payments nevertheless remained substantial at around 3.5–3.7% of GDP, indicating limited fiscal space to absorb large external shocks. A major depreciation accompanied by higher energy prices could therefore complicate consolidation by increasing inflation, input costs and expenditure demands. The evidence supports a conditional relationship: depreciation can worsen fiscal pressures, but the actual deficit outcome depends on whether policy responses and revenue performance are strong enough to offset those pressures.

Table 5: Exchange-Rate and Fiscal Transmission Mechanism

Rupee Depreciation Channel	Immediate Economic Effect	Potential Fiscal Effect	Expected Direction on Fiscal Deficit
Crude oil and energy imports	Higher rupee import cost	Greater subsidy/relief or lower fuel-tax flexibility	Increase

Rupee Depreciation Channel	Immediate Economic Effect	Potential Fiscal Effect	Expected Direction on Fiscal Deficit
Fertilizer and essential imports	Higher input prices	Higher subsidy requirements	Increase
Imported capital/intermediate goods	Higher production costs	Inflation and weaker margins/output	Potential increase
Foreign-currency liabilities	Higher rupee value of dollar debt	Higher debt-service burden	Increase
Export competitiveness	Higher rupee export receipts	Higher income/profits and tax revenues	Potential decrease
Imported inflation	Higher domestic price level	Higher government procurement/welfare costs	Increase
Nominal tax base	Higher nominal values	Possible increase in tax collections	Potential decrease
Exchange-rate valuation	Changes rupee value of foreign assets/liabilities	Balance-sheet and debt effects	Ambiguous

Source: Analytical compilation based on Reserve Bank of India, Ministry of Finance, DEA external debt reports, Economic Survey, and exchange-rate pass-through literature including Campa and Goldberg (2005) and Gopinath, Itskhoki, and Rigobon (2010).

Table 5 identifies the mechanisms through which rupee depreciation can affect fiscal performance. The most important adverse channel for India is the increased rupee cost of imported commodities, particularly energy and other essential inputs. Since international commodities are generally invoiced in foreign currencies, depreciation increases their domestic price even when the international dollar price is unchanged. The government may respond through subsidies, tax reductions or welfare support, all of which can affect the deficit. Currency weakness may also increase the domestic-currency burden associated with foreign-currency liabilities. Exchange-rate pass-through can contribute to inflation, raising procurement costs and potentially increasing expenditure on programmes intended to protect vulnerable households. However, depreciation also creates possible fiscal benefits. Exporters earning foreign currency can receive greater rupee revenues, which may improve profits, income and tax collections. Inflation can also raise nominal tax receipts, although such gains may be accompanied by welfare and macroeconomic costs. The expected fiscal impact is therefore theoretically ambiguous. What matters is the balance between import-related expenditure effects, debt exposure, export response, tax revenue effects and the policy measures adopted by the government.

Table 6: Assessment of Rupee Depreciation against Key Fiscal Variables

Fiscal Variable	Sensitivity to Rupee Depreciation	Main Reason	Overall Fiscal Risk
Import expenditure	High	Imported goods become costlier in rupee terms	High
Inflation	Moderate–High	Exchange-rate pass-through	High
Subsidy expenditure	Moderate–High	Energy/fertilizer cost transmission	High

Fiscal Variable	Sensitivity to Rupee Depreciation	Main Reason	Overall Fiscal Risk
External debt servicing	Moderate	Foreign-currency obligations become costlier	Moderate
Domestic public debt	Low direct effect	Predominantly rupee-denominated	Low–Moderate
Tax revenue	Mixed	Inflation and exports may raise nominal revenues	Mixed
Export-linked revenue	Positive potential	Export competitiveness/rupee receipts	Moderate benefit
Fiscal deficit	Indirect/conditional	Net result of expenditure and revenue channels	Moderate–High

Source: Author’s analytical assessment based on RBI, Ministry of Finance, DEA, IMF and World Bank evidence.

Table 6 synthesises the fiscal sensitivity of major variables to rupee depreciation. Import expenditure has high sensitivity because a weaker rupee raises the domestic-currency cost of foreign goods. Inflation is also rated moderate to high because exchange-rate changes can pass through to imported consumer goods and production inputs. Subsidy expenditure may become particularly important when the government seeks to cushion consumers, agriculture or industries against international price shocks. External debt servicing has moderate exposure, although India’s reliance on domestic borrowing limits direct sovereign exchange-rate vulnerability. Tax revenues show a mixed relationship: higher nominal prices and improved export earnings can raise collections, whereas weaker real activity and reduced profitability in import-intensive sectors can have the opposite effect. Consequently, the fiscal deficit itself is classified as indirectly and conditionally sensitive to depreciation. The results are consistent with the first objective: rupee depreciation can place upward pressure on the fiscal deficit through import costs, inflation, government expenditure and foreign-currency obligations. However, the magnitude depends upon commodity prices, debt composition, government policy and the broader state of economic activity.

Table 7: Objective-Wise Findings of the Study

Research Objective	Evidence Examined	Principal Finding
Examine the impact of rupee devaluation on fiscal deficit through import costs, inflation, expenditure and external debt	Fiscal deficit trends, deficit financing, external debt and transmission channels	Depreciation creates upward fiscal pressure mainly through indirect channels, but does not independently determine the fiscal deficit
Analyse exchange-rate fluctuations and fiscal performance and suggest measures for fiscal stability	Fiscal consolidation, debt structure, external buffers and transmission assessment	Fiscal discipline, domestic borrowing, reserves, revenue growth and expenditure management can offset part of the fiscal impact of depreciation

Source: Author’s compilation based on the preceding secondary-data analysis.

Table 7 connects the empirical and descriptive evidence directly with the objectives of the study. Regarding the first objective, the analysis establishes several plausible channels through which rupee depreciation can increase fiscal pressure. Higher import costs can affect fuel, fertilizer and other expenditure-sensitive commodities; imported inflation can raise public procurement and welfare costs; and foreign-currency debt can become more expensive in rupee terms. However, the historical fiscal-deficit series demonstrates that depreciation is not sufficient by itself to predict fiscal deterioration. India’s deficit declined substantially after the pandemic despite continued exchange-rate pressures, indicating the importance of

fiscal policy, revenue performance and economic growth. Regarding the second objective, India's predominantly domestic deficit financing and substantial foreign-exchange reserve buffer reduce direct vulnerability to currency movements. The 2024–25 external-debt report nevertheless shows that valuation effects remain relevant. Fiscal stability therefore requires a combination of prudent borrowing, reduced vulnerability to critical imports, stable revenue mobilisation, export competitiveness, energy diversification and careful expenditure management. Exchange-rate management and fiscal policy should consequently be understood as complementary elements of macroeconomic stability.

FINDINGS AND DISCUSSION

The overall findings indicate that rupee depreciation and fiscal deficit are connected through a complex set of direct and indirect mechanisms rather than a simple linear relationship. Historical fiscal data demonstrate that the Central Government deficit fell from 4.1% of GDP in 2014–15 to 3.4% in 2018–19 before increasing sharply during the pandemic. The subsequent consolidation toward 4.8% in the 2024–25 Revised Estimate and 4.4% in the 2025–26 Budget Estimate demonstrates that fiscal outcomes can improve even under conditions of a relatively weak rupee. The pandemic experience also illustrates why simple correlation between exchange rate and deficit can be misleading: fiscal deficits may be dominated by extraordinary expenditure and revenue shocks unrelated to currency depreciation.

The most important relationship is therefore indirect. Depreciation increases the rupee price of dollar-denominated imports. For an import-dependent economy, particularly one exposed to energy-market volatility, this can create inflation and increase production and transportation costs. If the government absorbs part of the shock through subsidies or tax reductions, expenditure may increase or revenues may decline. Conversely, full pass-through to consumers may reduce direct fiscal costs but increase inflation and potentially weaken domestic demand. Exchange-rate pass-through research has established that currency movements can affect domestic prices through both imported final goods and imported production inputs (Campa & Goldberg, 2005; Gopinath et al., 2010).

External debt constitutes another relevant channel. India's external debt stood at US\$736.3 billion at end-March 2025, equivalent to 19.1% of GDP. In rupee terms it was approximately ₹63 lakh crore. However, the direct implication for the Central Government deficit should not be overstated because external debt includes liabilities of different sectors, and the government finances the overwhelming part of its fiscal deficit through domestic sources. Budget data demonstrate that market borrowing is much larger than external debt financing. Therefore, rupee depreciation does not translate the entire external-debt stock into an equivalent increase in the Central Government's fiscal burden.

The analysis also reveals the importance of macroeconomic buffers. Foreign-exchange reserves represented 90.8% of external debt at end-March 2025, providing significant protection against external vulnerability. The World Bank's recent assessment likewise emphasizes India's macroeconomic buffers while recommending prudent fiscal management and energy diversification. Fiscal consolidation has continued, and the IMF has noted that India's current account deficit has remained contained alongside resilient services exports. These factors can reduce the fiscal consequences of exchange-rate volatility.

From a policy perspective, the findings suggest that the government should not attempt to address rupee depreciation solely through fiscal intervention. Sustainable fiscal stability requires reduced dependence on volatile imported energy, diversification of energy sources, expansion of competitive exports, prudent management of foreign-currency liabilities, strong tax mobilisation and efficient expenditure. Exchange-rate flexibility can act as an external shock absorber, but excessive volatility may create inflationary and fiscal risks. Therefore, coordination between monetary policy, external-sector management and fiscal policy remains important.

In conclusion, the data support the proposition that rupee depreciation can exert upward pressure on India's fiscal deficit, particularly when it coincides with high international commodity prices, inflation, weak growth or large subsidy requirements. However, depreciation is not an independent or deterministic cause of fiscal deficits. India's recent experience demonstrates that fiscal consolidation can proceed despite currency weakness when revenue growth, expenditure management, domestic financing and macroeconomic buffers remain supportive. The relationship should therefore be interpreted as conditional, multidimensional and policy-dependent, rather than as a direct mechanical relationship.

CONCLUSION

The study concludes that the devaluation or depreciation of the Indian rupee has important implications for India's fiscal deficit, although the relationship is neither direct nor uniform. Rupee depreciation influences public finances mainly

through higher import costs, inflationary pressures, subsidy requirements, government expenditure, and the domestic-currency burden of foreign-currency liabilities. India's dependence on imported crude oil, fertilizers, machinery, and other essential inputs makes the economy particularly vulnerable to exchange-rate fluctuations. A weaker rupee can increase the cost of these imports and consequently create additional pressure on government expenditure and fiscal management.

The analysis also indicates that depreciation does not necessarily result in a higher fiscal deficit in every period. India's recent fiscal consolidation demonstrates that effective expenditure management, improved revenue mobilization, economic growth, domestic borrowing, and adequate foreign-exchange reserves can moderate the adverse fiscal consequences of currency weakness. Moreover, rupee depreciation may enhance export competitiveness and increase rupee-denominated earnings of export-oriented industries, potentially contributing to higher economic activity and government revenues.

Overall, the relationship between rupee depreciation and India's fiscal deficit is multidimensional and depends upon global commodity prices, inflation, external debt exposure, trade performance, economic growth, and government policy responses. Maintaining fiscal stability therefore requires coordinated fiscal, monetary, trade, and exchange-rate policies. Reducing dependence on critical imports, promoting domestic production and exports, strengthening revenue mobilization, managing public debt prudently, and maintaining adequate foreign-exchange reserves can significantly reduce India's fiscal vulnerability to exchange-rate fluctuations and support sustainable long-term macroeconomic stability.

SUGGESTIONS

India should adopt a coordinated fiscal and monetary strategy to minimize the adverse effects of rupee depreciation on the fiscal deficit. The government should reduce dependence on imported crude oil, fertilizers, machinery, and essential inputs by promoting domestic production and renewable energy. Export competitiveness should be strengthened through infrastructure development, technological advancement, and trade diversification. Foreign-currency debt exposure should be carefully managed to limit exchange-rate risks. Greater emphasis should be placed on efficient subsidy targeting, expenditure rationalization, and improved tax revenue mobilization. Maintaining adequate foreign-exchange reserves, controlling inflation, encouraging stable foreign investment, and ensuring fiscal discipline can further strengthen India's resilience against exchange-rate fluctuations.

FUTURE SCOPE

Future research may extend the study by examining the long-term relationship between rupee depreciation and India's fiscal deficit using comprehensive time-series data and advanced econometric techniques. Researchers may employ ARDL, VAR, cointegration, and causality models to assess short- and long-run effects of exchange-rate movements on fiscal indicators. Comparative studies involving other emerging economies may provide broader insights into exchange-rate and fiscal interactions. Future studies can also investigate the role of crude oil prices, inflation, external debt, foreign capital flows, trade balance, and monetary policy. Sector-specific analysis may further identify industries most vulnerable to rupee depreciation and its fiscal consequences.

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