

## **INR depreciation and its impact on inflation**

INR has depreciated sharply in the last few days, crossing several key psychological levels. It closed at 90.19/\$ on 3 Dec 2025, touching a record historic low. There was a recovery subsequently on 4<sup>th</sup>. There have been several reasons contributing to this fall including strong demand from importers, slowdown in foreign inflows, high trade deficit and uncertainty over US trade deal. INR's depreciation has led to a lot of talk about the likely impact on the economy. Particularly, market participants remain wary of the impact of depreciation on inflation. Our analysis shows that a 5% depreciation in INR is likely to push up inflation by ~15-25bps on an annualized basis, with gold, edible oils and pulses likely to see the major impact.

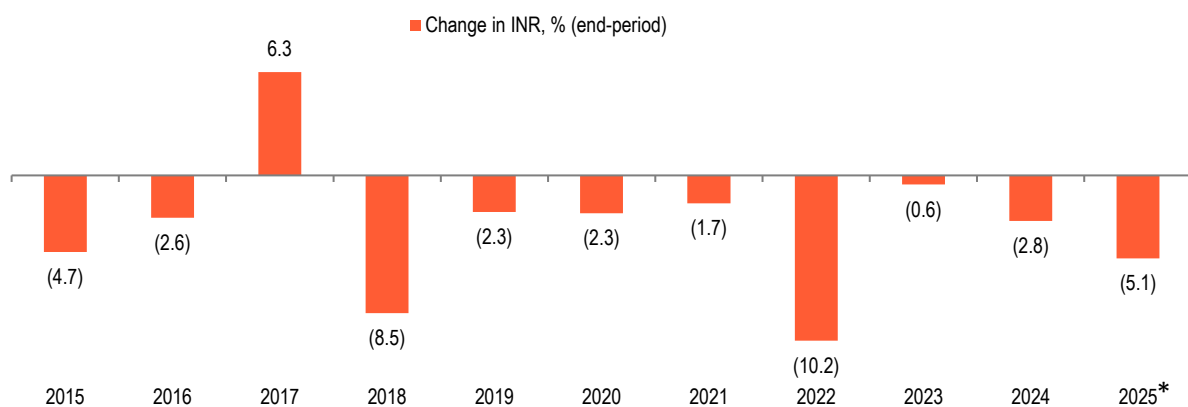
### **Movement in INR over the years:**

The depreciation seen in INR in recent days is not unusual as there has been a tendency for the currency to depreciate historically as well. This is not a unique phenomenon for India only, as exchange rate movements of a majority of developing countries also shows a similar trend. This is due to several factors including high inflation, large trade deficits, limited foreign flows and vulnerabilities to external shocks including financial system and commodity price risks.

Between 2010-2024 (calendar year), on a point-to-point basis, INR has depreciated 13 times, losing about 48% of its value. Even narrowing the range to the last 10 years (Fig 1), there is only a single year i.e 2017, in which the currency appreciated. The average depreciation in INR in the period is 2.9%. However, in 7 out of the 10 years, the actual depreciation was lower than the average. In fact, barring 2018 and 2022, the movement in the exchange rate has largely been within the long-term average trend. Even last year, the currency depreciated by just 2.8%. This was notwithstanding a 7% increase in the value of the dollar.

This year the situation is quite different. INR has depreciated by over 5% since 31 Dec 2024, even as the dollar has weakened. In fact, the DXY index has declined by ~9% since the start of the year.

**Fig 1: Currency depreciation over the years**

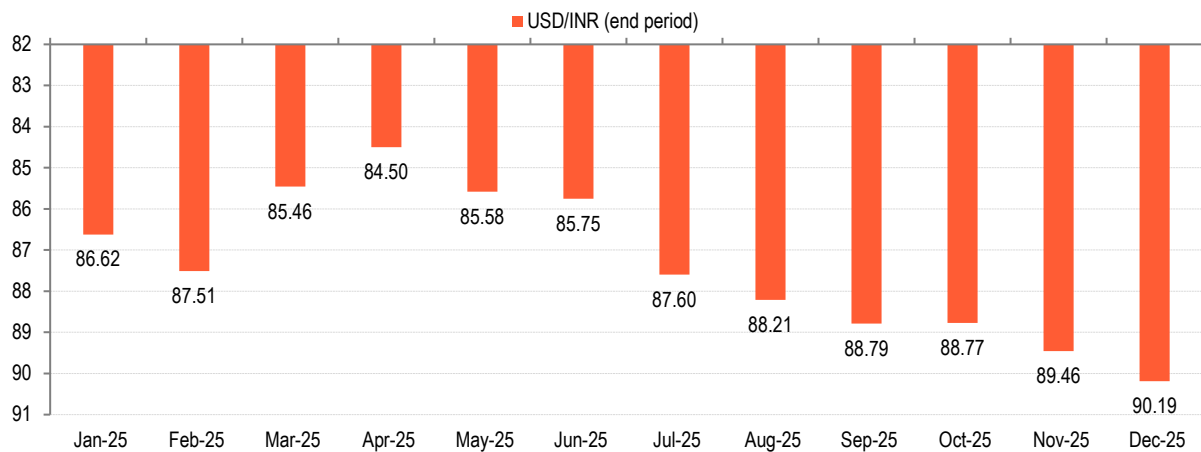


Source: Bloomberg, Bank of Baroda Research | Note: \*Data upto 3 Dec 2025

The recent episode of INR depreciation can be attributed to a few factors including, strong dollar demand from importers, lack of substantive foreign inflows, growing concerns over trade deficit as

well as lack of clarity on the India-US trade agreement. Fig 2 shows the movement in INR this year. The currency started the year at ~86/\$ level and fell to 87.51/\$ in Feb'25. Thereafter there was a period of consolidation in Mar-Apr'25, followed by stability in May and Jun'25. With the threat of higher US tariffs, the currency dipped by close to 3% in the span of two months to ~88-88.75/\$ levels. However, towards the end of Nov'25, the calm in the currency space was reversed with INR depreciating rapidly and touching a new record low in each of the last few successive sessions.

**Fig 2: INR movement this year**



Source: Bloomberg, Bank of Baroda Research | Note: For Dec'25 data is upto 3 Dec 2025

### Exchange rate and inflation:

Given the sharp decline in exchange rate, concerns have once again resurfaced over its impact on the economy. An important channel through which currency depreciation can impact a country is through imported inflation. India is a net importer. This means that the country has a high dependence on imports which can be either in the form of intermediate inputs or finished goods for consumption. Currency depreciation pushes up the cost of imports. This eventually also feeds into domestic inflation as imported goods become more expensive. In the present context, these concerns have reemerged. Inflation in India has been on a downward trajectory in the last few months; hence it is important to assess if the current episode could potentially derail this movement.

The CPI basket in India is heavily skewed in the favour of food products which account for ~46% of the index. Due to India's advantage as a major producer of agricultural products with near 100% self-sufficiency in several crops, import dependency in case of food products is very low. More specifically, within the food category India is majorly importing some pulses and edible oils. The combined weight of these products in the CPI basket is ~6%, which is where the impact of the currency depreciation is likely to be felt.

However, within these categories as well, there are only specific products which are imported. For example, within edible oils, India majorly imports palm oil and sunflower oil, which has a weight of only 1.3% in the CPI basket. At the aggregate level about 60% of the total edible oil requirement is imported. For pulses as well, tur, urad, masur and yellow peas are majorly imported. These account for around 1.4% of the CPI basket, within which only about 30% imported. Taking this into account and assuming a one-to-one pass through, the impact of a 5% decline in INR on inflation in this category would be less ~5-10bps.

Further, while INR depreciation would have a direct impact on the cost of oil imports, it is not likely to impact the retail prices which are being regulated by the OMCs. Hence, the inflation in this category is likely to remain unperturbed by the movement in the currency.

On the other hand, another import item which has a weight of over 1% in the CPI basket is likely to get impacted. Gold, with a weight of ~1.1% in CPI is likely to see a complete pass through to retail prices. We estimate inflation in this category to increase by ~10-15bps if INR depreciates by 5%.

Other categories of CPI are unlikely to see a major impact due to currency depreciation as the import dependence is either low or can be absorbed by producers.

*Hence, overall, we estimate that a 5% depreciation in INR could push up inflation by ~15-25bps, ceteris paribus.*

**Conclusion:**

The recent bout of weakness in INR raises concerns over the impact on the domestic economy. An important channel for a possible spillover of currency depreciation to the domestic economy is through inflation. This is because due to the rise in globalization, domestic consumption basket has become more diversified and includes some goods which are imported. Depreciation of the currency raises the price of these goods, thereby contributing to higher inflation.

Our analysis shows that since India has a low dependence on imports for food products, the impact of INR depreciation on domestic inflation is likely to be muted. The major impact will be felt on the miscellaneous category, which includes gold, which is largely imported.

Hence, we believe that INR depreciation is unlikely to have a significant bearing on CPI inflation and will not change overall outlook.

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