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GS Paper III: Economics

1. Depreciation of the Indian Rupee: Causes and Economic Impact

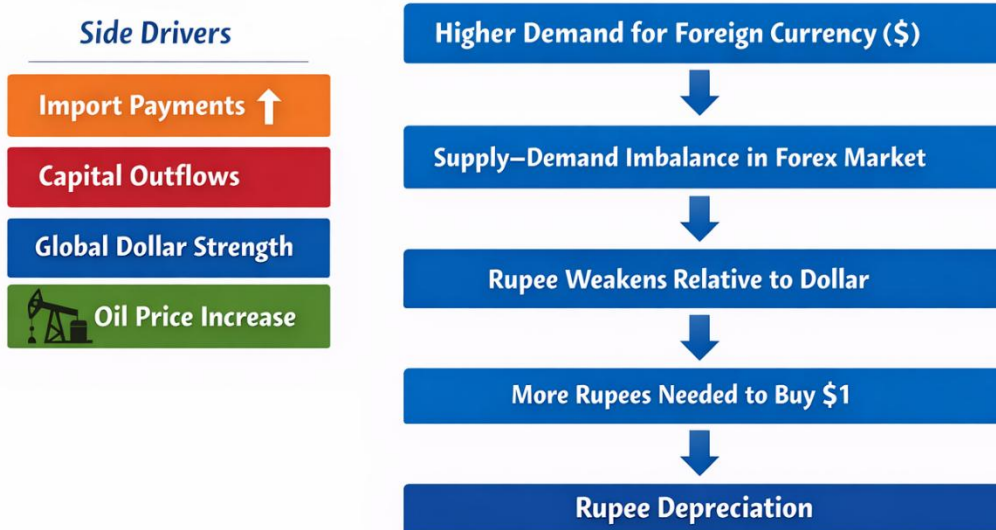
a. Introduction

The exchange rate of a currency reflects the relative strength of a country's economy within the global financial system. Movements in exchange rates influence trade flows, capital movements, inflation and overall macroeconomic stability. In the Indian context, fluctuations in the value of the rupee against major global currencies—particularly the United States dollar—are closely monitored by policymakers and financial markets.

Currency depreciation refers to a decline in the value of a currency relative to another currency in a flexible or market-determined exchange rate system. For example, if one United States dollar earlier exchanged for eighty-five rupees but later requires ninety-two rupees, the rupee is said to have depreciated. In such a situation, more domestic currency is required to purchase the same amount of foreign currency.

Depreciation usually occurs due to a combination of global economic conditions, trade patterns, capital flows and domestic macroeconomic factors.

How Currency Depreciation Happens in a Market-Determined Exchange Rate System



b. Major Causes of Rupee Depreciation

Several structural and cyclical factors contribute to the weakening of the Indian rupee.

i. High Import Dependence

- One of the most significant structural reasons for rupee depreciation is India's heavy dependence on imports for several essential commodities.
- Many imports—particularly energy resources and high-technology goods—are priced in United States dollars, increasing demand for foreign currency.
- Key imported commodities include crude oil, electronic goods, fertilisers and industrial machinery.

- Crude oil is especially important because India imports around 80–85 percent of its total oil requirement.

As import demand rises, Indian importers need larger quantities of dollars to pay for these goods, increasing demand for foreign currency and putting downward pressure on the rupee.

ii. Rise in Global Oil Prices

- Global oil prices strongly influence India's external balance.
- Oil imports constitute a major component of the country's import bill.
- When international oil prices rise, the total value of imports increases significantly.
- Higher oil prices require India to spend more dollars to meet its energy needs.

This increased demand for dollars weakens the rupee and can simultaneously raise inflation and affect fiscal balances.

iii. Capital Outflows

- Capital flows from foreign investors significantly affect exchange rate movements.
- Foreign Institutional Investors (FIIs) and Foreign Portfolio Investors (FPIs) invest large amounts of capital in Indian financial markets.
- During periods of global uncertainty, rising interest rates abroad or changing risk perceptions, investors may withdraw their funds.
- Before repatriating capital, they convert rupees into dollars.

This process increases demand for dollars in the foreign exchange market, leading to rupee depreciation.

iv. Strengthening of the United States Dollar

- The United States dollar is the dominant global reserve currency and is widely used in international trade and finance.
- When the US economy performs strongly or when the US Federal Reserve raises interest rates, investors shift toward dollar-denominated assets.
- This capital movement strengthens the dollar relative to other currencies.

Even when domestic economic conditions remain stable, the rupee may weaken due to global appreciation of the dollar.

c. Impact of Rupee Depreciation on the Economy

Currency depreciation produces multiple economic effects because it influences imports, exports, corporate finance and financial markets.

i. Impact on Imports and Inflation

- When the rupee depreciates, imported goods become more expensive because more rupees are needed to purchase foreign currency.
- Commodities such as crude oil, electronics, fertilisers and industrial machinery become costlier.
- Higher import prices raise production and transportation costs across the economy.
- Businesses often pass these higher costs to consumers.

This process leads to imported inflation, where rising prices originate from higher costs of imported goods and inputs.

ii. Impact on the Current Account Deficit

- The Current Account Deficit (CAD) represents the difference between a country's foreign exchange earnings and payments.
- Currency depreciation initially increases the cost of imports, raising the import bill.

- If exports do not increase sufficiently, the CAD may widen in the short term.
- Over time, however, depreciation can improve export competitiveness and potentially reduce the deficit.

iii. Impact on Export Sectors

- A weaker currency often benefits export-oriented industries.
- Exporters usually earn revenue in foreign currencies such as dollars or euros.
- When the rupee depreciates, these foreign currency earnings convert into a larger amount of rupees.
- This improves profit margins and price competitiveness in international markets.

Several Indian sectors benefit from this effect:

- Information Technology services
- Pharmaceutical exports
- Specialty chemicals and manufacturing exports

These industries incur most of their costs in rupees but earn revenues in foreign currencies.

iv. Impact on Companies with Foreign Currency Debt

- Some Indian firms borrow funds in foreign currencies because interest rates abroad may be lower.
- However, such borrowing exposes firms to exchange rate risk.
- When the rupee depreciates, the amount of rupees required to repay foreign loans increases.
- This raises the burden of debt servicing.

Sharp depreciation can therefore weaken corporate balance sheets and increase financial vulnerability.

v. Impact on Financial Markets

- Foreign investors measure returns in terms of their home currency.
- If the rupee depreciates, the value of their returns declines when converted into dollars.
- This can discourage foreign portfolio investment and trigger capital outflows.
- Such outflows may increase volatility in stock markets and place additional pressure on the rupee.

vi. Impact on Monetary Policy

- The Reserve Bank of India (RBI) must manage the macroeconomic consequences of currency depreciation.
- A weaker rupee can increase inflation through higher import prices, especially in energy and food sectors.
- Excessive exchange rate volatility may also undermine investor confidence.

To manage these risks, the RBI may:

- intervene in foreign exchange markets using reserves
- adjust interest rates
- implement measures to stabilise capital flows.

d. Sectoral Impact of Rupee Depreciation

The impact of depreciation differs across sectors depending on their dependence on imports or exports.

i. Sectors Adversely Affected

- Industries heavily dependent on imported inputs face rising production costs.
- Aviation companies experience higher fuel expenses due to rising aviation turbine fuel prices.
- Logistics and transportation sectors face increased operating costs.
- Chemical, paint and energy-intensive manufacturing industries may also face higher input prices.

ii. Sectors Benefiting from Depreciation

- Export-oriented sectors gain from improved global competitiveness.
- Information technology services firms earn most revenues in foreign currencies.
- Pharmaceutical exporters benefit from large international markets.
- Chemical exporters and specialised manufacturing industries also gain from improved price competitiveness.

e. Long-Term Macroeconomic Implications

Exchange rate movements have broader implications for the overall economy.

- Depreciation affects trade balances, inflation, investment flows and corporate profitability.
- Moderate and gradual depreciation can enhance export competitiveness and support economic growth.
- However, sharp or persistent depreciation may increase inflation, widen external imbalances and reduce investor confidence.

Therefore, maintaining exchange rate stability remains an important objective of macroeconomic management.

f. Way Forward

Reducing vulnerability to exchange rate fluctuations requires a combination of structural reforms and prudent macroeconomic policies.

i. Reducing Import Dependence

- Expanding renewable energy and domestic energy production can reduce reliance on crude oil imports.

ii. Strengthening Export Capacity

- Promoting manufacturing and export diversification can improve the trade balance.

iii. Maintaining Adequate Foreign Exchange Reserves

- Large reserves allow the RBI to manage temporary exchange rate volatility.

iv. Sustaining Investor Confidence

- Stable macroeconomic policies and structural reforms can maintain strong foreign investment flows.

Together, these measures can strengthen external sector resilience and support long-term currency stability.

Conclusion

Rupee depreciation is influenced by a combination of global financial conditions, capital flows, trade patterns and domestic economic factors. While a weaker currency can improve export competitiveness and support certain sectors, it also raises import costs, contributes to inflation and can create external sector pressures. Effective macroeconomic management, diversified exports and reduced import dependence are therefore essential for maintaining exchange rate stability and safeguarding India's long-term economic growth.

GS Paper III: Economics

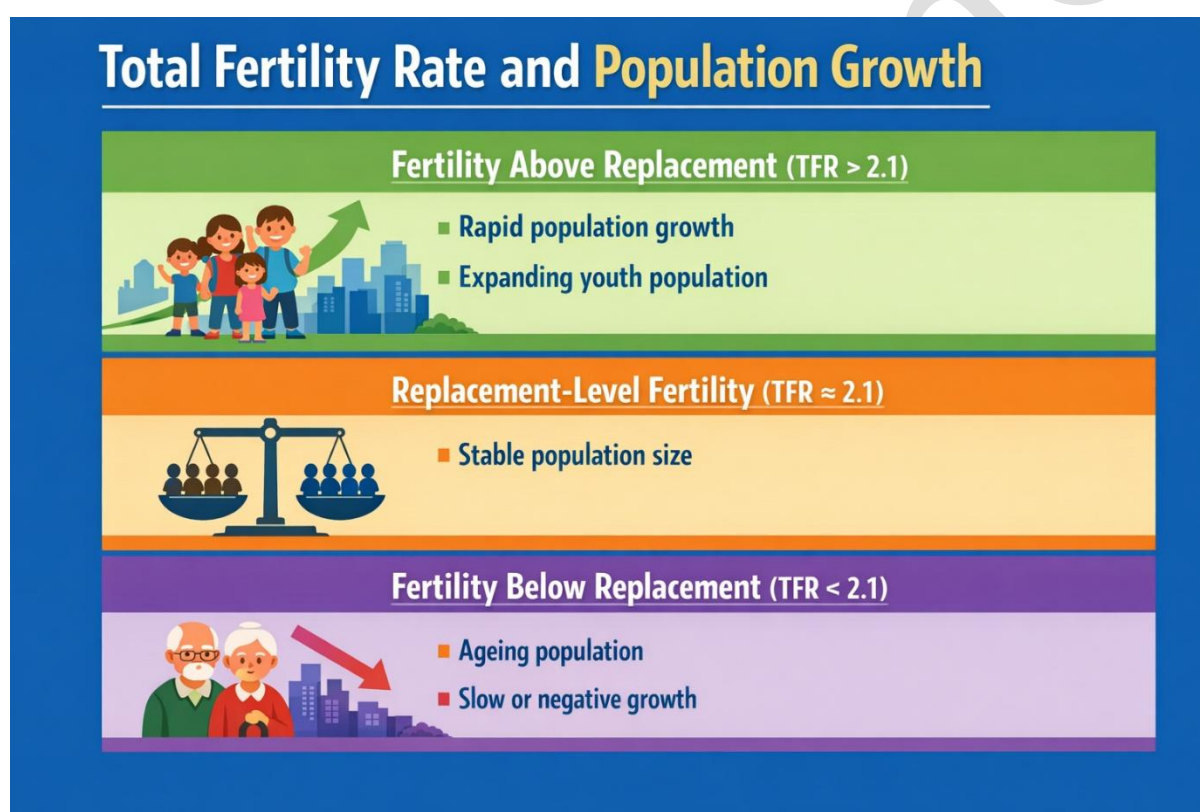
2. India's Fertility Transition: The Quiet Demographic Revolution

a. Introduction: From Population Explosion to Population Stabilisation

For much of the twentieth century, debates on India's development were dominated by concerns about rapid population growth. Policymakers feared that the population would grow faster than the economy's capacity to provide food, employment, housing and public services. Consequently, population growth was often viewed as a major constraint on economic development.

Over the last three decades, however, India has undergone a significant demographic transformation. The country has gradually moved from a high-fertility society to one characterised by low fertility. This shift has occurred quietly across most regions and is therefore often described as a "quiet demographic revolution."

The most visible indicator of this transformation is the steady decline in the Total Fertility Rate (TFR) across India.



b. Understanding Total Fertility Rate

The Total Fertility Rate (TFR) refers to the average number of children a woman is expected to have during her reproductive years, assuming that current fertility patterns remain unchanged.

It is one of the most important indicators used to understand long-term population trends.

i. Fertility Above Replacement Level

- When TFR is above 2.1 children per woman, the population tends to grow rapidly.
- This happens because each generation becomes larger than the previous one.

ii. Replacement-Level Fertility

- A TFR of 2.1 represents replacement-level fertility.
- At this level, each generation replaces itself without significantly increasing the total population.

iii. Fertility Below Replacement Level

- When TFR falls below 2.1, population growth slows down.
- Over time, the age structure of society begins to shift toward an older population.

c. India's Fertility Decline

India's fertility transition has been remarkably rapid compared with many other large countries.

- In the early 1990s, India's TFR was around four children per woman.
- Over the next three decades, fertility levels declined steadily across regions and social groups.
- According to the National Family Health Survey (2019–21), India's TFR has fallen to around two children per woman, slightly below replacement level.

This decline reflects a major shift in family preferences and social behaviour.

Most Indian families now prefer two or fewer children, indicating changing attitudes toward education, economic aspirations and family planning.

d. Regional Patterns of Fertility in India

In earlier decades, fertility levels varied significantly across different parts of India.

i. Early Fertility Decline in Southern States

- States such as Kerala and Tamil Nadu experienced fertility decline earlier.
- These states reached replacement-level fertility relatively quickly.

ii. Slower Transition in Northern and Central States

- States such as Uttar Pradesh and Rajasthan maintained higher fertility levels for longer periods.
- Some states in the northeastern region also recorded relatively high fertility rates.

iii. Gradual Convergence Across States

- Over time, regional differences have narrowed significantly.
- Most states today have fertility levels close to or below replacement level.

This convergence reflects the spread of education, healthcare services, urbanisation and smaller family norms across the country.

e. Major Factors Behind Fertility Decline

India's fertility decline is the result of multiple structural changes that have influenced family behaviour and reproductive choices.

i. Expansion of Female Education

- Rising female education has played a central role in reducing fertility.
- Education tends to delay the age of marriage and increase awareness of reproductive health and family planning.
- It also improves women's participation in the workforce and strengthens their decision-making power within households.

As women pursue education and careers, the opportunity cost of having many children increases, encouraging smaller family sizes.

ii. Urbanisation and Changing Social Norms

- Urbanisation has transformed family structures and lifestyles.
- Urban households face higher living costs, limited housing space and different social expectations.
- Exposure to media, modern lifestyles and social networks promotes smaller family norms.

Migration and urban interaction have accelerated the spread of these ideas across regions.

iii. Declining Child Mortality

- Improvements in healthcare, vaccination and nutrition have significantly reduced infant and child mortality.
- In earlier periods, families often had more children as a precaution, because not all children were expected to survive.

This behaviour is known as precautionary fertility.

With improved child survival rates, families feel less need to have large numbers of children.

iv. Rising Cost of Raising Children

- Economic transformation has changed the economic role of children within families.
- In traditional agrarian economies, children contributed to household labour and farm work.
- In modern economies, raising children requires substantial investment in education, healthcare and skill development.

Parents increasingly prefer fewer children but invest more resources in each child's development.

f. Demographic Dividend: A Major Opportunity

Declining fertility leads to important changes in the age structure of the population.

- As fertility falls, the proportion of people in the working-age group (15–64 years) increases relative to dependents such as children and the elderly.
- This creates the potential for a demographic dividend.

A demographic dividend can contribute to economic growth through:

- Higher labour supply
- Increased productivity
- Greater savings and investment

However, the demographic dividend is not automatic.

Its benefits depend on:

- employment opportunities
- skill development
- labour-intensive industrial growth.

Without sufficient job creation, a growing workforce may instead face unemployment or underemployment.

g. Emerging Challenge of Population Ageing

Over time, low fertility and rising life expectancy lead to population ageing.

- The proportion of elderly individuals gradually increases.
- Several Indian states have already entered this stage of demographic transition.

States such as Kerala, Tamil Nadu, Karnataka and Maharashtra are witnessing a growing elderly population.

Population ageing creates new policy challenges, including:

- sustainable pension systems
- expanded healthcare for older persons
- long-term care infrastructure

h. Regional Demographic Differences and Migration

India's demographic transition is occurring at different speeds across states.

- Southern and western states are moving faster toward ageing populations.
- Northern and central states still have relatively younger populations.

These differences are likely to encourage internal migration.

Younger workers from states with higher fertility levels may migrate to economically advanced and ageing regions in search of employment.

Such migration can:

- reshape labour markets
- accelerate urbanisation
- influence regional economic development.

i. Changing Policy Priorities

India's population policy priorities have evolved significantly over time.

i. Earlier Policy Focus

- In earlier decades, policies focused on population control and family planning to reduce population growth.

ii. Emerging Policy Priorities

- Today, with fertility near or below replacement level, policy priorities must shift.

Key areas of focus include:

- employment generation
- skill development
- human capital formation
- strengthening social security systems
- preparing healthcare systems for ageing populations

Urban infrastructure must also expand to manage increasing migration and urbanisation.

Conclusion

India's fertility transition represents one of the most important demographic transformations in its modern history. The country has moved from fears of a population explosion to the reality of a stabilising population.

This transition offers India a valuable demographic dividend, providing an opportunity for accelerated economic growth. At the same time, it introduces new challenges related to population ageing, migration and social welfare. The extent to which India benefits from this demographic shift will

depend on its ability to generate employment, strengthen human capital and build inclusive social protection systems.

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- data recall
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- objective pattern analysis

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