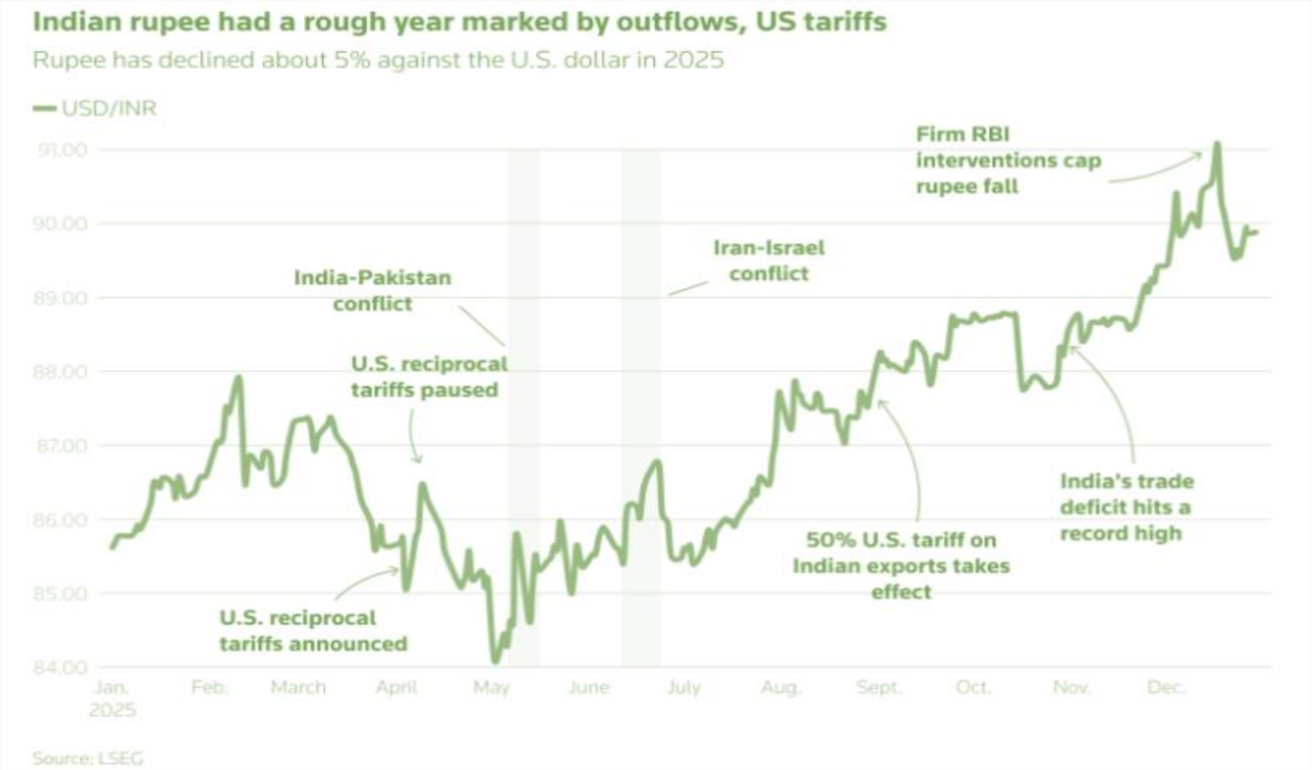
The Indian Rupee Is Depreciating Against the US Dollar - but What Does It Mean for Nepal?

The resurgence of tariff-driven trade policy under the renewed President Donald Trump's "America First" agenda has once again altered global trade and currency dynamics. In August 2025, the United States imposed a 25 percent reciprocal tariff on selected Indian exports. Within days, an additional 25 percent tariff was announced on certain product categories, with limited exemptions, effectively raising the tariff's burden to as high as 50 percent, citing reason as India's continued purchase of Russian oil and its sizable trade surplus with the United States. While these actions were framed as bilateral trade corrections, their impact extended beyond trade flows, feeding into currency markets and capital movements.

After a relatively stable period of two to three years, the Indian Rupee came under renewed pressure in 2025. From May onward, the currency entered a sustained depreciating trend, reflecting a combination of trade uncertainty, reduced export competitiveness in the US market (because of tariffs), and capital outflows. Pressure intensified toward the end of the year, with the rupee breaching the INR 90 per USD level multiple times in December. On December 16, 2025, it touched INR 91 per USD, before closing the year at INR 89.8—an annual depreciation of 4.72 percent and its weakest performance since 2022. Over a twelve-month period, the depreciation approached around 6 percent on high.

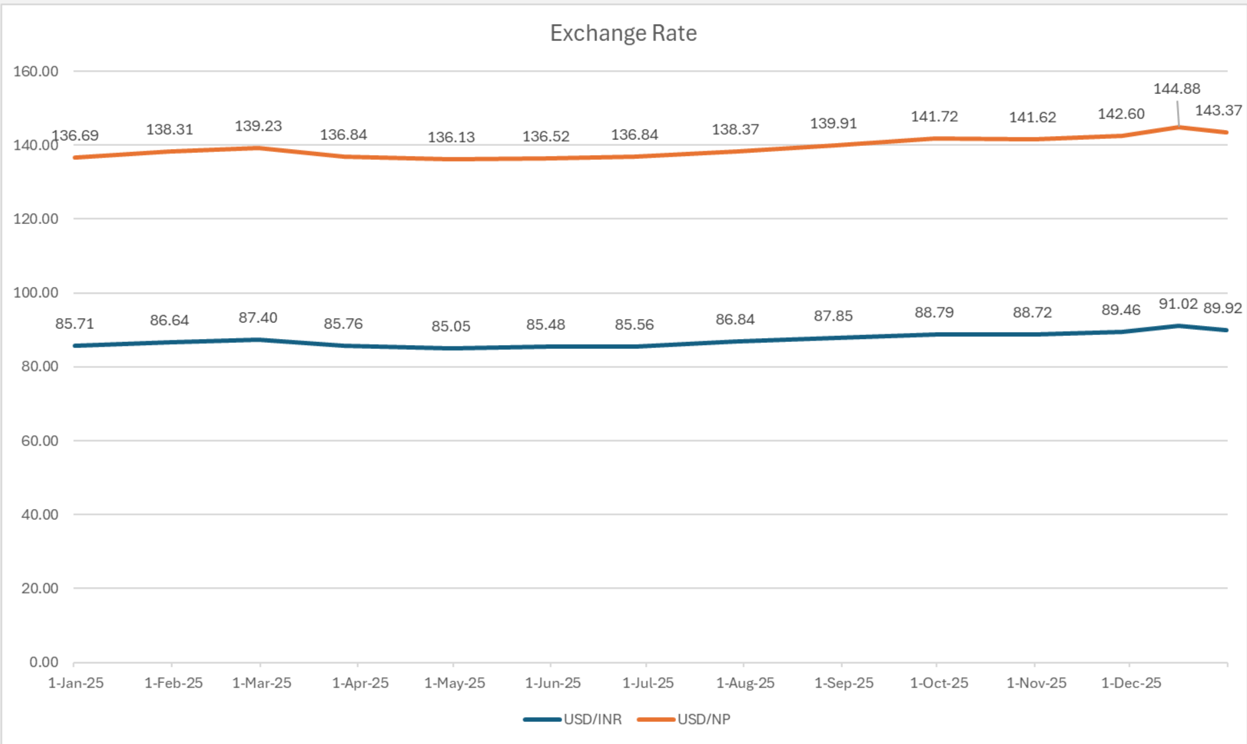


Source: Reuters

But why does it matter most for Nepal? While such movements are often analyzed primarily through

India's domestic macroeconomic conditions, their significance is magnified in Nepal due to the structure of its exchange-rate regime. The Nepali Rupee is pegged to the Indian Rupee, and Nepal does not maintain an independent exchange rate vis-à-vis the US dollar. As a result, any appreciation or depreciation of the INR against the USD is automatically transmitted to the NPR, regardless of Nepal's own economic fundamentals. In practical terms, Nepal does not choose its dollar exchange rate; it inherits it. When the Indian Rupee weakens against the US dollar, the Nepali Rupee weakens automatically, even if nothing has changed inside Nepal's domestic economy. Nepal is therefore best understood as a passenger, not a driver, in the exchange-rate system.

This arrangement has been in place since 1993, with the NPR currently fixed at 1.6 per INR. While India operates under a managed floating exchange-rate regime, Nepal effectively imports India's currency movements against the dollar. The indirect linkage between the NPR and the USD is therefore structural rather than incidental. Exchange-rate data illustrate this clearly: as the dollar appreciated against the INR during 2025, it also appreciated against the NPR in near lockstep, confirming Nepal's passive exposure to external currency shocks originating outside its borders.



Sources: NRB and RBB

A weakening currency, however, is not inherently harmful. In export-oriented economies with huge manufacturing bases and flexible supply capacity (e.g. China), depreciation can improve competitiveness and stimulate export growth. Even in countries with trade deficits, export-focused sectors may benefit as firms earn more domestic currency for each dollar of foreign revenue. In Nepal, this effect is visible in narrow segments such as IT services and freelance exports, where earnings are largely dollar denominated. For these sectors, depreciation increases rupee income for the same volume of foreign contracts. Whether depreciation ultimately benefits or harms an economy, however, cannot be assessed by exchange-rate movements alone. What matters is how an economy trades, how much it trades, and with whom it trades. This leads to a broader analysis of Nepal’s trade dynamics.

Nepal’s trade structure fundamentally limits its ability to benefit from currency depreciation. The economy is predominantly import-based (i.e. How do we trade?); a reality clearly reflected in its long-term trade patterns. Over the past five decades, Nepal’s trade deficit has widened persistently. While the deficit accounted for roughly 25 percent of total trade around 50 years ago, it has now expanded to around 70–80 percent, underscoring Nepal’s growing dependence on foreign goods. In simple terms, Nepal consistently buys far more from the rest of the world than it sells. This imbalance is not confined to merchandise trade alone. Nepal also runs a persistent deficit in the services account, driven by payments for education, transport, insurance, health, and financial services that exceed earnings from tourism and other service exports. In FY 2081/82 (2024/25), the services deficit stood at NPR 90.04 billion, while the merchandise trade deficit reached NPR 1,527.09 billion, highlighting the scale and persistence of Nepal’s external imbalance. Because international trade in goods and services is predominantly invoiced and settled in foreign currencies, especially the US dollar, these deficits translate directly into recurring demand for foreign exchange.

Measured relative to the size of the economy (i.e. How much we trade?), the imbalance becomes even more pronounced. According to Nepal Rastra Bank, total international trade in FY 2081/82 amounted to about 34.1 percent of GDP. Exports accounted for only 4.5 percent of GDP, while imports reached around 29.5 percent, resulting in a trade deficit close to 25 percent of GDP. In effect, for every NPR 100 of domestic value added generated, Nepal earned only NPR 4.5 from exports but required imports worth almost NPR 29.5. The gap must therefore be financed through non-trade inflows (such as remittances, capital inflows, and external borrowing) rather than export earnings. The imbalance was even more severe in FY 2075/76 (2018/19), when the trade deficit reached approximately 38.31 percent of GDP.

Nepal’s external vulnerability is further reinforced by extreme concentration in its trading partners (i.e. With whom we trade?). On the import side, approximately 86.6 percent of total imports originate from just five countries, with India accounting for nearly 60 percent and China about 18 percent. On the export side, more than 81 percent of Nepal’s exports are destined for India. Other major destinations—such as the United States (6.6 percent), Germany (1.6 percent), the United Kingdom (1.1 percent), the UAE (1.0 percent), and China (0.95 percent)—collectively account for most of the remaining exports, with these six markets together covering around 92.5 percent of Nepal’s total export value. Such geographic concentration limits diversification and reduces resilience to external shocks. Over the past three years, exports have accounted for only around 10.3 percent of total trade on average, indicating limited production depth and insufficient capacity to scale up exports in response to currency depreciation. Moreover, the dominance of India as Nepal’s primary export destination further weakens the depreciation channel. A large share of exports to India is invoiced and settled in Indian Rupees under the fixed peg, significantly further limiting any gain from depreciation against the US dollar. The composition of trade compounds this constraint. Nearly 48 percent of Nepal’s exports to India consist of refined soybean oil, where raw materials are imported and invoiced in US dollars while exports are settled in Indian Rupees. Although this trade benefits from tariff concessions under SAFTA, it exposes Nepal to significant currency mismatch and exchange-rate risk. On the import side, petroleum products, Nepal's single largest import category are sourced almost entirely from India but priced in line with global crude oil markets denominated in US dollars. As a result, when the INR weakens against the USD, Nepal's import bill rises sharply without a compensating increase in export earnings, transmitting inflationary pressure into the domestic economy.

These outcomes can be explained through the elasticity framework, although its application in small, pegged import-dependent economies is inherently constrained. Nepal's export elasticity is low due to limited diversification and supply constraints, while import elasticity is also low because imports consist largely of essential goods whose demand is relatively insensitive to price changes. When the sum of export and import elasticities is less than one, currency depreciation raises the domestic cost of imports without improving the trade balance. Under Nepal's fixed exchange-rate regime, this constraint becomes binding: depreciation amplifies costs rather than facilitating external adjustment.

The costs of depreciation extend beyond trade into Nepal's external debt structure. As of mid-December 2025, Nepal's outstanding external debt stood at approximately NPR 1.49 trillion, with over 92 percent effectively linked to the US dollar, either directly or through SDR denomination. Although only about one-fifth of the debt is explicitly denominated in USD, nearly three-quarters are denominated in SDRs, whose value is heavily influenced by movements in the dollar. On the creditor side, multilateral institutions account for more than 90 percent of Nepal's external debt, with the International Development Association (IDA) alone comprising nearly half, followed by the Asian Development Bank (ADB) and the International Monetary Fund (IMF). Although these loans are largely concessional, they nonetheless expose Nepal to foreign-currency repayment obligations. As a result, depreciation automatically increases the NPR value of outstanding debt and debt-servicing obligations, even without any new borrowing. The magnitude of this effect is not merely theoretical. Between mid-July to mid-November, and by mid-December 2025, exchange-rate movements alone added approximately NPR 44.22 billion and NPR 77.67 billion respectively to Nepal's public debt burden, intensifying fiscal pressure and foreign-exchange demand simultaneously.

Thanks to remittances, Nepal still bridges a significant portion of its trade and services deficits. With a narrow export base and weak net travel earnings, remittances averaging around 25–26 percent of GDP, continue to be Nepal's largest source of foreign currency. While depreciation does not increase remittance inflows in dollar terms, it raises their rupee conversion value, easing near-term balance-of-payments pressure and providing temporary liquidity support. However, this gain is largely arithmetical rather than real. Most remittance income is spent on import-intensive consumption, meaning higher NPR receipts are quickly offset by imported inflation. Moreover, remittances are not highly responsive to exchange rate movements; their volume depends primarily on overseas employment conditions, wage growth, migration policies, and global economic stability.

Underlying these dynamics are India's own dollar flows. In FY 2024, India recorded a trade surplus of roughly USD 45 billion with the United States when goods and services are combined. At the same time, around 86 percent of India's total trade is invoiced in US dollars, even though the US accounts for only 9–11 percent of India's total trade. This invoicing structure makes India's foreign exchange market highly sensitive to developments affecting dollar inflows and outflows. Tariffs on Indian exports weaken dollar earnings, while capital outflows—for example, foreign institutional investors sold around USD 18 billion of Indian equities in 2025—along with rising gold imports and overseas education payments, sustain strong dollar demand. Together, these forces exert downward pressure on the Indian Rupee, an outcome that Nepal inherits mechanically through the exchange-rate peg.

Taken together, the evidence leads to a conclusion. For Nepal, INR depreciation against the US dollar does not function as an adjustment mechanism. Under a fixed exchange-rate regime, low trade elasticities, high import dependence, USD-linked debt, and concentrated trade patterns, depreciation manifests as higher inflation, rising debt burdens, increased foreign-exchange demand, and pressure on reserves. Remittances soften the impact but do not resolve the structural imbalance. Currency depreciation, in Nepal's case, operates not as a tool for competitiveness, but as a transmission channel for external shocks—making it a structural macroeconomic cost rather than a source of economic adjustment.