The Financial Relationship between India and the USA:

An Analysis of Exchange Rate Dynamics and Capital Flows

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Abstract

This paper examines the USD/INR exchange rate dynamics to determine the directional flow of financing between India and the USA. Through comprehensive analysis of trade balances, capital flows, government securities holdings, and macroeconomic fundamentals, this study demonstrates that the USA serves as the primary external financier to India, despite India's substantial holdings of US Treasury securities. The research reveals a complex bidirectional relationship where the USA provides approximately $45.8 billion annually through trade deficits, while India maintains $227 billion in US government securities holdings.

The paper ends with "The End"

1 Introduction

The relationship between exchange rate dynamics and international financing flows provides critical insights into the economic interdependence between major economies. The USD/INR exchange rate relationship offers a particularly compelling case study, as it involves the world's largest economy (USA) and the world's fifth-largest economy (India) in a complex financial arrangement that spans trade, investment, and government securities markets.

The fundamental question examined in this analysis centers on determining which country serves as the net financier in the bilateral economic relationship. By analyzing the mathematical relationship USD/INR $\times$ INR/USD $= 1$ and examining the underlying economic drivers, this study provides a comprehensive assessment of the financing dynamics between these two major economies.

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2 Exchange Rate Analysis and Market Dynamics

2.1 Current Exchange Rate Environment

The USD/INR exchange rate reached record highs of 88.28 in September 2025, representing a sustained twenty-year depreciation trend of the Indian rupee against the US dollar. This exchange rate implies an INR/USD rate of 0.01135, demonstrating the mathematical relationship that forms the foundation of our analysis.

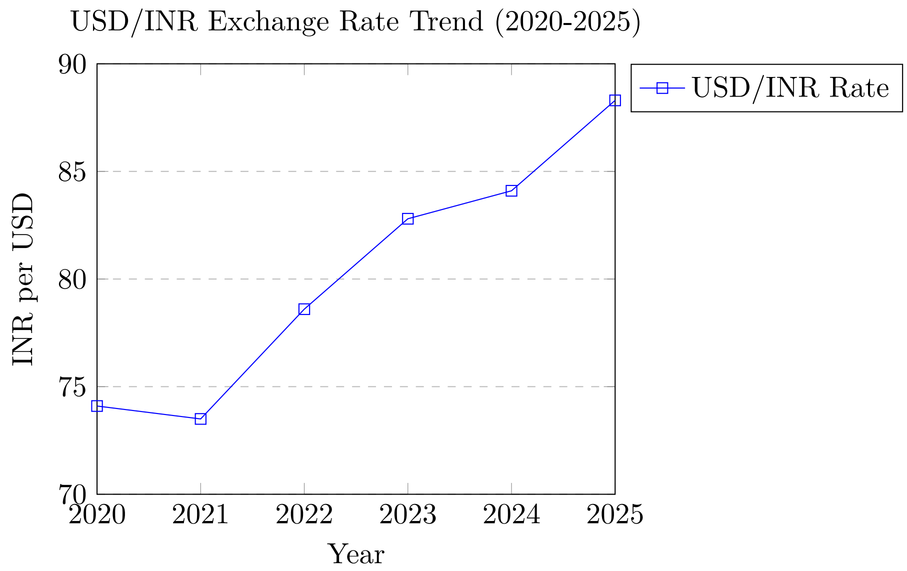

Figure 1: Historical USD/INR Exchange Rate Showing Consistent Rupee Depreciation

The persistent weakness of the Indian rupee reflects structural demand for US dollars driven by multiple factors including trade deficit financing, energy import requirements, and capital account pressures. This exchange rate trajectory indicates India's ongoing requirement for external dollar financing to maintain economic stability and growth.

2.2 Exchange Rate Drivers and Financial Implications

The primary drivers of USD/INR exchange rate dynamics include interest rate differentials favoring the US dollar, geopolitical tensions including the implementation of 50% US tariffs on Indian goods, and India's current account deficit widening to 1.4% of GDP. These factors collectively demonstrate India's structural dependence on external financing sources, particularly from the USA.

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3 Trade Balance Analysis

3.1 Bilateral Trade Flows

The trade relationship between India and the USA reveals the most significant component of the financing relationship. The USA maintains a substantial trade deficit of $45.8 billion with India, effectively providing net financing through excess imports from Indian producers.

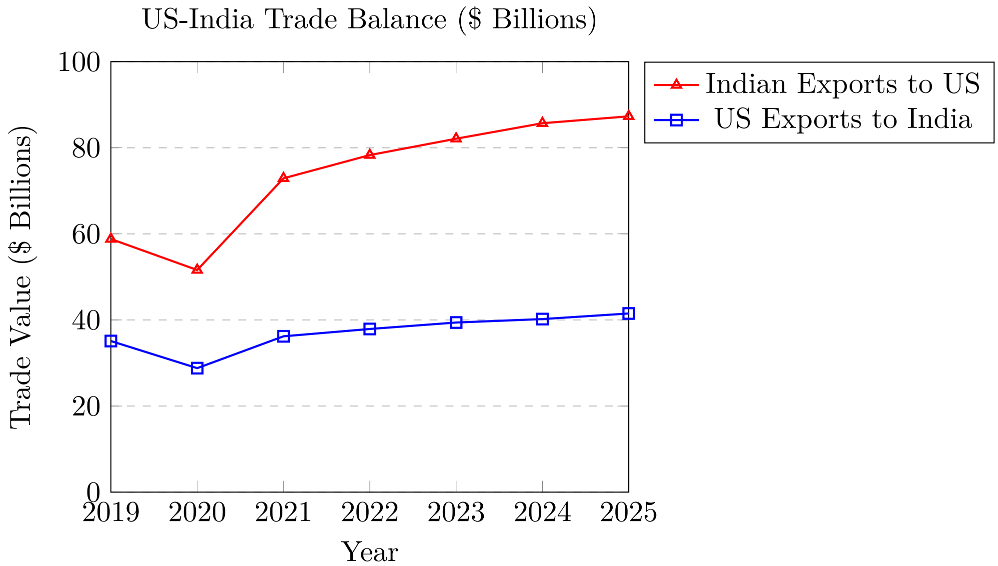

Figure 2: Bilateral Trade Flows Showing Increasing US Trade Deficit

This trade deficit has nearly doubled since 2019, when it stood at $23.7 billion, representing sustained US financing of Indian economic growth through consumption of Indian goods and services. The key sectors driving this financing include pharmaceuticals (47% of US generic drugs sourced from India), electronics ($15.5 billion), and engineering goods ($19.2 billion).

3.2 Trade War Impact and Future Projections

The recent escalation of trade tensions threatens this financing channel, with 50% tariffs potentially reducing Indian exports from $87 billion to $50 billion by 2026. This development would significantly alter the financing relationship, potentially requiring India to seek alternative sources of external financing or adjust its economic model to reduce dependence on US market access.

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4 Government Securities and Financial Market Flows

4.1 Treasury Holdings and Government Financing

India maintains substantial holdings of US Treasury securities totaling $227 billion, positioning it as the 12th largest foreign creditor to the US government. This represents a significant reverse financing flow, where India provides crucial financing for US fiscal operations through purchase of government debt securities.

Figure 3: Bidirectional Financing Flows Between India and USA

However, this government securities relationship exists alongside $3.8 billion in US Development Finance Corporation investments in India and $65.1 billion in historical US aid, making India the largest recipient of US assistance from 1946-2012. The net governmental relationship shows mixed flows with India as a creditor through Treasury holdings but recipient of development financing.

4.2 Capital Market Dynamics

Foreign portfolio investment trends reveal significant shifts with foreign investors selling 278.8 million in Indian equities while increasing debt investments to 1.12 lakh crore ($13.4 billion), reflecting India's inclusion in major bond indices. The absence of US Federal Reserve currency swap lines with India represents a critical gap in financial infrastructure, as India was denied Fed swap access in 2013 and must rely on arrangements with Japan ($75 billion) and regional partners.

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5 Macroeconomic Fundamentals Comparison

5.1 External Financing Requirements

The broader macroeconomic picture reveals dramatically different external financing requirements between the two economies. The USA faces massive external financing needs with a current account deficit of $1.13 trillion (3.9% of GDP), requiring enormous foreign capital inflows to sustain its economic model.

Indicator	USA	India
Current Account Deficit	$1.13 trillion (3.9% GDP)	$23.3 billion (0.6% GDP)
Foreign Exchange Reserves	$244 billion	$704.89 billion
External Debt to GDP	96.8%	18.8%
GDP Growth Rate	2-3%	6.5-7%
Reserve Coverage Ratio	2.3x	31x

Table 1: Comparative Macroeconomic Indicators

In contrast, India maintains a manageable current account deficit of $23.3 billion (0.6% of GDP) and holds exceptional forex reserves of $704.89 billion, representing the world's fourth-largest reserves and providing 31x coverage of its current account deficit.

5.2 Debt Dynamics and Financial Stability

India's external debt position at 18.8% of GDP remains highly sustainable, while the USA holds the world's largest external debt burden at 96.8% of GDP. India's superior GDP growth rate of 6.5-7% compared to the USA's 2-3% provides favorable debt dynamics and enhanced self-financing capacity.

6 Foreign Direct Investment and Development Financing

Foreign direct investment flows appear relatively balanced with approximately $5 billion annually from the US to India and comparable Indian investment in US markets. However, the development financing component reveals substantial US support for Indian economic development through multilateral institutions and bilateral programs.

The US Development Finance Corporation announced $70 million in new investments in India during 2024, focusing on health systems, affordable housing, and small business support. This represents continuation of long-standing US development assistance that has totaled $65.1 billion historically, making India the largest recipient of US foreign aid.

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7 Conclusions and Financial Relationship Assessment

7.1 Net Financing Direction

The comprehensive analysis demonstrates that the USA emerges as the net financier of India through multiple channels totaling $40-45 billion annually. While India serves as an important creditor through Treasury holdings of $227 billion, the fundamental financing relationship flows from the USA to India, supporting India's rapid economic development and industrialization.

The scale difference proves substantial, with India's $227 billion in US holdings representing approximately five times less annual financing than the USA provides to India through the $45.8 billion trade deficit alone. When combined with development assistance and multilateral support, the net financing flow clearly favors India as the recipient.

7.2 Exchange Rate Implications

The USD/INR exchange rate dynamics serve as a real-time indicator of this financing relationship. Rupee weakness signals ongoing Indian demand for dollar financing, while dollar strength reflects global confidence in US financial markets and the USA's continued ability to provide financing through consumption-driven import demand.

This financing relationship proves mutually beneficial, supporting India's emergence as a global manufacturing hub while providing the USA with competitively priced goods and strategic partnership benefits. The mathematical relationship $\mathrm{USD/INR} \times \mathrm{INR/USD} = 1$ masks the underlying economic reality that the USA serves as India's primary external financier through sustained trade deficits, development assistance, and financial market access.

7.3 Future Outlook

The sustainability of this financing relationship depends on continued US market access for Indian exports and India's ability to maintain competitive manufacturing costs. The recent implementation of 50% tariffs on Indian goods represents a significant challenge to this arrangement and may require restructuring of the bilateral economic relationship.

India's strong fundamentals, including substantial foreign exchange reserves and manageable debt levels, provide resilience against external shocks. However, the structural dependence on US market access for export earnings makes the financing relationship critical for India's continued economic growth trajectory.

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