

## **Indian Financial Markets - Resilience amid Global Turbulences - Way Forward<sup>1</sup>**

Good afternoon. Distinguished speakers, esteemed panellists, office bearers of FIMMDA and PDAI, delegates, ladies, and gentlemen. At the outset, I am honoured to be amidst you today at the 23<sup>rd</sup> Annual Conference of FIMMDA jointly organised with the PDAI. It is indeed a great pleasure addressing the thought leaders of the Indian financial markets present here.

2. On a lighter vein, post-lunch sessions are always the most challenging. However, I will ensure that the next 10-15 minutes have a few volatile moments to keep you constructively engaged. After all, traders usually embrace high volatility as their friend! In fact, many of you get disoriented when confronted with a situation of prolonged low volatility.

3. The Indian financial market landscape is at the cusp of a new era of massive transformation. It is undeniable that India has witnessed a period of “great resilience” in the recent years amidst unprecedented global shocks.

4. Since 2020, events that materialised in modern history at infrequent intervals, often measured on a temporal scale of decades, if not centuries, have squeezed themselves into a span of the previous 3 - 4 years. During this period, the world has been buffeted by one crisis after another. It began with a once-in-a-century kind of event - the pandemic. This was followed by a major war in Europe, the first after the second World War. Meanwhile a global inflation shock emerged - the first after 30 - 40 years. As if the world had not had enough, in March 2023, a banking crisis unfolded in the USA. Again in October 2023, much to our consternation, another conflict erupted in the Middle East after decades when Hamas launched the attack on Israel.

5. While the pandemic is a thing of the past, the wars and global inflation together with their consequences still continue. These disparate disruptive events seem to be occurring with regular, and perhaps, even increasing frequency. Therefore, I feel that

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<sup>1</sup> Address delivered by Shri Radha Shyam Ratho, Executive Director, Reserve Bank of India in the 23<sup>rd</sup> FIMMDA - PDAI Annual Conference 2024 held in Barcelona on April 08, 2024. The contributions of Shri Sabyasachi Sarangi, Assistant General Manager are gratefully acknowledged.

a VUCA (Volatility, Uncertainty, Complexity and Ambiguity) world has become the new normal.

6. This VUCA world of the last 3 - 4 years and the possibility of the “new normal” continuing in future, have made it imperative for India to strive for “Atmanirbhar Bharat”. It is my considered view that “Internationalisation of the Indian Rupee” is a *sine qua non* for “Atmanirbhar Bharat”.

7. As we progress along the path of internationalising the Indian Rupee, there are bound to be far reaching changes that would, at least in the short term, bring about more volatility in our financial markets. Therefore, it is not just global events that you all dealers have to contend with going ahead, there will be internal developments also which will cause some volatility, at least in the short run.

8. Many of you would be wondering as to why I have brought in a forex market issue to a conference of fixed income market participants. But then all of you are aware that markets are inter-connected. In fact, they are becoming more and more inter-connected with the passage of time. As internationalisation of the Rupee progresses, there will be higher volume of capital inflows and outflows causing frequent gyrations in the domestic liquidity conditions. These developments will impact money market rates and bond yields. Therefore, all of you need to keenly watch as INR gradually becomes internationalised and, also endeavour to understand and anticipate the changes that it may bring about in money and bond markets.

9. Some of you may have gone through the RBI’s Inter-Departmental Group’s Report on “Internationalisation of the Indian Rupee” that was published on July 05, 2023 on the RBI website. The Inter-Departmental Group comprised of several important department heads and I had the honour of contributing to the deliberations as Chairman. The recommendations of the Report and the roadmap elaborated therein gives you the possible changes that are likely to happen and their impact on the financial markets.

10. The members of the Inter-Departmental Group were unanimous in the view that internationalisation of the Rupee will be a gradual process and not an event *per se*. The formulation, adoption, and implementation of a wide array of policy changes require at least a decade or may be more. However, as we go down the path of

internationalisation, implementation of the 10 short-term recommendations of the Report that may be implemented within two years will unleash a sea change in markets. Therefore, both the bond as well as money market traders should be well-armoured to navigate such transformations.

*Being in the markets, you are well aware of the prospective benefits of internationalisation of the Rupee. Therefore, let me now turn to some concerns expressed in various quarters regarding this.*

### **Firstly, Internationalisation will increase volatility of the Indian Rupee**

11. It is feared that with greater holding of the Indian Rupee overseas and increased capital flows, for example, due to recent inclusion of G-secs in global bond indices, there may be more sudden stops and reversals as well as greater contagion of global shocks. The Inter-Departmental Group has recommended several measures to counter this, viz. (i) develop robust markets for hedging of interest rate and currency risks for non-residents, (ii) develop a liquid onshore INR NDF market (e.g., at GIFT City), (iii) bring back offshore NDF transactions to GIFT City by permitting all transactions that are possible at global forex hubs, and (iv) facilitate round-the-clock customer transactions in onshore markets for spot, derivatives, etc. as are permitted in other global hubs. Besides, we all know that passive flows *via* bond indices are more stable than active flows.

### **Secondly, there will be a decline in forex reserves**

12. It is also argued that higher volatility in the Rupee would require more sell-side intervention resulting in fall in reserves. More trade in local currencies will also lead to accumulation of non-reserve currencies resulting in a fall in hard-currency reserves. However, more trade in local currencies itself would reduce the need for hard currencies. As internationalisation of INR progresses, non-reserve currencies shall be acceptable as they can be used to pay for imports from and repay debts of partner countries or even third-party countries.

### **Thirdly, Monetary policy will become less effective**

13. Another concern is that currency internationalisation may come in conflict with domestic monetary policy as increased holding of the Rupee offshore may adversely impact transmission. However, as highlighted earlier, internationalisation is expected to be a slow process. So the initial holding of Rupee overseas will be a modest amount. Further, dynamic limits can be imposed on provision of Rupee liquidity offshore, say, as percentage of NDTL, M3, value of bilateral trade, etc. This would help in ensuring that the availability of INR liquidity is modulated as per the actual requirement. Moreover, experience gained as the internationalisation process progresses gradually would help in preserving the effectiveness of monetary policy.

### **Fourthly, it is argued that the Local Currency Settlement (LCS) system is beneficial only if India has a Balance of Payment (BoP) deficit with the other country**

14. If India has a surplus, then it is feared that on a net basis, we will accumulate the other country's currency, which is not a hard currency, instead of US Dollar. However, by definition, if India has a BoP deficit, then the other partner country enjoys a BoP surplus with us and therefore will accumulate INR. Hence, it will not be interested in a Local Currency Settlement agreement with us. Besides, what if with the passage of time, India's deficit turns into a surplus.

15. As I have elaborated above, most of the concerns or challenges are largely unfounded. The incremental approach as opposed to a big-bang approach will further ensure that the fears do not materialise. Some examples of the incremental approach are (i) the Local Currency Settlement system will be first for trade transactions, soon thereafter for non-trade transactions and, finally capital account transactions, (ii) INR accounts for non-residents would be first opened by branches/subsidiaries of Indian banks among AD cat 1 banks, then by foreign banks operating as AD cat 1 in India and lastly by foreign banks not having a presence in India. Similar gradual approach would be followed regarding opening up of financial markets, providing INR liquidity outside India, etc.

16. The Inter-Departmental Group felt that it is better that INR internationalisation is a slow and steady process rather than a hasty process that may cause disruptions

resulting in a rollback. I have already elucidated each concern and how to navigate them. With the passage of time, we are getting more confident that Rupee can indeed be an international currency.

17. Most of you would be aware that the Reserve Bank has already signed Memorandum of Understandings (MoUs) involving Local Currency Settlement system with the Central Bank of UAE on July 15, 2023, and the Bank Indonesia on March 7, 2024. In July 2022, even while the Inter-Departmental Group was deliberating on the process, the Reserve Bank enabled opening of Special Rupee Vostro Accounts (SRVA) by overseas banks for settling trade transactions in the Indian Rupee. Surplus balances in SRVA accounts can also be used for select capital account transactions, such as investment in G Secs. Many countries are showing interests in the SRVAs. Significant progress in opening of SRVAs and their usage for settlement of trade transactions in INR have been witnessed recently. We remain focussed in exploring more and more ways of utilising the SRVA balances.

## **Conclusion**

18. More than half a century or precisely six decades ago, Martin Luther King Jr. delivered the iconic “I have a dream” speech. In a completely different context, I also have a dream that one day the Indian Rupee will be internationalised. Needless to say that all of you are expected to contribute towards making the Rupee internationalised.

Thank you. Namaskar.