NIBM WORKING PAPER SERIES

(Policy Research Notes)

INR Internationalization: A Process and Not an Event

Gargi Sanati

Working Paper

(WP32/2023)

NATIONAL INSTITUTE OF BANK MANAGEMENT
Pune, Maharashtra, 411048
INDIA
August 2023

Citation Guideline:

Sanati Gargi (2023), "INR Internationalization: A Process and Not an Event". NIBM Working Paper Series: Policy Research Notes WP32/August.

https://www.nibmindia.org/static/working_paper/NIBM_WP32_GS.pdf

INR Internationalization: A Process and Not an Event
Gargi Sanati
NIBM Working Paper No. 32
August 2023

ABSTRACT

India's external sector has grown significantly through economic liberalization reforms, resulting in increased trade and capital flow ties with the world. The Inter-Departmental Group (IDG) of the Reserve Bank of India has been formed to discuss the internationalization of INR. The group recently submitted its report on October 22, which was released on 5th July 2023. The report suggested time-bound steps to accelerate progress. The process of internationalization involves capital account convertibility, with robust financial markets being crucial for success. Positive steps have been taken toward promoting the use of the INR in international trade transactions, and past initiatives should be built upon to achieve success.

Gargi Sanati (*Corresponding Author*)
gargi@nibmindia.org

INR Internationalization: A Process and Not an Event[1]

1. Context

The Reserve Bank of India (RBI), published a report on the Internationalization of the Rupee submitted by Inter-Departmental Group (IDG) in October 2022 and released on 5th July 2023. This report provides more information on the potential risks and challenges associated with internationalizing the INR, and how these risks can be mitigated. This will help readers make a more informed decision on whether or not to support the internationalization of the INR.

India has made impressive strides in its external sector since implementing economic liberalization reforms over the past three decades. The country's trade and capital flow ties with the rest of the world have grown, leading to significant increases in foreign exchange reserves, foreign direct investment, imports, and exports. Moreover, the international monetary and financial system has become more diverse, with other currencies, including the INR, emerging for international transactions, resulting in a decline in the USD's share of foreign exchange reserves of countries.

To continue this progress, the Inter-Departmental Group (IDG) was formed to discuss the internationalization of INR, examine related issues, and propose a roadmap toward achieving it. The IDG has suggested a set of time-bound steps that could accelerate the pace of internationalization, considering institutional capacity, preparedness, and macroeconomic supporting conditions. The group highlights that some of these steps are already underway and will be prioritized accordingly for swift implementation.

The report's first chapter thoroughly examines the internationalization of the currency. IDG highlights that the process is gradual and involves capital account convertibility, ultimately resulting in the domestic currency acquiring the characteristics of a freely convertible currency for international financial transactions. The size of an economy and external trade are crucial factors that directly influence the internationalization of a currency. IDG firmly believes that INR has the potential to become an internationalized currency as India is one of the world's fastest-growing countries. Despite significant challenges, India has demonstrated remarkable resilience. Capital account convertibility, global value chain integration, and the establishment of GIFT city are just a few of India's noteworthy accomplishments. With the increased usage of INR in international trade invoicing, settlement, and capital account transactions, INR's international presence will undoubtedly become more prominent. This chapter also delves into various aspects and underlying factors that significantly affect the pace of a currency's internationalization process.

The report's second chapter provides valuable insights into the internationalization of currencies by examining cross-country experiences. IDG

[1] RBI Report on the Internationalization of the Rupee submitted by Inter-Departmental Group (IDG) in October 2022, released on July 5th, 2023.

highlights the rise of the Chinese Yuan as an international currency, despite capital controls in many areas. The report reviews the increasing prominence of CNY in nations' IMF, SDR baskets, and foreign exchange reserves. China's export-oriented manufacturing sector is the primary factor behind the internationalization of the Renminbi, supplemented by arrangements with partner countries. The chapter into other countries' experiences, which provide significant insights into the pace factors that influence a currency's internationalization process. Bilateral currency swaps have been noted as an effective means of promoting the use of INR for foreign trade settlement, which is essential in achieving the internationalization of INR. The Chinese experience has been particularly informative in this regard. Additionally, Local Currency Settlement (LCS) frameworks have been observed to facilitate wider use of local currencies in current and capital account transactions. This is particularly beneficial for the ease of doing business and reducing dependence on hard currencies.

The third chapter of the report outlines the IDG's approach to internationalizing the INR, which aims to minimize negative disruptions and create a natural demand for the INR in cross-border transactions. With the current level of Capital Account Convertibility (CAC), steps can be taken toward internationalization. The INR's introduction as a settlement currency under the Asian Clearing Union arrangement and its inclusion as a designated foreign currency by Sri Lanka are positive steps towards promoting the use of the INR in international trade transactions. The IDG's approach is to identify the current level of internationalization and suggest a roadmap toward steady internationalization. Robust financial markets play a crucial role in the successful internationalization of INR. In the fourth chapter, the report discusses measures for promoting internationalization, such as liberalizing the capital account, promoting international usage of INR, and strengthening financial markets. It is important to note that internationalization is a continuous process, and past initiatives must be built upon to achieve success.

Internationalizing the INR is a must and measures should be taken toward achieving it. The focus should be on minimizing negative disruptions and creating a natural demand for the INR in cross-border transactions. Positive steps have been taken towards promoting the use of the INR in international trade transactions, such as its introduction as a settlement currency under the Asian Clearing Union arrangement and its designation as a foreign currency by Sri Lanka. To achieve steady internationalization, the current level of internationalization must be identified and a roadmap towards it must be suggested. Robust financial markets are crucial to the successful internationalization of INR, and measures such as liberalizing the capital account, promoting international usage of INR, and strengthening financial markets must be taken to promote internationalization. It is worth noting that internationalization is a continuous process and past initiatives should be built upon to achieve success. The recommendations for promoting internationalization have been divided based on the expected time required for implementation, taking into account institutional capacity, macroeconomic priority, and accompanying prerequisites.

2. Measures Recommended for Implementation

To ensure success in the coming days, the IDG recommends implementing the following measures depending on the required time horizon:

(I) Short Term Goals: Timeline for implementation: up to 2 years

1. **Standardised approach for Central Bank (INR/FCY) swaps and multilateral/bilateral trade arrangements**: The IDG recommends implementing standardized approaches for Central Bank swaps and trade arrangements within two years. A uniform template should be adopted to ensure consistency in dealing with proposals involving bilateral and multilateral trade agreements, settlement mechanisms, and bilateral swaps. The objective is to identify terms of trade with counterpart countries and ensure mutual benefit. These recommendations are based on suggestions from the Task Force on offshore Rupee markets[2].

2. **Leverage on existing bilateral and multilateral currency settlement systems**: We can promote the international use of INR by utilizing established bilateral and multilateral payment and settlement systems like ACU. This involves enabling the usage of INR as an additional settlement currency in these systems. The Bank may consider implementing a mechanism to make INR an additional settlement currency in the ACU.

3. **Facilitating and encouraging Local Currency Settlement (LCS) and implementation of a liquidity framework for the same:** Upon thorough examination of the trade terms with the relevant counterpart country/countries and confirmation of ample liquidity in both the international and domestic banking sectors, the IDG strongly recommends a comprehensive evaluation of the LCS framework.

4. **Operationalising Swaps in Local Currencies (LCYs):** To successfully operationalize bilateral swap arrangements with our counterpart countries in LCYs, the IDG suggests exploring opportunities for investing surplus LCYs with mutual agreement.

   i. Such investments could include FDI, FPI, sovereign and corporate debt, infrastructural projects, and interest-bearing deposits, among other possibilities. We must acknowledge the growing importance of bilateral swap arrangements in the INR's internationalization.

   ii. As the market for local currencies continues to advance, the need to rely on a third currency such as USD as a reference point when converting currencies may become obsolete.

---

[2] some suggestions have been taken by the IDG from the recommendations of the Task Force on offshore Rupee markets headed by Ms. Usha Thorat. The recommendations in the IDG report at points 10, 13 and 14 are based on the recommendations of the Task Force. The IDG feels that these recommendations need to be implemented for furthering internationalisation of INR.

iii. To optimize financial transactions and tackle potential hurdles, it is advisable to consider alternative messaging platforms such as SFMS, along with international and national payment systems like RTGS, NEFT, and UPI. Additionally, broadening the accessibility and participation of non-residents and other jurisdictions in these systems warrants exploration.

iv. It is important to motivate Indian commercial banks to establish correspondent banking connections in Indian Rupees and the local currencies of other countries they are dealing with.

5. **Opening of INR Accounts by non-residents:** Opening accounts in a foreign currency for non-residents is essential to facilitate internationalization. It can be made simpler by allowing overseas branches of authorized dealers to open accounts for non-residents, making cross-border business and investing more accessible. There are several measures and recommendations that (ADs) can undertake to perform current and capital account transactions allowed under the FEMA, 1999. In the future, based on the implementation experience and system readiness, it may be possible to allow the opening of an INR account with any overseas bank with no restrictions on purpose, including transactions between two non-residents. Additionally, non-residents may be permitted to use a single SNRR account for all permissible capital and current account transactions.

6. **Expanding the footprint of highly successful INR-based payment systems:** In order to effectively promote the internationalization of INR, a reliable payment mechanism denominated in INR is crucial. This mechanism must allow for timely settlements and inter-bank transfers. Further, implementing payment systems similar to UPI-Pay Now in partnership with other countries can simplify cross-border INR/LCY-denominated transactions within current frameworks. This measure will greatly enhance accessibility and streamline cross-border transactions for businesses.

7. **Strengthening financial markets:** In order to optimize the effectiveness of a currency as a global vehicle currency, it is imperative to establish a well-performing financial market.

(a) A highly recommended approach is to create a global 24x5 INR market by authorizing AD Cat-I banks to conduct interbank forex transactions via their overseas branches and subsidiaries. It would also be wise to allow market-makers in the interest rate derivative market to carry out customer and interbank transactions on a 24x5 basis through their overseas branches and subsidiaries. Moreover, extending the operational hours of CCIL-operated trading platforms like FX SWAP and FX Clear, could prove beneficial in maintaining a continuous discovery of prices and providing liquidity through overseas branches and subsidiaries.

(b) Integration of onshore and offshore forex markets: With the new measure to allow AD Cat-I banks with an operational IFSC Banking Unit (IBU) to deal with INR non-deliverable forex derivatives, it is expected that the segmentation between onshore and offshore markets will be removed and price discovery will become more efficient. It is believed that allowing all AD Cat-I banks to deal with such derivatives will further improve the integration of the markets.

(c) Promoting India as the hub of INR transactions and main center for INR price discovery: Enabling greater freedom in accessing the forex derivative market without the need for underlying exposure has the potential to enhance market liquidity and support the onshore market as the primary hub for INR price discovery. It has been proposed that resident users should have the same ability to engage in non-deliverable INR forex derivatives as non-resident users, without any limitations on purpose. Ultimately, both resident and non-resident users should have unfettered access to exchange-traded and deliverable forex derivative markets, with no restrictions on purpose.

(d) Launch of BISIP-INR: The Bank is considering the possibility of launching a BISIP-INR with the BIS to promote the internationalization of INR and make it easier to include INR in the SDR basket. This move could potentially enhance market liquidity and support the onshore market as the primary hub for INR price discovery. There has been a proposal to allow resident users to engage in non-deliverable INR forex derivatives on the same basis as non-resident users, with no limitations on purpose. Ultimately, both resident and non-resident users should have unfettered access to exchange-traded and deliverable forex derivative markets, with no restrictions on purpose. .

(e) Inclusion of Indian Government Bonds in global bond indices: The Bank is looking into ways to boost the visibility of IGBs in global bond indices, which may improve market liquidity and strengthen the onshore market.

8. **Recalibrating the FPI regime:** To encourage more foreign investment in the Indian government and corporate debt markets, it's important to make the FPI regulations simpler and more efficient. A possible solution is to incorporate all government securities into the Fully Accessible Route (FAR). Corporate bonds could have investment limits under the Variable Rate Repo (VRR) system set as a percentage and reviewed annually, like the MTF. Additionally, it's suggested that the short-term and concentration limits in the MTF be removed while keeping other macroprudential controls intact.

9. **Equal treatment to exporters invoicing and settling in INR:** It would be beneficial for the government to consider providing the same benefits and incentives to exporters who choose to settle their transactions in INR, as they do for those who settle in other freely convertible currencies. This would encourage more businesses to use INR and could potentially lead to a boost in the Indian economy.

10. **Harmonising of KYC Requirements:** As part of the efforts to facilitate the participation of non-residents in the domestic financial markets, it is recommended that the KYC guidelines for FPIs be reviewed. This will help rationalize the KYC requirements and reduce transaction and compliance costs for

international investors. Such measures will encourage more foreign exchange earnings by incentivizing exporters who choose to settle their transactions in INR. It is important for the government to consider extending the same benefits and incentives to such exporters.

(II) Medium-Term Goals: Timeline for implementation: 2 to 5 years

1. **Masala bonds framework liberalization:** The concerned authorities should consider examining the potential benefits of waiving the withholding tax for Masala bond issuances, as it could lead to a reduction in the cost of issuance and ultimately the cost of capital.

2. **Expanding RTGS system for settling international transactions:** It is imperative that Real-Time Gross Settlement (RTGS) be utilized for international and cross-border transactions. Additionally, Unified Payments Interface (UPI) should be expanded for cross-border settlements beyond a select few individuals and limited amounts. This may require exemptions from current documentation requirements under the Foreign Exchange Management Act (FEMA) due to the rapid settlement process. To ensure accurate data for Balance of Payments (BoP) compilation, the National Payments Corporation of India (NPCI) should furnish aggregate import/export figures for these transactions.

3. **Inclusion of INR in Continuous Linked Settlement (CLS) system:** Including INR as a direct settlement currency in CLS could take up to two to three years due to the thorough analysis of legal aspects of clearing and settlement in India. Nevertheless, this move would bring more visibility to the INR and potentially increase its usage. The clearing system would give member banks the option to purchase currencies against their domestic currency, which could eventually lead to the creation of an Indian Clearing System. A central clearing and settlement mechanism for non-residents' deals in the onshore market could also be established to facilitate hedge transactions for non-residents. However, regulatory guidelines under each jurisdiction may pose challenges that need to be addressed.

4. **Resolving Taxation issues:** It seems that one of the major obstacles to free investments in Indian markets is the taxation issue. According to the IDG, it is suggested that the government could take a look at the issue of taxation in financial markets to try and bridge the gap between tax regimes in India and other major international financial centers such as Singapore, Hong Kong, and London. By doing so, this could potentially encourage non-residents to participate in the onshore market.

5. **Banking Services in INR through offshore branches of Indian banks -** As an Indian bank, it may be beneficial to provide banking services in INR in offshore markets as a way to increase the share of INR in international markets. It is important to note that offshore branches of Indian banks are subject to host country regulations and must abide by them. While there are no explicit restrictions on offshore branches providing banking services and participating in financial markets in INR, guidelines have not yet addressed this aspect. Therefore, it may be necessary to revisit existing regulations and make necessary changes to accommodate this type of banking business.

(III) Long-Term Goal: Timeline for implementation: 5 years and above

1. **Inclusion of INR in SDR basket** – It seems like you are interested in the efforts being made to establish the Indian Rupee (INR) as a "Vehicle Currency". As part of this objective, it's possible that the Bank may aim to have the INR included in the SDR basket. This could potentially have significant implications for the international use and recognition of the Indian Rupee.

   The report also mentions the reason **China focused on Renminbi internationalization.** It is clear that promoting the internationalization of the Renminbi would be beneficial for China both economically and politically. By reducing exchange rate risks and increasing cost-effectiveness for financial institutions, the Renminbi can become a currency of choice for global payments, ultimately giving China more flexibility in domestic and international markets. While China has taken steps towards this goal by launching the offshore Renminbi and signing currency swap agreements, there are still challenges ahead such as the need for capital control measures and limited convertibility on the capital account.

3. Suggested Structural Changes

The following section reports some structural changes in INR settlements

1. Swaps and Bilateral/Multilateral arrangements - Indian experience

Over the past decade, the global network of bilateral swap lines has seen a dramatic expansion. This growth began during the Global Financial Crisis when the Fed renewed the BSLs with the five major central banks in 2010 and converted them into permanent standing facilities in 2013. During this time, China also expanded its BSL network to promote the internationalisation of the Renminbi and facilitate trade and investment. The number of BSLs increased from just a few in 2007 to 74 by the end of 2019. Since the COVID-19 pandemic began, the global BSL network has grown even further, reaching 91 by the end of 2020. The US Fed has extended temporary BSLs to nine AEs and EMs, contributing to this growth.

India has made several trade and payments arrangements with other countries to ensure liquidity during financial difficulties. Let's take a look at some of the frameworks currently in place.

(a) **Asian Clearing Union (ACU):** The Asian Clearing Union (ACU) was established in 1974 to facilitate trade among its member countries: Bangladesh, Bhutan, Iran, India, Maldives, Myanmar, Nepal, Pakistan, and Sri Lanka. While the ACU framework originally intended for domestic currencies to be used for trade settlements, only the USD, Euro, and Yen are currently accepted for payment and settlement on a multilateral net basis due to operational convenience and usage. It's worth noting that trade settlements with Sri Lanka are now allowed outside the ACU mechanism.

(b) **SAARC SWAPs:** The SAARC Currency Swap Framework was established on November 15, 2012, to provide short-term foreign exchange liquidity support or balance of payments relief until longer-term arrangements are in place. SAARC is a group of eight countries including Afghanistan, Bangladesh, Bhutan, India, Maldives, Nepal, Pakistan, and Sri Lanka. As part of the framework for 2019-22, the Reserve Bank has agreed to offer USD 2 billion (withdrawable in US dollars, euros, or Indian rupees) to promote regional financial and economic cooperation. The Framework also includes some benefits for swap drawls in Indian Rupee. The Currency Swap Facility is open to all SAARC member nations if they sign bilateral agreements.

(c) **Central Bank of UAE:** In February 2016, the RBI and the Central Bank of UAE signed a Memorandum of Understanding to explore the possibility of entering into a currency swap agreement. This was subject to the approval of their respective governments. Later, in December 2018, India and UAE signed a currency swap agreement.

2. Provisioning for INR Liquidity

For the protection of the Reserve Bank's balance sheet and to ensure that the bank only acts as a lender of last resort when necessary, it is recommended that offshore Indian banking institutions receive their INR liquidity from their onshore parent.

i. All Foreign Entities

Approach	Negotiated lines of INR liquidity from Indian commercial banks to foreign entities could be established for a suitable period (beyond intra-day) based on their risk perception, to encourage their participation in INR-based clearing and settlement.
Concerns	Domestic banks may not be inclined to take such credit exposure.
Recommended solutions	1. RBI may encourage domestic commercial banks to establish negotiated lines of credit for clearing purposes. Some relaxation in provisioning/risk weight may be permitted by RBI to encourage them to establish such negotiated lines of credit. 2. In case of further requirements of funds, these foreign entities can also arrange funds through arrangements with major domestic commercial banks (by paying commitment fees or any other suitable arrangements). 3. Alternatively, the financial institutions may get INR liquidity through their central banks who may, in turn, get INR funding through bilateral/multilateral swaps. 4. Going forward, a repo facility in INR on the lines of LAF may be explored for foreign central banks.

Source: Internationalization of INR, RBI Report.

ii. Central Bank and Sovereign Backed Securities

Approach	RBI could be the provider of liquidity for an extended period (beyond overnight) through bilateral/multilateral swap arrangements with foreign central banks/sovereign backed entities. Going forward, a scheme similar to LAF may be explored for these foreign central banks/sovereign backed entities based on evolving market conditions.
Concerns	The RBI liquidity support for INR internationalisation should be of modest amounts so that it does not impede the public policy objectives of low and stable inflation with desired growth.
Recommended solutions	The RBI may get into a swap arrangement with those central banks. As the lender of last resort, a) RBI can formulate a scheme akin to the LAF facility which is currently extended to participating banks. Under this scheme, the other central banks and Sovereign- backed entities, that have investments in G-secs may be allowed fixed rate repo and fixed rate reverse repo/standing deposit facility for an extended period. This design would also help minimise the risk on the balance sheet of the Bank. This will be in addition to the other avenues for the deployment of surplus funds. b) These central banks and sovereign-backed entities, which avail INR liquidity from the RBI, can be allowed to act as clearing agents for the entities under their jurisdiction. For uniformity, liquidity support to foreign central banks can be provided on similar terms as the domestic LAF participants.

Source: Internationalization of INR, RBI Report

3. Process flow for UPI [P2P and P2M(QR)] and RuPay (P2M POS)

The Reserve Bank of India and the Monetary Authority of Singapore have announced a project to link their fast payment systems, which will enable instant fund transfers between the two systems without the need to get onboarded onto the other system. This means that a user of UPI does not require to be a part of the PayNow system to be able to transfer funds to a PayNow user in Singapore and vice versa. This development is in line with the Reserve Bank's vision of reviewing inbound remittance corridors between India and other countries and can foster cross-border interoperability of payments, providing impetus to retail payments during travel and remittance flows in domestic currencies between the two countries. The UPI-PayNow linkage is expected to be a significant milestone in the development of infrastructure for cross-border payments between India and Singapore and aligns with the G20's financial inclusion priority of enabling faster, cheaper, and more transparent cross-border payments. It can also contribute to fulfilling United Nations (UN) Sustainable Development Goals (SDG 10.c) by reducing the cost of remittances.

Currently, settlements are made through NOSTRO/VOSTRO accounts between banks in India and Singapore. This method will remain unchanged with the implementation of the new linkage. However, there are other benefits that the linkage will provide, such as increased ease, speed, and cost-effectiveness of transactions. These benefits include:

- Ease of transactions, as they can be executed using a Virtual Payment Address (VPA), mobile number, or national ID without the need to enroll in another payment system.
- Near real-time payments, as opposed to the current settlement period of at least one working day.
- Enhanced transparency, as foreign exchange rates and charges will be visible before confirming the transaction.
- Lower cost of transaction due to reduced time of payment and settlement, resulting in lower markup by the participating banks.

It has been discovered through detailed discussions with NPCI that the current UPI system can be upgraded to include all types of transactions, potentially making the UPI system a game changer for cross-border remittances. The real-time payments feature of UPI and the low cost of UPI transactions make it an attractive option for personal and retail transactions. The UPI-based payment system can be implemented in its existing form with enhancements, and tie-ups between banks across borders for retail segments, remittances and foreign travel can be instituted. However, trade and other related international transactions will require certain additions in the processes by the banking industry and examination of reporting and regulatory compliance requirements. It is important for the RBI, NPCI and the banking industry to collaborate closely in order to make these changes and improvements.

4. Proposed Framework of Indian Clearing System (ICS)

A proposal has been made to establish a Special Purpose Entity (SPE) with shareholding from several central banks. The SPE's base could be in India, and all AD banks from these countries may become members of the SPE and hold multi-currency accounts. The SPE shall hold domestic currency accounts in participating central banks, and AD banks will approach the SPE for the purchase and sale of currency. The transactions will be put through on a gross basis by debit and credit to respective accounts, and the accounts shall be settled through multilateral netting. The multicurrency account may be pre-funded, and an overall positive balance should be maintained throughout the transaction cycle. The clearing system can also be linked to RTGS of the member countries to swap in/swap out the local currency from the accounts maintained at their central banks as per the transactions of the day. The member banks and the SPE may be provided liquidity support through bilateral/multilateral swap agreements.

Benefits accruing from such a system

There are several benefits to creating a marketplace for the purchase and sale of currencies that are not freely convertible. One of the main advantages is that it will enable the development of a vibrant forex market in these currencies, which could be cross-rates initially and market-determined over time. This will also bring efficiency to the settlement in domestic currencies and reduce the cost of depending on a correspondent banking network. Additionally, there will be reduced liquidity requirements on account of the netting of transactions at the AD bank level.

Approach toward creating an ICS

Initially, ICS can be implemented in bilateral/multilateral settlement arrangements and then scaled up to include willing countries.

Near-Term Recommendation – Enable UPI for retail segments, remittances, and foreign travel.

Medium Term Recommendation – Enable UPI for trade and related transactions. Swift messaging shall continue and may be also used for domestic currency transactions.

Long-Term Recommendation – Develop an Indian Clearing system that provides for multi-currency settlement for countries using domestic currencies for trade and other transactions.

5. Inclusion of INR in the SDR basket - a long-term agenda

It is important that we take a closer look at the current system of composition and weighting in the SDR currency market to ensure better outcomes and a stable SDR. One potential solution to consider is the inclusion of INR in the SDR basket, but we must first examine the currency inclusion criteria and review India's position in relation to other major exporters. This will allow for a more informed decision and a more effective system overall.

India's export of goods and services is making impressive strides towards meeting the qualifying criteria. The IMF's currency use indicators reveal that the INR has gained significant prominence in public and private international finance transactions, particularly since 2010. The INR has achieved a higher overall ranking across currencies in the over-the-counter foreign exchange turnover, which is a great achievement. The growth rate of the INR during 2016-2019 has been equally impressive.

6. Integration of onshore and offshore markets

The Reserve Bank has established a robust onshore foreign exchange market that is easily accessible to both residents and non-residents. The Bank acknowledges the bidirectional price connection between onshore and offshore rates and the fact that volatility spill overs from offshore markets and market segmentation can impede efficiency. Recently, the Bank has focused on improving access to the onshore markets, while also promoting product innovation. Since May 8, 2020, Indian banks have been actively participating in the INR NDF markets, and the daily turnover has been steadily increasing. This increased participation has positively impacted the price differential between offshore and onshore rates. Additionally, the Reserve Bank recognizes that the market for Rupee interest rate swaps (IRS) has been growing offshore, which has effectively segmented the market and hindered efficient price discovery. To deepen the onshore market, non-residents were granted access to the onshore interest rate derivative market in 2019, thereby reducing market segmentation. To further improve the efficiency of price discovery, banks in India are now permitted to undertake transactions in the offshore Foreign Currency Settled Overnight Indexed Swap (FCS-OIS) market with non-residents and other market makers. The involvement of Indian banks in the NDF/FCS-OIS market has expanded the avenues for interbank risk management and could potentially lower hedging costs for customers.

Reference:

Reserve Bank of India (2022), Report of the Inter-Departmental Group (IDG) on Internationalisation of INR