

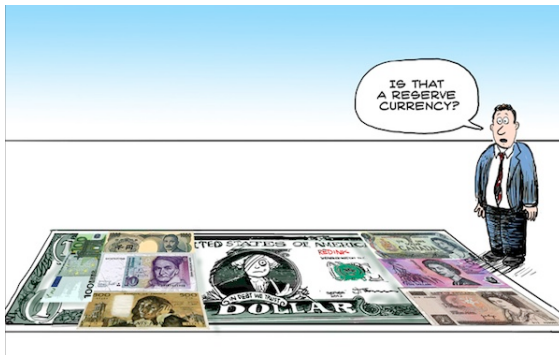
# Macro Pre-conditions for Rupee Internationalisation

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# Outline

- 1 The Dollar's international currency status.
- 2 Efforts by China to internationalize RMB.
- 3 Macro pre-conditions for Indian Rupee internationalization.



# Attributes of an international currency

- 1 **Scale:** Size of economy, size of international transactions with rest of the world.
- 2 **Stability:** Confidence in the value of the currency.
- 3 **Liquidity:** Buying and selling assets without affecting price of the currency.

## Measures of currency internationalization

- Share of the currency in countries' FX reserves.
- Share of the currency in international bonds' denomination.
- Share of the currency in global trade invoicing.

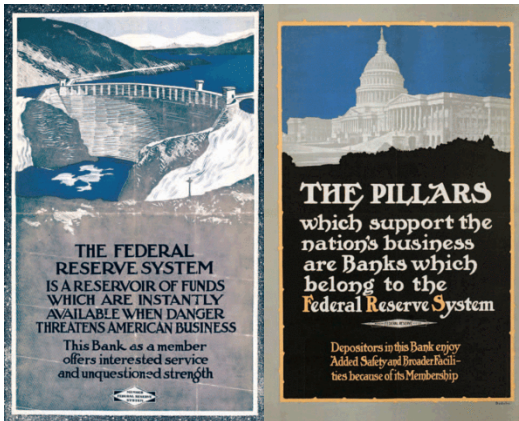
# 19th century international economy: Pre WW I

- Bank of England : “conductor of the international orchestra” (Keynes, 1930)



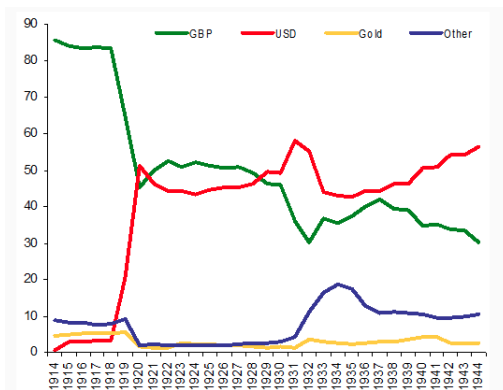
# Early 20th century

- In 1913 the Federal Reserve Act established the central bank in the US.



# Early 20th century

- By 1924, Dollar had emerged as an international reserve currency alongside the Pound.
  - Concerted policy reform and institutional innovation can help develop a liquid market needed to support currency internationalization.
  - By late 1930s, Dollar surpassed Sterling as a currency of denomination for international bonds



# Mid 20th century: Dollar Standard

- Post WW II, international economy organized around the Dollar and was dominated by the US.
- In the Bretton Woods System countries pegged their currencies to Dollar which was pegged to gold.
  - US provided political stability, financial depth, and financial intermediation.
  - US provided deep and liquid financial markets, that were open to the world.
    - This gave the Federal Reserve System leverage over global financial conditions

# Currency Composition of FX Reserves, 1947-2013

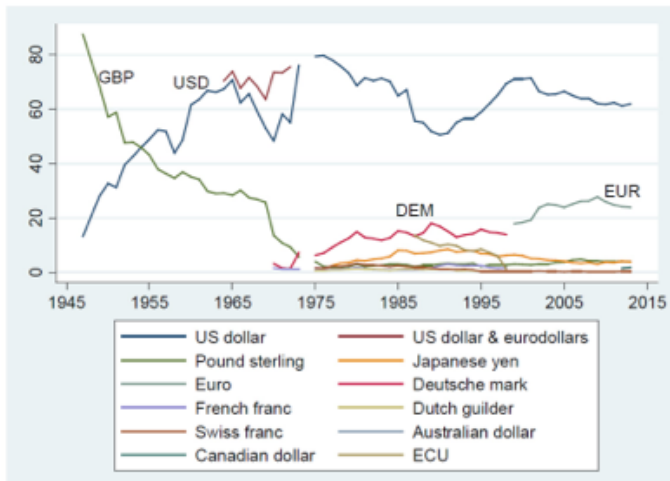
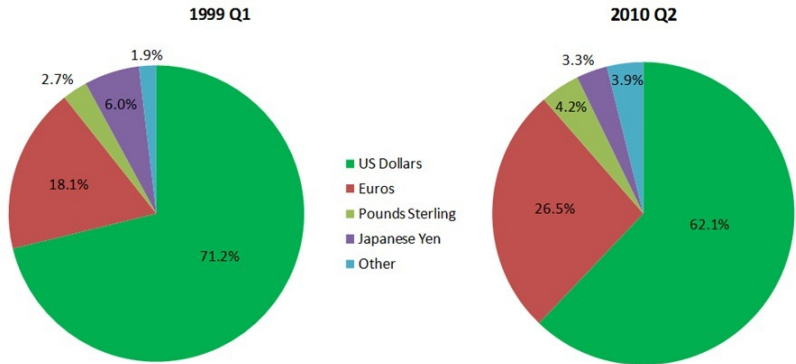


Figure: Chitu, Eichengreen and Mehl (2014)



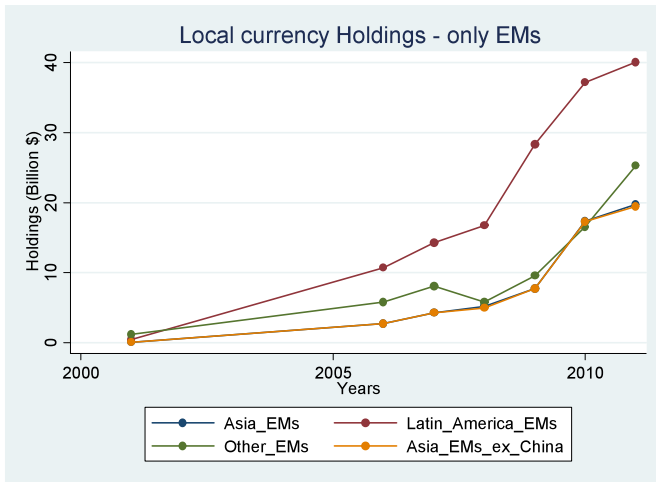
# Currency Composition of FX Reserves 1999 vs 2010

Market Share of Foreign Exchange Reserves

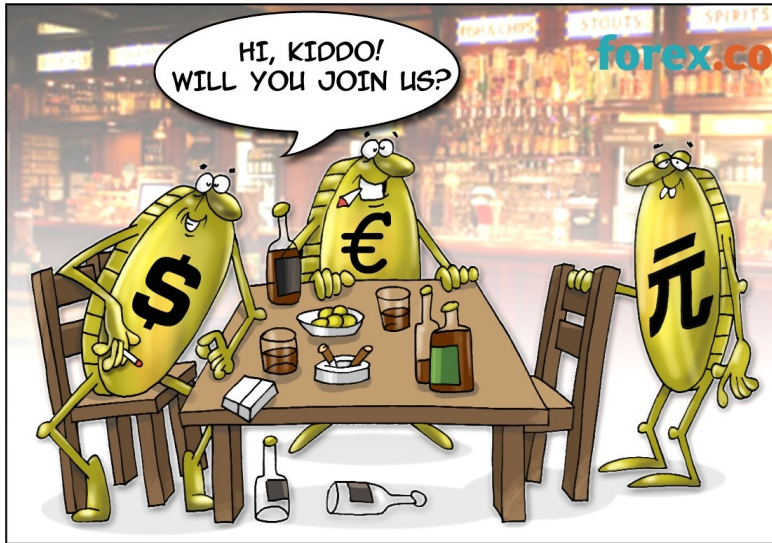


Source: IMF

# US holdings of EME LC bonds



# New currency on the block?



# China and the RMB



# China and the RMB



- **Scale:**

- China is the world's largest trading nation.
- By 2030, it will account for 28% of global GDP compared to 18% for US.
- Significantly smaller in terms of international financial transactions, compared to the US.

- **Stability:** Financial, Economic, Political

- Lack of a political democracy in China could be a challenge.

- **Liquidity:**

- Local currency bond market is very small in size
- Capital controls are a deterrent.

# Macro pre-conditions for Rupee Internationalization

## ● Scale

- Indian economy is 7th largest in the world by nominal GDP (\$2.38 trillion).
- It is the world's fastest growing major economy since 2014Q4.
- India has the potential to become the world's 3rd-largest economy by the next decade.
  - However share of India's trade in world trade is less than 3%.

## ● Stability

- Inflation has been declining.
- Policy credibility is getting established (reduction of fiscal deficit and adoption of inflation targeting).
- Like all other countries with international currencies, India is a political democracy.

## ● Liquidity

# Challenges for Rupee Internationalization

- **Liquidity:**

- India does not have a deep and liquid bond market.
  - Hedging opportunities against all possible risks are limited.
  - There continues to exist a comprehensive set of capital controls.
  - Exchange rate is in a managed floating regime.
- Steps must be taken to facilitate financial development, improve financial stability and liquidity, before internationalization of the Rupee becomes feasible.

Thank you.