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RESERVE BANK OF INDIA

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## RBI Bulletin - August 2020

The Reserve Bank of India today released the August 2020 issue of its monthly Bulletin. The Bulletin includes Second Bi-monthly Monetary Policy Statement, 2020-21, two speeches, three Articles and Current Statistics.

The three articles are: I. Onshoring the Offshore; II. Monetary Policy and Financial Markets: Twist and Tango; and III. Policy Rate Expectations in Media.

### I. Onshoring the Offshore

Several currencies in recent years, particularly those of emerging market economies (EMEs), have emerged as candidates for internationalisation. Over the last three years, EME currencies' turnover, driven to an extent by the rise of Non Deliverable Forwards (NDF) markets, outpaced global turnover in foreign exchange markets, boosting their global share. Among the EMEs, as per the BIS Triennial Central Bank Survey, 2019, trading in Indian Rupee (INR) has almost doubled in the last three years. Recognising the linkages between onshore and offshore markets, and the possible impact of offshore markets on price discovery onshore, the Reserve Bank is engaged in developing a deep and liquid onshore foreign exchange market. Against this backdrop this article reflects on the recent efforts made in onshoring the offshore.

The article provides a comparative overview of NDF markets globally, and provides some insights into the microstructure of the Rupee NDF market. It also discusses cross country approaches to the NDF market including the efforts undertaken by the Reserve Bank.

**Highlights:**

- From January 2020, Authorised Dealer Category-I banks have been permitted to offer foreign exchange prices to users at all times out of their Indian books, in order to obviate time zone hindrances to trading. This also provided opportunities for domestic banks to access a larger international clientele, including by leveraging on their overseas branch networks.
- The Reserve Bank, in January 2020, also permitted exchanges in the GIFT City International Financial Services Centre (IFSC) to offer INR derivative contracts with settlement in foreign currency.
- Banks in India were permitted by the Reserve Bank to participate in NDF markets from June 01, 2020. Several banks have started participating in the market with steady increase in average daily turnover by banks in India. The volumes have been almost entirely concentrated in the interbank segment, although there are indications that interest from global funds and corporates is slowly growing.

- The participation of Indian banks in the NDF market has increased avenues for interbank risk management and, going forward, could help bring down hedging cost for customers.
- A revised regulatory framework for hedging of foreign exchange risks was introduced in April, 2020, which will be effective from September 1, 2020. These measures are aimed at easing the access of residents and non-residents and further develop the domestic foreign exchange market.
- The measures aimed at liberalising and further developing the domestic foreign exchange market will facilitate shifting of offshore INR transactions to onshore and also provide a conducive environment for internationalisation of the INR.

**II. Monetary Policy and Financial Markets: Twist and Tango**

The Reserve Bank of India has initiated two special market operations – Operation Twist (OT) and Long-Term Repo Operations (LTRO) since December 2019 and February 2020 respectively. These two special operations are designed to ensure comfortable liquidity in the financial system and to facilitate monetary policy transmission. This article analyses the impact of these two sets of special operations on money and government securities (GSEC) markets.

**Highlights:**

- The study shows that the Overnight Indexed Swap (OIS) rates can be used to separate out expected and unexpected component of monetary policy, and therefore, can be deployed to track the impact of monetary policy announcements on longer-term yield.
- The relationship between OIS rates and GSEC yields indicates that monetary transmission to longer-term yield had dampened since mid-2019.
- An event study analysis shows that both OT and LTRO had a significant static as well as dynamic impact on GSEC yields of some maturities, thereby facilitating policy transmission.

**III. Policy Rate Expectations in Media**

Micro voluminous data generated on the internet at high frequency has paved the way for new sources of data/ information, which help in providing real time inputs for policy making. Big data tools like text mining and natural language processing techniques facilitate in quantifying such unstructured information. The central bank's decision on policy rate is keenly awaited by various stakeholders in the economy and receives wide coverage in print and electronic media. This article taps the unstructured text contained in news items and builds a sentiment indicator on policy rate decision. A measure, *viz.,* Sentiment Concentration Class (SCC) was constructed to evaluate media sentiment *vis-à-vis* directional change in repo rate.

**Highlights:**

- Daily news was culled out on a near real time basis, within a specific time window before the announcement of monetary policy.
- Sentiments were assigned based on the semantic orientation keywords present in the news.

- It is found that the SCC based on media sentiment captured ahead of the policy announcement date moves in sync with the actual direction of policy rate decision on most of the occasions during the study period.
- A measure like the SCC, thus, can be tracked to gauge media's expectations regarding the policy rate decision and this methodology has the potential to be extended to gauge media sentiments on key macroeconomic variables before their actual public release.

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