प्रेस प्रकाशनी PRESS RELEASE

भारतीय रिज़र्व बैंक
RESERVE BANK OF INDIA

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July 06, 2022

Liberalisation of Forex Flows (Revised)

The global outlook is clouded by recession risks. Consequently, high risk aversion has gripped financial markets, producing surges of volatility, sell-offs of risk assets and large spillovers, including flights to safety and safe haven demand for the US dollar. As a result, emerging market economies (EMEs) are facing retrenchment of portfolio flows and persistent downward pressures on their currencies.

India’s growth prospects remain strong and resilient. Despite headwinds from geopolitical developments, elevated crude oil prices and tighter external financial conditions, high frequency indicators point to an ongoing recovery in several sectors. Illustratively, the purchasing managers’ index (PMI) relating to services accelerated in June 2022 to its highest level since April 2011. The expansion of the merchandise trade deficit in June 2022 underlines the strength of domestic demand. India’s external sector has exhibited resilience and viability on the back of robust exports of goods and services and rising remittances. The current account deficit (CAD) is modest. All capital flows barring portfolio investments remain stable and an adequate level of reserves provides a buffer against external shocks. Reflecting these strong fundamentals, the Indian Rupee has depreciated by 4.1 per cent against the US dollar during the current financial year so far (upto July 5), which is modest relative to other EMEs and even major advanced economies (AEs). India’s foreign exchange reserves stood at US$ 593.3 billion as on June 24, 2022, supplemented by a substantial stock of net forward assets.

The Reserve Bank has been closely and continuously monitoring the liquidity conditions in the forex market and has stepped in as needed in all its segments to alleviate dollar tightness with the objective of ensuring orderly market functioning. In order to further diversify and expand the sources of forex funding so as to mitigate volatility and dampen global spillovers, it has been decided to undertake measures listed below to enhance forex inflows while ensuring overall macroeconomic and financial stability.

1. Exemption from Cash Reserve Ratio (CRR) and Statutory Liquidity Ratio (SLR) on Incremental FCNR(B) and NRE Term Deposits

At present, banks are required to include all Foreign Currency Non-Resident (Bank) [FCNR(B)] and Non-Resident (External) Rupee (NRE) deposit liabilities for computation of Net Demand and Time Liabilities (NDTL) for maintenance of CRR and SLR. It has been decided that with effect from the reporting fortnight beginning July 30, 2022 incremental FCNR(B) and NRE deposits with reference base date of July 1, 2022 will be exempt from the maintenance of CRR and SLR. This relaxation will be available for deposits mobilised up to November 4, 2022. Transfers from Non-Resident (Ordinary) (NRO) accounts to NRE accounts shall not qualify for the relaxation.

2. Interest Rates on FCNR(B) and NRE Deposits

At present, interest rates on Foreign Currency Non-Resident Bank [FCNR(B)] deposits are subject to ceilings of Overnight Alternative Reference Rate (ARR) for the respective currency/swap plus 250 basis points for deposits of 1 year to less than 3 years maturity and overnight ARR plus 350 basis points for deposits of 3 years and above and up to 5 years maturity. In case of NRE deposits, as per extant instructions, interest rates shall not be higher than those offered by the banks on comparable domestic rupee term deposits. It has been decided to temporarily permit banks to raise fresh FCNR(B) and NRE deposits without reference to the extant regulations on interest rates, with effect from July 7, 2022. This relaxation will be available for the period up to October 31, 2022.

3. FPI Investment in Debt

Foreign Portfolio Investors (FPIs) can invest in government securities and corporate bonds through three channels: (a) the Medium-Term Framework (MTF) introduced in October 2015; (b) the Voluntary Retention Route (VRR) introduced in March 2019; and (c) the Fully Accessible Route (FAR) introduced in April 2020. In order to encourage foreign portfolio investment, the following changes to the regulatory regime relating to FPI investment in debt flows are being put in place:

i. Fully Accessible Route (FAR): Currently, all central government securities (G-Secs) with 5-year, 10-year and 30-year tenors are categorized as “specified securities” under the FAR. In order to increase the choice of G-Secs available for investment by non-resident investors under the FAR as also to augment liquidity across the sovereign yield curve, it has been decided that all new issuances of G-Secs of 7-year and 14-year tenors, including the current issuances of 7.10% GS 2029 and 7.54% GS 2036, will be designated as specified securities under the FAR.

ii. At present, FPI investment in government and corporate debt under the MTF is subject to a macroprudential short term limit *viz*., not more than 30 per cent of investments each in government securities and corporate bonds can have a residual maturity of less than one year. It has been decided that investments by FPIs in government securities and corporate debt made till October 31, 2022 will be exempted from this short term limit. These investments will not be reckoned for the short term limit till maturity or sale of such investments.

iii. As part of the macroprudential framework under the MTF, FPIs can invest only in corporate debt instruments with a residual maturity of at least one year. It has been decided that FPIs will be provided with a limited window till October 31, 2022 during which they can invest in corporate money market instruments *viz*., commercial paper and non-convertible debentures with an original maturity of up to one year. FPIs can continue to stay invested in these instruments till their maturity / sale. These investments will not be included for reckoning the short term limit for investments in corporate securities.

4. Foreign Currency Lending by Authorised Dealer Category I (AD Cat-I) Banks

At present, AD Cat-I banks can undertake overseas foreign currency borrowing (OFCB) up to a limit of 100 per cent of their unimpaired Tier 1 capital or US$10 million, whichever is higher. The funds so borrowed cannot be used for lending in foreign currency except for the purpose of export finance. It has now been decided that AD Cat-I banks can utilise OFCBs for lending in foreign currency to entities for a wider set of end-use purposes, subject to the negative list set out for external commercial borrowings (ECBs). The measure is expected to facilitate foreign currency borrowing by a larger set of borrowers who may find it difficult to directly access overseas markets. This dispensation for raising such borrowings is available till October 31, 2022.

5. External Commercial Borrowings (ECBs)

Under the automatic ECB route, eligible borrowers are allowed to raise funds through their AD banks, without approaching the RBI, as long as the borrowing is in conformity with the prudential parameters of the ECB framework such as all-in cost ceiling, minimum maturity requirements and the overall dynamic ceiling. It has now been decided to temporarily increase the limit under the automatic route from US$ 750 million or its equivalent per financial year to US$ 1.5 billion. The all-in cost ceiling under the ECB framework is also being raised by 100 basis points, subject to the borrower being of investment grade rating. The above dispensations are available up to December 31, 2022.

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