

India's Entry into Global Bond Index: Exercising Caution as the Watchword

Global Bond Indices and India's Inclusion: Pros and Cons

Global Bond Indices: Global bond indices, like JPMorgan Govt Bond Index-Emerging Markets (GBI-EM), monitor local currency bonds from developing nations. Inclusion in such indices attracts foreign portfolio investors, enhancing liquidity and ownership base.

Pros of India's Inclusion:

- 1. Expansion of Investor Base:**
 - **Benefit:** Improves the investor base for Government Securities, positively impacting the government's fiscal situation.
- 2. Strengthening of Rupee:**
 - **Benefit:** Influx of dollars increases demand for the rupee, leading to rupee appreciation.
- 3. Increased Capital Inflows:**
 - **Benefit:** Anticipated additional inflows of \$20-25 billion, boosting the economy.
- 4. Lower Borrowing Costs:**
 - **Benefit:** Inclusion reduces bond yields, potentially lowering borrowing costs for the government and corporates.
- 5. Lower Risk:**
 - **Benefit:** Investments in rupee-denominated securities are considered less risky compared to dollar debt.

Cons of India's Inclusion:

- 1. Risk of Capital Flight:**
 - **Concern:** Passive investors, influenced by index weightage, may lead to capital flight if India's weightage reduces due to policy disagreements with major Western powers.
- 2. Dependency on Foreign Funds:**
 - **Concern:** Risk of vulnerability to foreign fund whims, subject to political pressures, potentially impacting India's financial stability.
- 3. Pressure on Forex Market:**
 - **Concern:** Conversion of holdings to foreign currency for withdrawal puts pressure on India's relatively thin forex markets.
- 4. Rupee Depreciation:**
 - **Concern:** Bulk demand for dollars may lead to rupee depreciation, impacting inflation, increasing current account deficit, and raising fiscal deficit.
- 5. Vulnerability to External Shocks:**
 - **General Concern:** Susceptibility to volatile international financial flows can lead to currency volatility, financial crises, and macroeconomic instability.
- 6. Impact on Domestic Industries:**
 - **General Concern:** Influx of foreign capital can impact domestic industries, potentially harming local industries due to currency appreciation.

Conclusion: India should approach inclusion with caution, considering associated risks, including potential capital flight, dependency on foreign funds, forex market pressure, and impacts on the rupee and domestic industries. Careful consideration of risks and strategic planning is crucial.

UPSC Syllabus Topic : GS Paper 3 Indian Economy.

On Currency in Circulation – Unraveling the Enigma of Cash Demand

Digital Payments in India: A Comprehensive Overview

Status of Digital Payments: One of the most notable advancements in recent years is the widespread adoption of digital payments in India. Facilitated by the Unified Payments Interface (UPI), digital payments have seen remarkable growth, expanding at a Compound Annual Growth Rate (CAGR) of 51% in volume and 27% in value between 2016-17 and 2022-23.

Benefits of Digital Payments:

1. Instant and Convenient Transactions:

- **Advantage:** Immediate money transfers using mobile numbers or user-friendly virtual payment addresses, eliminating the need for physical cash transactions.

2. Enhanced Financial Inclusion:

- **Advantage:** Digital access to bank accounts reduces barriers like time and travel costs, promoting financial inclusion for individuals who may have been deterred from using formal banking services.

3. Increased Transparency in Government Systems:

- **Advantage:** Direct digital transfers of government benefits to beneficiaries reduce the risk of leakage and fraudulent transactions, ensuring transparency and efficiency.

4. Safe and Secure Transactions:

- **Advantage:** Digital payments require multi-level authentication, providing a secure mode of transactions compared to the vulnerability of cash payments to theft.

5. Formalization of the Economy:

- **Advantage:** Digital payments contribute to the formalization of the economy by establishing users' financial footprints, increasing access to financial services, reducing informal cash transactions, and ensuring tax compliance.

Currency in Circulation (CiC):

1. Definition:

- **Explanation:** CiC represents the total value of banknotes and coins issued by a country's monetary authority, minus the amount removed from circulation. It is a crucial component of a country's money supply.

2. Status of Currency Circulation in India:

- **Observation:** Despite the surge in digital payments, the demand for cash, indicated by Currency in Circulation, has been growing. During the Covid-19 pandemic, CiC increased by 16.6% of GDP in 2020-21, reducing to 13.2% of GDP in 2021-22 but still higher than the pre-demonetization period's 11.5-12% of GDP.

ON STRONG NOTE



Factors Influencing the Increasing Demand for Cash in the Economy:

1. Disruption Caused by the Pandemic:

- **Impact:** Behavioral changes due to the pandemic may have prompted people to hold more cash as a precautionary measure to deal with uncertain situations.

2. Growing Informalization of the Workforce:

- **Influence:** The informal sector relies on cash for settlements, potentially driving the demand for cash. Higher Currency in Circulation (CiC) may reflect the increasing informalization of the workforce.

3. Higher Inflation:

- **Influence:** Increased inflation in recent years could contribute to the growing demand for cash. High inflation episodes often necessitate more spending, potentially leading to higher CiC.

4. Digital Benefits Used in Cash Transactions:

- **Influence:** Despite benefits being digitally transferred, the actual usage may be in cash due to factors like limited digital payment options in certain areas, such as village shopkeepers not accepting digital payments.

5. Tax Evasion and Black Money:

- **Influence:** Cash may still be preferred in large transactions to evade taxes, especially in sectors like real estate. Reports of cash seizures during elections indicate the continued generation of illicit cash in the system.

These factors collectively contribute to the sustained demand for cash in the economy, highlighting the multifaceted nature of the forces shaping currency circulation