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RUPEE-DOLLAR SWAP COULD BOOST FOREIGN FUND FLOWS UNDER VOLUNTARY RETENTION ROUTE

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The RBI's decision to infuse rupee liquidity through long term foreign exchange swap, a first of its kind in liquidity management policy, is likely to boost investments by foreign portfolio investors under the voluntary retention route (VRR).

The central bank will conduct dollar-rupee buy/sell swap action of $5 billion for a three-year tenor, on March 26. Such a swap route has been explored by various emerging market economies as an effective tool to manage liquidity.

Apart from liquidity infusion, the move will boost the country's foreign exchange reserves and is likely to support the exchange rate.

Introduced on March 1 by RBI, the VRR for investments by foreign portfolio investors (FPIs) is subject to a minimum retention period of three years from the date of allotment.

During this period, FPIs shall maintain a minimum of 75% of the allocated amount in India, RBI had said.

"Since investments made under VRR are subject to a three-year lock-in, this perfectly suits them," U.R. Bhat, managing director, Dalton Capital Advisors India.

Lower premium

"There is no liquid market for three-year forward cover. Three-year forward cover is not easily available in the market and here, RBI is providing that cover and the premium could be lower. And the premium will be market determined. There will be less uncertainties for the FPIs who want to take the VRR route," he said.

Investments under VRR (by all FPIs taken together) are capped at Rs. 40,000 crore for government securities and Rs. 35,000 crore for corporate debt securities.

According to Soumya Kanti Ghosh, Group Chief Economic Adviser, SBI, the new tool could have several implications, including lowering cost of hedging for the importers, with forward premia taking a dip. "Also, this move will complement the recently announced VRR route, wherein the stated objective of the regulator is to attract long-term and stable FPI investments in the debt market while providing FPIs with operational flexibility to manage their investments," Mr. Ghosh said.

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