GS-III: Borrow abroad and profit

Context

The government is planning to issue 10 year bonds denominated in foreign currency.

Why it is a good idea

- Such borrowing would be cheaper because dollar or yen interest rates are lower than rupee interest rates.
- Our debt to GDP ratio is not very high, the exchange rate is stable, and foreign exchange reserves are high. So foreign borrowing, if its long term, is not a problem.
- If foreign bond issuance was accompanied by a move towards greater capital account convertibility then it may be worth pursuing.
- A country pays a country premium for borrowing in dollars; currently, the US 10-year bond is trading at 2%. A complex set of factors determine the country’s premium, but the magnitude of reserves and foreign currency debt are important attributes. India has less debt denominated in foreign currency, close to 5%. Thus, we should be able to borrow at a somewhat lower premium than 150 bp, possibly 130bp.
- Indian inflation has moved structurally downward over the last three years.
- It will also help to significantly lower the real repo rate to respectable levels.

Problems with these bonds

1. Usually, the lower dollar interest rate is offset in the long run by higher principal repayments as the rupee depreciates against the dollar.
2. Loss of sovereignty and may lead to currency depreciation

No country has grown at “trend” rates with a real repo rate of around 3.4%, not even 2.4% or 2%. Issuing bonds now is an idea whose time has come.