

## DID IFC's MASALA BONDS TEMPERED INDIAN FOREX MARKET?

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### ABSTRACT

*Masala Bonds are instruments of debts that are ordinarily used by corporates to raise money in INR from foreign capitalists. They are rupee denominated financial instruments issued by Indian companies to raise capital from foreign investors in Indian currency. These bonds are particularly destined for the overseas investors who are interested to participate in Indian assets. International Finance Corporation (IFC), a global development and investment institution, launched the first Masala bonds at London Stock Exchange (LSE) in year 2014. IFC issued 7 tranches of offshore rupee-denominated bonds, settled in US Dollars and pinned to the rupee foreign exchange rate, for maturities ranging from 3 to 7 years. The main objective of the study is to understand what Masala bonds are and how the issuance of these bonds by IFC have affected the Forex market and exchange rates in India. The research also emphasis only on the period when Masala Bonds were issued solely by IFC as the study aims to find the competitiveness of IFC masala bonds on Indian foreign exchange rates.*

**Keywords:** *Masala Bonds, International Finance Corporation, Exchange Rate, Forex Market, Foreign Exchange Fluctuation, Indian Capital Market.*

### Introduction

Masala Bonds are basically rupee denominated financial instruments issued by Indian companies to raise capital from foreign investors in Indian currency. These are new financial instrument in Indian market which are listed on offshore stock exchanges. These bonds are particularly destined for the overseas investors who are interested to participate in Indian assets.



Source: Business Today<sup>1</sup>

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Masala Bonds have gained an exaggerated publicity not only in Indian market but also in Foreign Markets. These can be termed as instruments of debts that are ordinarily used by corporates to raise money from foreign capitalists. The “Masala bonds” strike the foremost rupee bonds indexed at the London Stock Exchange. IFC termed these ‘Masala’ bonds as ‘masala’ is an internationally acknowledged term that arouses the lifestyle and delicacies of India. Naming the bonds after the lifestyle of a nation has been happening very often. For e.g.- Chinese bonds are known as Dim Sum bonds, Samurai from Japanese bonds, Yankees of USA and Bulldog of UK.

#### **International Finance Corporation (IFC)**

International Finance Corporation (IFC) is a global development and investment institution that provides investment, advisory and asset-management services to promote private-sector development in developing countries. IFC - a sister organisation of the World Bank and member of the World Bank Group - focuses on economic development by investing in profit and commercial projects in order to eradicate extreme poverty and promote shared prosperity in every country. IFC was established in 1956 under the strong recommendation of Robert L. Garner, the senior executive of the World bank, in 1950. According to him, private business could play an important role in international development and thus proposed the establishment of a new institution for making private investments in less developed countries served by the World Bank.

IBRD (International Bank for Reconstruction and Development), the only financing institution of the World Bank that time, was facing two main shortcomings in its lending system. First, it provides loans only to the member countries on the guarantee of the member countries. Second, the World Bank could provide fixed interest loans and not the equity capital. In order to overcome these shortcomings, IFC was established with a specific aim to finance the private sector projects in less developed member countries. The World Bank draft of the IFC describes IFC as “*an autonomous international institution designed to stimulate growth in its developing member countries, by investing in productive enterprises in association with private capital and management and without any government guarantee*”.

#### **Evolution of Masala Bonds**

The macroeconomics disposition and the broadening prospect, in the modern economies had loosen up after the 2008 setback. In the aftermath of this crisis, Emerging Market Economies (EMEs) have itemized the local currency bond markets (LCBMs) as a main strategy. In the aspect of the regions large dependency on bank finance, expansion of LCBMs can donate to a bigger role for capital markets and a steadier financial system. As per the perspectives of EMEs, issuing of local currency bonds have many advantages to both the Issuers and Investors viz. alleviation of foreign currency risk, obtaining balance sheet damages from currency ill-matches, especially where income is denoted in domestic currency. Not only this, local currency debt provides an extra approach for carrying overseas resources into domestic long span infrastructure developments for which capitalizing is often scant and expensive (IMF, 2016; Dong and McCauley 2010).

Above stated benefits of local currency financing reflecting improved credit quality of EMEs, have attracted India to participate in Local currency bond program. In October 2013, the first offshore bond program of \$1billion was launched by International Financial Corporation (IFC) and Indian Government for various maturities. IFC, from 2013 to 2014, issued 7 tranches of offshore rupee-denominated bonds, settled in US Dollars and pinned to the rupee foreign exchange rate, for maturities ranging from 3 to 7 years (IFC, 2017).

#### **Literature Consulted**

- **“Masala Bonds: A Viable Option for Capital Starved Indian Public Sector Banks” Chopra (2017):** Masala bond market may be the most viable option for the Indian banks to raise capital due to certain inherent characteristics of the market. The Masala bond market at present is at a very nascent stage, but has huge potential with a much wider investor base and greater appetite. This could come to the rescue of Indian PSBs and solve a lot of their capital raising related problems.
- **“IFC launches \$1-b Masala bonds” Business Line (2018):** Under the first tranche of \$100million Masala Bonds programme, IFC launches masala bonds of worth \$1 billion which was sold to a range of investors including asset managers, banks, and a pension fund in US and Europe. India has been taking a series of steps to support Masala bonds as these bonds

<sup>1</sup> <https://www.businesstoday.in/current/economy-politics/masala-bonds-norms-modi-govt-prevent-rupee-fall/story/282482.html>

are not only meant for supporting capital market development but are also providing rupee financing for investment activities in India. Last month, Indian authorities exempted withholding tax on these bonds. The Reserve Bank of India has permitted banks to issue Masala bonds overseas for their capital requirements and to finance infrastructure and affordable housing.

- **“Dual listing of masala bonds being explored” Ram (2018):** Masala bonds could also be dual-listed in India under options being explored by the London Stock Exchange Group and the National Stock Exchange of India. As many as 46 Masala bonds have raised over \$5 billion in London since they were first listed, but it is hoped that the dual listing would extend access to a wider base of global investors as well as domestic and regional investors registered on the NSE's International Exchange, and NSE IFSC Limited in Gujarat International Finance Tech City.
- **“Masala Bonds spiced-up, will it help in stemming rupee fall?” Money Control (2018):** Raising funds through Masala Bond has declined in the current fiscal as compared to last year due to various factors such as introduction of the requirement of prior approval of RBI for issuing such Bonds, and the interest rates being high on such instruments when compared to the interest rates available in the domestic market. With a view to contain the Current Account Deficit and augment the foreign exchange inflow, the Central government has sought to incentivise low-cost foreign borrowings by Indian companies by issuing Masala Bonds. The Central Board of Direct Taxes (CBDT) has notified the decision to exempt interest payable on Masala Bonds during the period September 17, 2018 to March 31, 2019 from being taxed in India.
- **“Masala Bonds and its Financial Impact on Issuing Companies” Agrawal & Jain (2018):** Masala bonds are the debt instruments issued in international market to raise funds in Indian currency (INR). These bonds are offering benefits to investors as well as issuing companies. Investors of the bonds are getting higher interest rate as compared to home country and a gain if rupee appreciate at the time of maturity. The issuing firm on the other hand are getting funds from the foreign market in INR and the currency risk is borne by the investors. As per the research, Masala Bonds have a direct impact on the financial status of the issuing companies but it may vary from company to company depending on their capital structure and requirements.
- **“Local Currency Bond Markets as an Integral Part of a Developed Financial System” Colla & Ullrich (2018):** A country's economic development is crucially dependent on its operative financial system which includes local bond market. In this market the public and corporate sector can raise funds in local currency. In many countries, the local currency bond market has scope for expansion. The public and corporate sector would benefit from the opportunity to borrow for long maturities in their own currency. At the same time, sufficient attention should be given to the stability of the financial system to prevent it from becoming the starting point and strengthening instrument of crises. The development of a local bond market differs from one national economy to another and measures aimed at improving the framework and regulations must be aligned with the level of development and needs of the respective country. Development measures ranging from support in expanding the capacities of the system to support for individual transactions must be tailored to the specific financial system and take the stability of the system into account.
- **“Masala Bonds - A New Dish in the Indian Bond Market Platter” Anshika (2016):** Masala Bonds can be termed as bonds that are denominated in the Indian rupee and are listed on the offshore stock exchanges. Issuance of masala bonds is the step initiated by the Reserve Bank of India towards the internationalisation of the Indian currency. The first Indian rupee denominated bonds were issued by International Financial Corporation in the year 2014 listed on the London Stock Exchange. The maximum permissible amount that the issuer company can raise through masala bonds under automatic route is INR 50 billion or its equivalent during a financial year. The amount raised through these bonds should not be used for the real estate projects and in the areas reserved for the Foreign Direct Investment. The minimum maturity period for such bonds is up to 3 years. With the issuance of masala bonds, the issuer companies can now diversify their portfolio and also leads to cut down the cost.
- **“Masala Bonds Will Find Appetite, But the Market Will Take Time to Develop” Joshi (2015):** The Reserve Bank of India's efforts to operationalise the issuance of Masala bonds by Indian corporates are commendable and consistent with the global trend to reduce currency mismatches for its resident entities. These bonds would potentially provide corporates an

alternate avenue to raise debt funding from international investors in addition to the existing channels of external commercial borrowings (ECBs), plain vanilla bonds and foreign currency convertible bonds. The study identifies various impacts which the issuance of masala bonds may have such as opening up of new options for retail savers, help in deepening domestic bond markets, promote the use of Rupee in global trade & investment and lastly, prompt corporates to go for substantial money raising.

### Objectives of the Study

- To understand the Masala Bonds introduction by International Finance Corporation (IFC) in India.
- To study the inflow of funds in India through IFC's Masala Bonds.
- To analyze the competitiveness of IFC issued Masala Bonds on Indian Foreign Exchange rates.

### Hypothesis of the Study

**H<sub>0</sub>:** There is no significant difference in exchange rates between pre and intra Masala bond issuance period.

### Data Analysis and Finding

The first offshore issue of rupee-denominated bonds was launched by the International Finance Corporation (IFC) in 2014. Subsequent issues followed and their successful placements with global investors made these bonds a hit in international markets. This bolstered the confidence of Indian regulators (Khan 2015) with the RBI quickly allowing resident corporate firms, real estate and infrastructure investment trusts to issue masala bonds of a 5-year tenor up to \$750 million annually, under the automatic route for the first time.

Given below is the list of Masala bonds issued by IFC till date:

**Table 1: IFC's Masala Bond**

S. No.	Issue Date	Issue Size	Coupon	Tenure	Exchange Rate (per USD) *
1.	7 March 2017	INR 0.28bn	4.85%	5 years	INR 66.57
2.	21 March 2016	INR 2bn	7.10%	15 years	INR 66.49
3.	10 <sup>†</sup> August 2015	INR 3.15bn	6.45%	5 years	INR 63.85
4.	30 April 2015	INR 18bn	6.45%	3.5 years	INR 63.45
5.	18 November 2014	INR 10bn	6.3%	10 years	INR 61.75

Source: Indian Rupee Bonds on London Stock Exchange<sup>1</sup> & MUDS<sup>2</sup>; \*Pound Sterling Live<sup>3</sup>.

The table 1 contains the details of the masala bonds issued by IFC. It provides the details about the issuance and maturity date, value of fund raised along with the returns earned by the investors on these bonds. The table also gives the rate of exchange in terms of USD per INR on the date of issue of the bonds.

As per table 1., the rate of foreign exchange is showing an upward trend i.e., it is increasing on continual basis. This indicates that the masala bonds have benefited the issuing company in terms of exchange rate fluctuation risk.

Table 2 shows the foreign exchange rate before and after the issuance of Masala Bond by International Financial Corporation (IFC). In order to study the competitiveness of IFC issued Masala bonds in particular, the data for the period till December, 2015 has been taken into account, as thereafter other organisations also came up with these bonds' issuance.

Data reveals that before issue of Masala bond there was fluctuation in foreign exchange rate, where there was progress in foreign exchange rate from January, 2013 to September, 2013 but after November, 2013 there was decrement in foreign exchange rate till May, 2014. After Issue of Masala bond by IFC in June, 2014 there was continues increment in foreign exchange rate till December, 2015. Average exchange rate before Masala bond was ₹ 59.32 whereas after issue of Masala bond average exchange rate was ₹ 63.19. Standard deviation before and after issue of Masala bond was ₹ 3.35 and ₹ 1.92 respectively.

<sup>1</sup> <https://www.londonstockexchange.com/specialist-issuers/debts-bonds/masala/masala-factsheet.pdf>

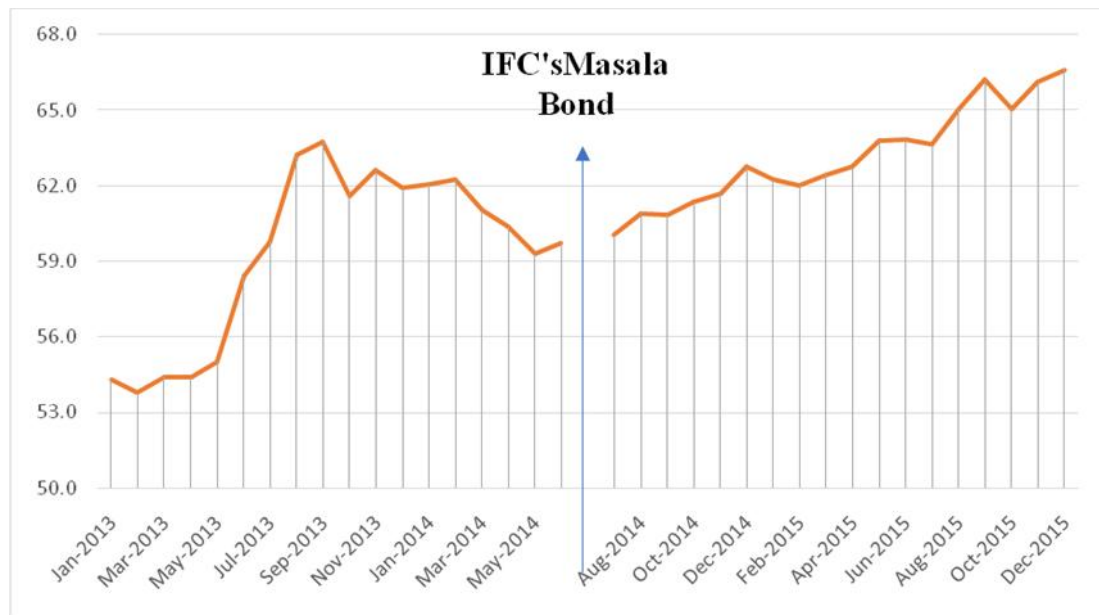
<sup>2</sup> <https://muds.co.in/masalabonds/>

<sup>3</sup> <https://www.poundsterlinglive.com/best-exchange-rates/us-dollar-to-indian-rupee-exchange-rate>

**Table 2: Pre and Intra IFC Masala Bond's Exchange Rates**

Foreign Exchange Rate			
Pre-Masala Bond		Intra-Masala Bond	
Month	Exchange rate	Month	Exchange rate
Jan-2013	54.3168	Jul-2014	60.0586
Feb-2013	53.7737	Aug-2014	60.8952
Mar-2013	54.4046	Sep-2014	60.8649
Apr-2013	54.3757	Oct-2014	61.3420
May-2013	55.0108	Nov-2014	61.7042
Jun-2013	58.3973	Dec-2014	62.7530
Jul-2013	59.7754	Jan-2015	62.2259
Aug-2013	63.2088	Feb-2015	62.0376
Sep-2013	63.7521	Mar-2015	62.4498
Oct-2013	61.6156	Apr-2015	62.7532
Nov-2013	62.6330	May-2015	63.8003
Dec-2013	61.9103	Jun-2015	63.8607
Jan-2014	62.0760	Jul-2015	63.6350
Feb-2014	62.2540	Aug-2015	65.0723
Mar-2014	61.0140	Sep-2015	66.2178
Apr-2014	60.3566	Oct-2015	65.0580
May-2014	59.3050	Nov-2015	66.1171
Jun-2014	59.7307	Dec-2015	66.5955
Average	59.3284	Average	63.1912
Std Dev.	3.3505	Std Dev.	1.924607
skewness	-0.57701	skewness	0.323348
Kurtosis	-1.20325	Kurtosis	-0.9448
<b>t - Statistics</b>	<b>t - Value</b>	<b>- 4.12192</b>	
	<b>Sign.</b>	<b>0.000</b>	
	<b>N</b>	<b>36</b>	

The pattern of exchange rates is clearly visible in the figure 1 below. Before the issuance of Masala bonds, the rates of foreign exchange were showing steep fluctuations with the lowest and highest rate of exchange varying from INR 53.7737 per USD in February, 2013 to INR 63.7521 per USD in September, 2013.



**Figure 1: Pre & Intra IFC's Masala Bond Exchange Rate**

On the other hand, with the issue of Masala bonds, the rates of exchange have been increasing on regular basis. Where the rate was INR 60.0586 per USD in June, 2014, it has increased continuously to INR 66.5955 per USD by December, 2015.

Table 2 also provide results of t-test which shows that the t-value was – 4.121 at significance value of 0.000 which is less than 5 % level of significance. This means that it is statistically evident for the existence of significant difference in exchange rates between pre and intra Masala bond issuance period.

So, as per statistical results the study indicates that after the issuance of masala bonds the exchange rates have increased continuously benefiting the issuers in terms Foreign Exchange risks. Though the value of Indian rupee in terms of USD has depreciated continuously indicating a negative effect on the economy, the issuers of Masala Bonds are highly benefited by it. The basic feature of Masala bonds is that these bonds are repaid at the time of maturity in domestic currency, which has profited the issuers as the increase in exchange rate hardly affect them.

### Conclusion

Introduction of Masala bonds as an innovative funding source is important for India due to structural as well as cyclical reasons. The country has a large, unmet infrastructure gap which requires funding. And despite many initiatives and efforts, India still lacks the vibrant developed bond market that is needed to fill this vacuum. The evolution of Masala bonds by IFC as a new financial instrument have gained an exaggerated publicity not only in Indian market but also in Foreign markets.

The purpose of issuance of Masala bonds for raising overseas funds for the development of infrastructure in the country seems to be achieved to some extent. As the funds raised through these instruments are not subjected to foreign exchange fluctuations and are redeemed back in INR, the issuers are hardly affected by the rise in exchange rates, which otherwise restricted the issuers to raise foreign capital through other External Commercial Borrowings. Thus, it can be stated that the Masala bonds so issued by IFC are competitive enough for India Capital market to raise funds from overseas markets.

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