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## Reshaping India's Financial Landscape: *The Journey Towards De-Dollarization*





## Indian De-dollarization

De-dollarization, the process of reducing reliance on the U.S. dollar in international trade and financial transactions, has emerged as a significant global economic phenomenon. In recent years, several countries, including India, have begun exploring strategies to diversify their currency reserves, promote bilateral trade in local currencies, and mitigate the potential risks associated with overdependence on the U.S. dollar. De-dollarization is not merely a shift in currency preferences; it represents a broader economic and geopolitical strategy to enhance financial stability, reduce exposure to currency fluctuations, and foster greater autonomy in international economic interactions.

As one of the world's largest and fastest-growing economies, India has increasingly engaged in discussions and initiatives related to de-dollarization. The Indian government and financial institutions are contemplating measures to lessen the country's vulnerability to the fluctuations of the U.S. dollar, which has traditionally been the dominant global reserve currency. This move is driven by the desire to insulate the Indian economy from the risks of currency depreciation, capital outflows, and economic disruptions arising from a volatile dollar-centric global financial system. Additionally, promoting the use of the Indian Rupee in regional and international trade could offer India greater control over its monetary policy and enhance its role on the global economic stage.

## Importance of the De-dollarisation



The U.S. dollar has been the world's reserve currency for over 70 years. However, there has been growing momentum towards de-dollarization in recent years as countries seek to reduce their reliance on the U.S. dollar. India is one of the countries that is leading the charge towards de-dollarization. There are several reasons why India is interested in de-dollarization.

- The U.S. dollar is volatile, and its value can fluctuate wildly. It can make it difficult for Indian businesses to plan and make importing and exporting goods more expensive.

- The U.S. dollar is a politicized currency. The U.S. government has been known to use the dollar against its adversaries by imposing sanctions or freezing assets. It makes it risky for India to hold large amounts of U.S. dollars.

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- The government encourages businesses to trade in local currencies rather than the U.S. dollar.

- The government is increasing the use of the Indian Rupee in international settlements.

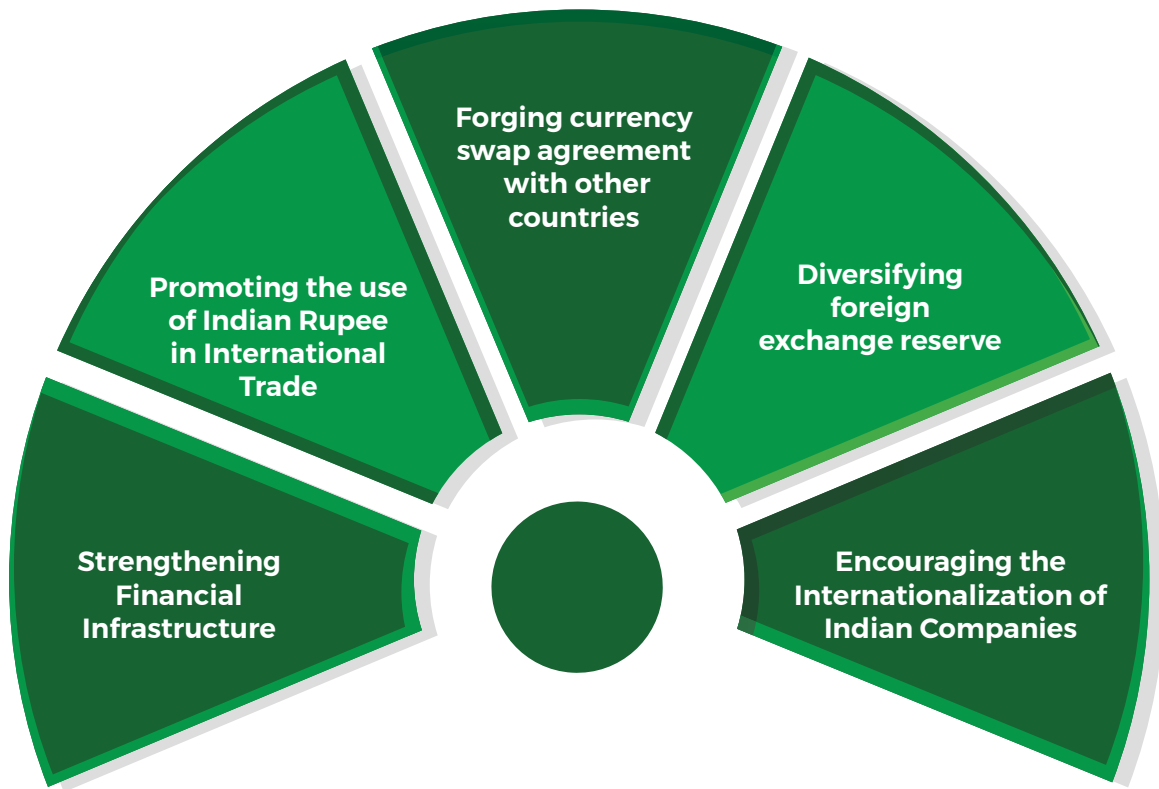
- The government invests in other currencies, such as the euro and the yuan.



# India's initiative towards de-dollarisation?

De-dollarisation refers to the process by which a country or group of countries reduces their reliance on the U.S. dollar (USD) as the primary currency for international trade, investment, and reserves. This concept has gained attention due to its potential implications for global economic stability, geopolitical dynamics, and the autonomy of individual nations.

Figure 1: India's initiative towards de-dollarisation



Source: Agpaytech Research



# India's Strategies in Pursuing Trade De-dollarisation

## **Vostro Rupee Account Settlements**

The Reserve Bank of India (RBI) has authorized banks from 18 different nations to establish dedicated Special Vostro Rupee Accounts. These accounts facilitate transactions conducted in Indian rupees, thereby allowing partner countries to circumvent the need for U.S. dollar involvement. This initiative reduces dependence on the U.S. currency and actively encourages the utilization of local currencies in international trade.

## **Trade agreements**

India has been actively formalizing trade agreements with partner countries, including the UAE and Australia. These agreements aim to streamline the utilization of the Indian Rupee in both bilateral and worldwide trade activities. Through ongoing negotiations of trade pacts with entities like the U.K. and the European Union.

## **Expanding Local Currency Settlement Frameworks**

India has been diligently striving to enhance its local currency settlement frameworks with other nations, aiming to advance the de-dollarisation process. An illustrative instance is the expansion of the Bilateral Swap Arrangement (BSA) between India and Japan in 2020. This extension incorporated provisions for local currency settlement, facilitating trade transactions conducted in Indian rupees and Japanese yen.

## **Promoting Regional Financial Integration**

India has been energetically engaging in endeavours to foster regional financial integration, with the overarching goal of encouraging the prevalence of local currencies in trade activities. An apt illustration of this commitment is India's membership in the South Asian Association for Regional Cooperation (SAARC). Within this context, India has been dedicated to bolstering the adoption of local currencies within the SAARC region.

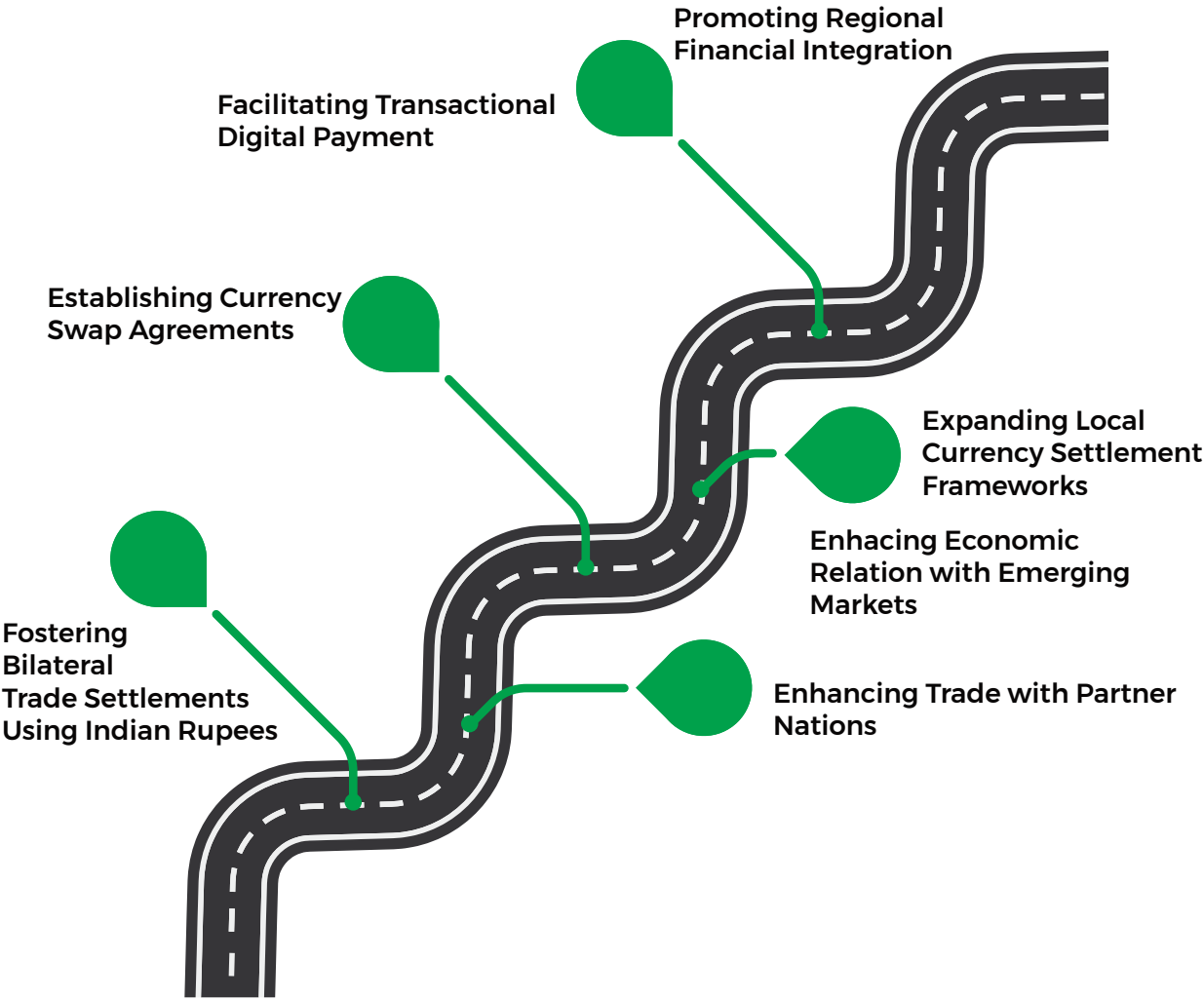
## **Facilitating Transnational Digital Payments**

India has allocated resources towards developing cross-border digital payment systems, aiming to stream trade and financial interactions through utilizing local currencies. A notable case in point is the collaborative effort between India and the United Arab Emirates (UAE), culminating in the introduction of a Remittance Facility. This innovative system permits instantaneous money transfers between the two nations using Indian rupees and UAE dirhams as the designated currencies.

### Enhancing Economic Relations with Emerging Markets

India has been actively fortifying its economic connections with burgeoning economies such as Brazil, Russia, China, and South Africa (BRICS). This strategic approach is geared towards broadening its array of trade partners while concurrently decreasing dependency on the U.S. dollar.

Figure 2: India's Strategies towards de-dollarisation trade



Source: Agpaytech Research

# Is De-Dollarization of Trade Beneficial for India?

India's strategic focus on the de-dollarization of trade holds considerable merit. This strategic reorientation can be realized through a series of measures:

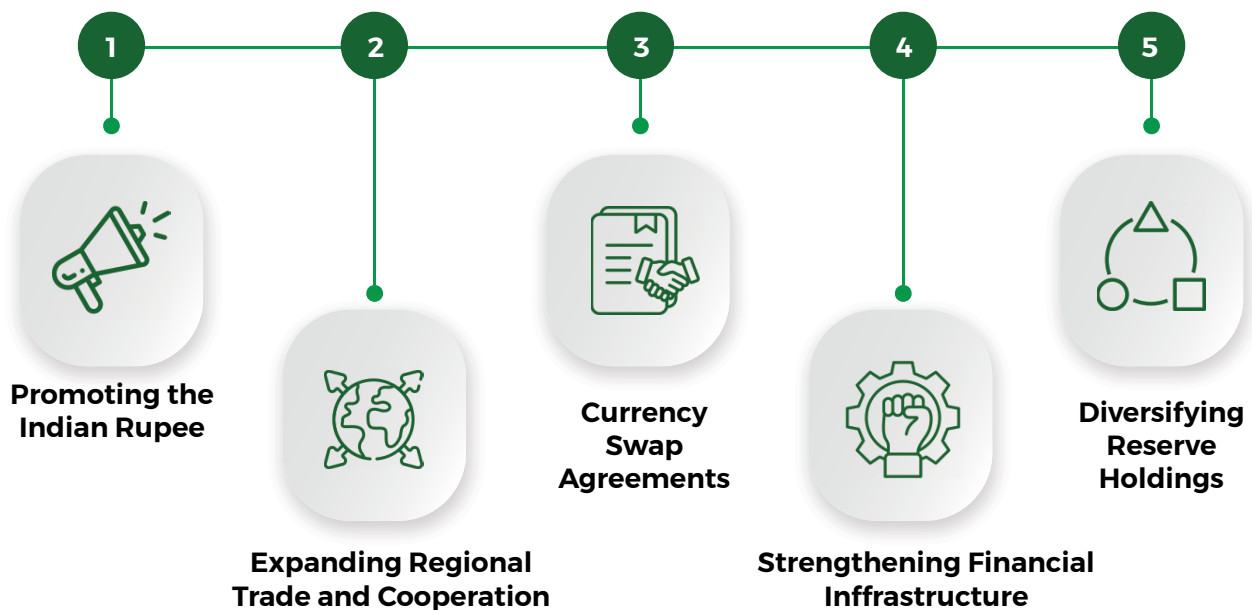
## ■ Reducing Reliance on Singular Currency

De-dollarization serves to curtail India's overreliance on the U.S. dollar as the world's predominant reserve currency. This strategic pivot would bolster the Indian economy's resilience against potential adverse impacts from global events. Recent instances, such as the repercussions of U.S. sanctions on Iran and Russia and the far-reaching effects of the COVID-19 pandemic, underscore the pertinence of this move. India can chart a more stable course by minimizing vulnerability to such events.

## ■ Cultivating Regional Trade Dynamics

De-dollarization fosters a conducive environment for regional trade alliances and cooperative initiatives, notably collaborating with fellow BRICS nations. This endeavour effectively works towards diminishing India's reliance on Western powers. Notably, India has utilized the Indian Rupee in bilateral trade with nations reliant on oil exports. Evident from its establishment of a multi-agency task force to identify potential countries for rupee-based trade, India's determination to stimulate regional trade bolsters its pursuit of reduced dollar dependency.

Figure 3: Benefits of de-dollarisation



Source: Agpaytech Research





## Challenges of De-Dollarization to the Indian Financial System

India's diversification of its currency reserves shows its willingness to challenge the existing global financial system, which developed economies have dominated. This assertiveness raises India's international standing and strengthens its position in international forums, where economic power is often linked to geopolitical influence.

- **Strengthen the Indian Rupee**

The Indian government can take steps to strengthen the Indian Rupee, such as reducing the fiscal deficit and improving the trade balance. It would make the Rupee more attractive to investors and help to reduce the risk of capital outflows.

- **Develop alternative payment systems**

India can develop alternative payment systems not based on the US dollar. It would help to reduce the country's reliance on the US dollar for international trade and payments.

- **Increase cooperation with other countries**

India can work with other countries that are also interested in de-dollarization. It would help to create a more stable and liquid market for alternative currencies.

- **Build up foreign exchange reserves**

The Indian government can build up its foreign exchange reserves to help buffer against the de-dollarisation shocks. It would also help reduce the country's reliance on the US dollar to finance its imports.

The challenges of de-dollarization are significant, but they are not insurmountable. With careful planning and execution, India can reduce the risks and disruptions of de-dollarization and reap the benefits of a more diversified and resilient financial system.

A close-up photograph of a hand holding a 5 Rupee coin. The coin is silver and features the number '5' in the center, with 'RUPEES' and '2001' below it. The word 'रुपय' (Rupee) is written in Hindi at the top. The background is blurred, showing a person's face in profile.

## Conclusion

In the global finance and trade realm, India's pursuit of de-dollarization emerges as a nuanced strategy to bolster its economic autonomy, diversify its trade dynamics, and mitigate risks associated with external shocks. The concerted efforts to promote the Indian Rupee, expand regional cooperation, and cultivate alternative financial mechanisms underscore India's commitment to charting a course less dependent on the U.S. dollar. India's evolving economic relationships with major players like China and Russia and its proactive approach to forging bilateral agreements in local currencies signal a shifting landscape in the global monetary order. As India navigates this terrain, its success will be determined by its ability to surmount the obstacles of infrastructure development, currency volatility, and international consensus-building.

India's journey towards de-dollarization reflects its aspirations for greater financial sovereignty and regional influence. As the nation embarks on this transformative path, it must harness its economic strengths, navigate complexities with prudence, and engage in collaborative efforts to redefine its position in the evolving global financial ecosystem.