

The Market India Forgot

The future of the rupee depends on building a deeper bond market



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Without going into the unresolvable debate on whether a strong or weak rupee matters, our ambition must be to ensure the rupee has a larger share of global foreign exchange reserves by 2047. At a recent ICAP India and NCAER Distinguished Lecture in Mumbai, economic historian Barry Eichengreen argued that currencies become international not because governments make them strong, but because investors find the financial systems behind them difficult to leave. Reserve currencies are not created by exchange-rate management but by financial development. The dollar's dominance rests less on America's GDP than on the unmatched depth, liquidity and credibility of its financial markets. Reserve currencies are built with trust, not intervention. Investors hold currencies backed by deep bond markets, predictable rules and abundant liquidity. If India wants the rupee to matter globally, the priority is not defending its price every day but building financial

markets the world is reluctant to leave.

By almost every macroeconomic yardstick, India looks like a success story. Growth is strong, headline reserves exceed US\$700 billion, inflation is contained and fiscal consolidation is back on track. India has built world-class digital public infrastructure, formalised millions of transactions and created one of the world's largest domestic savings pools. Yet every few years, markets remind policymakers of an uncomfortable reality that macroeconomics is necessary but not sufficient. The rupee comes under pressure. Government bond yields rise. Foreign investors turn cautious. Market intervention intensifies. The policy debate quickly turns to oil prices, geopolitics, portfolio flows, trade uncertainty and global risk sentiment. They explain the trigger, not the vulnerability.

The more important question is why a country with strong macroeconomic fundamentals, substantial domestic savings and growing global economic relevance still struggles to develop a fixed-income market capable of absorbing shocks and anchoring confidence. The answer lies in a less discussed reality—India built a world-class equity market but never quite finished building a bond market revolution. Yet before discussing what needs to be built, it is worth understanding how India arrived here. A reserve currency needs more than a large economy. It needs deep markets, abundant liquidity, credible institutions and the confidence that rules will not change when the rules become inconvenient. India has some of these ingredients in abundance. It has not yet assembled all of them into one financial architecture.

The Revolution That Never Happened

Over the past decade, India has transformed the way households participate in financial markets. The number of demat accounts expanded from fewer than 4 crore in 2020 to more than 22 crore. Monthly SIP inflows have crossed ₹32,000 crore, while mutual fund assets under management now exceed ₹85 lakh crore. Millions of first-time investors entered capital markets through digital platforms that made investing cheaper, faster and more accessible than ever before. This is one of the great success stories of modern Indian finance. But the transformation is asymmetric. Equities became accessible, visible and aspirational, fixed-income investing remained largely institutional. This was never an explicit policy choice. It emerged because taxes favoured equities, distributors sold what was simple and regulation prioritised safety over liquidity. The result is an unintended imbalance—a deep equity market alongside a shallow bond market.

For decades, India has also limited foreign participation in government debt markets. The memory of the Asian financial crisis and the Latin American debt crisis encouraged caution. India chose stability over openness and for good reason. The strategy largely worked, government borrowing remained funded by domestic institutions, currency volatility stayed contained and sovereign debt markets avoided the boom-bust cycles seen in several emerging economies. But every policy choice comes with a cost. The same framework that reduced vulnerability also reduced the urgency of building a broad, liquid and diversified bond market. India entered the twenty-first century with sophisticated equity markets but relatively shallow fixed-income markets. Today, that imbalance is becoming harder to ignore.

One Market, Two Symptoms

Markets are far less bureaucratic than governments. Policymakers debate exchange rates, bond markets, taxation, liquidity and capital flows in separate meetings. Investors price them together. This is also how international currencies acquire staying power. The dollar is not dominant simply because America is large. It is dominant because trade, banking, payments, reserves and the Treasury market reinforce one another. Financial networks have memory. Once liquidity concentrates somewhere, liquidity attracts more liquidity. A household choosing between equity and debt and

a global fund deciding whether to hold Indian bonds both care about the same thing, the overall investment experience, not the institutional chart behind it.

This is why stress rarely remains contained. When one part of the system misfires, transmission is fast and rarely polite. India's inclusion in global bond indices has increased foreign participation in government securities. Foreign ownership of India's FAR-eligible government bonds has risen from roughly 4.6 percent a few years ago to nearly 7 percent today. That may still look small, but markets care about direction more than percentages. India is no longer on the margins of global fixed-income portfolios. As international investors actively hedge currency and interest-rate risk, bond and foreign-exchange markets increasingly move together.

Reading the Signals

The recent episode is not a macro crisis. India is not facing a 1991- or 2013-style external stress event. Reserve buffers are strong, banking balance sheets are healthier than they were a decade ago. Growth remains among the highest globally. Markets are not questioning India's trajectory. They are questioning the plumbing underneath it. That financial architecture matters beyond today's exchange rate.

The FY27 Budget promised fiscal discipline with a deficit target of 4.3 percent of GDP. Markets noticed the ₹17 lakh crore gross market-borrowing programme instead. That's because debt markets don't price aspirations; they price supply. Every additional bond issued needs someone willing to own it. The second signal is domestic demand. India has successfully created a nation of equity investors. It has not yet created a nation of bond investors. The distinction is not semantic. Equity markets are excellent at mobilising risk capital; bond markets are designed to mobilise patient capital. A large and ambitious economy, aspiring to finance infrastructure, housing, urbanisation, energy transition and industrial expansion, tends to eventually discover it needs both. Without broad participation, banks, insurers, provident funds, and regulatory mandates continue to absorb sovereign and corporate debt. The market continues to function, of course, just not with much enthusiasm.

India has no shortage of savings. The challenge is turning those savings into liquid financial assets and ultimately into rupee-denominated assets that foreigners are willing to hold. Internationalisation begins with transactions but ends with assets that foreigners willingly accumulate.

The third signal is friction. India has made government securities more attractive to foreign investors, but markets don't reward isolated reforms. They reward seamless systems. Investors look at taxes, documentation, settlement, hedging costs, liquidity and regulatory certainty together. The deepest bond markets were built not by offering the highest returns, but by removing the most obstacles.

The fourth signal is global participation. Daily turnover in rupee derivatives has risen from around US\$38 billion in 2013 to more than US\$130 billion in 2025. The rupee is no longer simply a domestic currency occasionally traded by global investors; it has become a globally traded risk asset. That changes the policy challenge. India's financial architecture can no longer treat the exchange rate, bond market and currency derivatives market as separate worlds. As global participation grows, the plumbing connecting them becomes more important and more visible. India should start building its financial markets for the currency the world is already trading, not just the currency it hopes to internationalise.

An Unintended Bias

Every financial system needs two engines. Equity funds risk. Debt funds time. India has become exceptionally good at mobilising risk capital but remains underpowered in mobilising long-term capital. And internationalisation ultimately requires something even more basic: foreigners need reasons to accumulate rupee assets, not merely reasons to transact in rupees. That matters because the next twenty years will be financed less by venture capital than by bond capital for infrastructure, housing, logistics, urbanisation, municipal finance, the energy transition and private credit.

Instead, corporate bond markets remain relatively small by peer comparison. Secondary-market liquidity is limited, market-making remains thin and credit-risk transfer mechanisms are still underdeveloped. As a result, the system continues to lean heavily on banks for intermediation. That works—until it becomes expensive. That's where the cost of capital quietly rises.

Firefighting Isn't Reform

Policymakers are not wrong to intervene in periods of volatility. Foreign exchange intervention has a legitimate role. Liquidity operations have a legitimate role. Open market operations and debt switches have a legitimate role. Regulatory restrictions on positions and capital flows also have a role. The problem begins when intervention quietly stops being a bridge and starts becoming a substitute for structure.

The RBI's recently concluded FCNR(B), ECB and OFCB swap measures are a good example. More than \$70 billion was mobilised through these facilities, with FCNR(B) deposits accounting for the bulk of the inflows. The measure brought in dollars when the system needed dollars. But there is a familiar lesson here. India used a similar FCNR(B) mechanism in 2013, when the rupee was under pressure. It solved the immediate liquidity problem; it did not build the bond market that would make the next episode less dependent on intervention. The danger is that we become very good at moving the symptom forward without fixing the disease.

Markets work best when they price risk. They work less well when they start pricing the probability of regulatory intervention. They also price something harder to measure, whether the rules will remain predictable when the market becomes inconvenient. Reserve currencies require more than liquidity. They require institutional credibility. Liquidity

dries up, price discovery weakens and private capital steps back. Gradually, the state becomes the primary market-maker, not because it wants to, but because private market-making has become too thin.

That is the difference between firefighting and reform. A subsidy can bring capital. An intervention can calm a currency. A swap can buy time. None of them, by itself, creates deeper markets, better price discovery or greater investor confidence. If the same problem keeps returning, perhaps the problem is not the absence of another intervention. Perhaps it is the absence of the market architecture that makes intervention necessary in the first place.

Finishing the Job

If the diagnosis is right, the prescription is straightforward. India needs less firefighting and more financial architecture. Stop treating exchange rates, bond markets, taxation, liquidity and capital flows as separate policy conversations. Governments regulate in silos. Markets invest in systems. A stronger rupee, lower borrowing costs and deeper bond markets are not different objectives. They are different outcomes of the same financial architecture.

Start with incentives. Household savings should move between equity and debt based on risk and return, not tax arbitrage. Deep bond markets cannot emerge if policy continues nudging discretionary savings overwhelmingly towards equities.

Next, reduce friction. Global investors don't evaluate taxes, settlement, documentation, hedging costs and exit liquidity separately. They judge the entire investment experience. Capital chases returns, but it stays for convenience.

Then build liquidity. India's bond market is still largely a buy-and-hold market. Deep markets need active trading, stronger market-makers, broader repo markets, better risk-transfer instruments and long-term institutional investors such as pension funds and insurers.

Finally, build trust. Deep markets cannot be legislated into existence. Investors need confidence in the rules, institutions and backstops behind those markets. The dollar's advantage was never just the size of the American economy; it was the combination of liquid assets, credible institutions and a financial system that the world learned to trust. India cannot copy that history. But it can learn the lesson.

None of this guarantees a reserve-currency rupee. Nor should India confuse ambition with inevitability. Local-currency settlement with Russia, the UAE and Bangladesh has shown that transactions can move into rupees; it has not yet created a strong appetite among foreign central banks to hold them. The difference matters. Internationalisation begins with transactions but ends with assets that foreigners willingly accumulate.

India's first generation of reforms liberalised the economy. The second digitised it. The third must deepen its financial markets. A reserve currency is not defended into existence; it is built into existence. The rupee's future will depend not on how aggressively India manages its price, but on whether the world has enough reasons to hold its assets. The market India forgot is the market it now needs to build.