Analytical Speaking

RBI's move to shore up sagging Rupee-Reduces limit of Overseas Investments

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Article

Keeping in view the current macroeconomic situation of India and as a measure to shore up the sagging rupee, the Reserve Bank of India (RBI) has issued a press release[1] announcing two major amendments in overseas direct investment policy as applicable to Indian Corporates and individuals:

1. Reduction in limit for making overseas direct investments by corporates in joint ventures/wholly owned subsidiaries (JV/WOS) abroad[2]
2. Reduction in limit for making overseas investment/incurring overseas expenses by individuals under Liberalized Remittance Scheme (LRS) of RBI[3]

These quick measures turned up immediately on August 14, 2013 after the rupee closed at an all-time low of 61.44 to the dollar against previous day's close of 61.18. Below we analyse both of the changes:

Reduction in limit for making investments in JV/WOS abroad by Indian Corporates

Amendments Introduced:

In general ODI policy

As per the extant FEMA overseas direct investment policy, an Indian party could make financial commitments in its JV/WOS set up abroad up to a limit of 400% of its networth as on last audited balance sheet under the automatic route. However, w.e.f. the date of the notification i.e. August 14, 2013, the overall limit for such investments has been reduced to 100% of networth of the Indian party.

In natural resources and energy sectors

The revised limit of 100% of Indian company's networth has also been introduced for investments in the overseas unincorporated entities in the energy and natural resources sectors under automatic route with an exception of applicability to Navratna PSUs, ONGC Videsh Limited and Oil India Ltd to their existing projects duly approved by the Government. Previously, the limit for investing in oil and natural resources sector was 400% of the networth of the Indian party as on date of its last audited balance sheet.

Our Analysis:

The reduction in limit has been introduced with immediate effect and the change is prospective in nature. In other words, an Indian party can now only invest up to

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[1] Text of the press release is available here: http://rbi.org.in/scripts/BS_PressReleaseDisplay.aspx?prid=29309

[2] Text of the notification is available here: http://rbi.org.in/Scripts/NotificationUser.aspx?Id=8305&Mode=0

[3] Text of the notification is available here: http://rbi.org.in/Scripts/NotificationUser.aspx?Id=8306&Mode=0

100% of its networth in all new JV/WOS to be set up. It has been clarified in the notification that such change would not apply to the existing JV/WOS set up under the extant regulations. Will this mean that an Indian party can continue to have an exposure up to 400% in all its existing ventures? Yes, as per the notification, the reduced limit is applicable to all new ventures of an Indian party and it may continue to have investments up to 400% of its networth in its existing ventures. It reverses the relaxation in automatic investment that had been eased to 400% by 2007. Any genuine requirement beyond these limits will continue to be considered by RBI under the approval route.

However, it is pertinent to note that previously, the limit of 400% was applicable to all 'financial commitments' of the Indian party and included, apart from equity investments, guarantees, loans, investments in other securities etc. The notification has used the term '*overseas direct investments*' and thus unclear whether the guarantees, loan etc are included in the revised limit or whether its applicable to investments in securities only. In our view, the revised limit should be applicable to whole 'financial commitments' of the Indian party as the very intention of the Central Bank behind bringing such a change will only be served if every possible way of investing, direct or indirect, outside India is put within this limit. Also, the previous limit of 400% was applicable to 'financial commitments', hence, even the language is unclear, the revised limit will also be applicable to which it applied previously, i.e. 'financial commitments' and not only the 'investments outside India'.

Reduction in limit of investments abroad by individuals

Amendments introduced:

The overall limit for making investments in permitted capital and current account transactions as specified in FEMA (Permissible Capital Account Transactions) Regulations, 2000 and FEMA (Current Account Transactions) Regulations, 2000 respectively was USD 2 lacs per individual per year which has now been reduced to USD 75,000 per year per individual under the LRS scheme and any genuine requirement beyond this limit will continue to be considered by RBI under the approval route. In addition, the applicability of LRS for investments in immovable properties abroad has been withdrawn.

Our Analysis:

The liberalized remittance scheme for individuals was rolled out in 2004, and expanded gradually to allow people to buy property, shares or debt instruments or any other assets outside India, without needing RBI's prior approval by remitting a sum of USD 2 lacs per year. However, with effect from the date of the notification, individuals can spend/remit only USD 75,000 per year for permissible capital and current account transactions or a combination of both.

Article

Indian rupee is currently traded above 61 to the dollar, compared to 54 in March, 2013. The rupee has fallen more than 10% this year – the second worst performance in Asia after the Japanese yen – exacerbating an already stubborn current account deficit that is currently a record 4.8% of GDP[4]. The recent measures of RBI including the present one are aimed at restricting the outflow of foreign currency, thus reducing pressure on the rupee.

Some other measures adopted by the RBI in past few months to strengthen rupee includes prohibiting import of gold in the form of coins and medallions, raising its Marginal Standing Facility (MSF) rate from 8.25% to 10.25%. But foreign exchange analysts expressed negative views on the recent step of RBI reducing the ODI limits stating that it attempts to conserve dollar resources to defend the rupee and cut the current account deficit, and thus, may not be very useful.

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[4] http://www.centralbanking.com/central-banking/news/2289138/rbi-cuts-overseas-investment-limit-by-three-quarters