Non-Deliverable Derivative

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Non-Deliverable Derivative Latest News

Recently, the Reserve Bank of India’s (RBI) gave a directive to bar banks from non-deliverable derivative (NDD) contracts in the rupee.

About Non-Deliverable Derivative

- An NDD is a **derivative contract** where two parties agree on a **future exchange rate for the rupee, but settle the difference in cash**, usually in US dollars.
- **Reason for formation:** As India has capital controls, offshore investors **can’t freely trade** in the **rupee in physical form**. This led to the creation of the NDD markets in the rupee.
- **Participating Parities:** The NDD market is widely **used by foreign investors, hedge funds and global banks** who cannot freely access and play in the Indian rupee market.
- These trades take place offshore, **outside the control of the RBI.**
- This often acts as a **price discovery mechanism for the rupee**, even influencing expectations before Indian markets open.

- **Issues with NDD**
    - **Distort Price Discovery:** These instruments have long been criticised for **distorting price discovery**.
    - **Used For Speculation:** Some participants would **cancel and re-enter contracts** to take advantage of favourable movements, effectively turning hedging tools into speculative instruments.

Source: IE
