Sovereign Risk, Currency Mismatch and Financial Stability in Emerging Economies: An Integrative Review of Macro-Financial Transmission Channels with Evidence from India

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Abstract

This paper presents a review of the research related to transmission of currency risk across balance sheets of sovereigns, banks, foreign investors and corporations that are interconnected. It provides a comprehensive review of the existing literature relating to sovereign risk, cross-border capital movements, exchange rate risk in banks, local currency bond market and currency mismatch. This paper also aims to present a framework for further studies on the determination of financial stability in emerging economies. Financial stability in emerging economies is not solely governed by foreign currency debt of sovereigns but is also impacted by distribution of currency risk across the financial system, hedging of currency risk by corporations and resilience of domestic financial system to financial stress. This paper also attempts to integrate these factors to present a framework for further research.

Keywords: Sovereign Risk; Currency Mismatch; Financial Stability; Emerging Economies

JEL classification: F31; F34; F36; G15; G21; G32.

1.Introduction

The relationship between exchange rates, external financing of sovereigns and financial stability has become an area of growing importance in international finance. External financing provided to emerging and developing economies can aid investment and economic development but also can create issues during large exchange rate movements or during changes in the environment surrounding external financing.

External financing, exchange rates, external borrowing in foreign currencies, capital flows and costs of financing are all closely related to the domestic costs of financing.

Currency mismatch arises when firms have currency mismatches in assets/income (and/or) liabilities. For example, an Indian firm can earn most of its income in the domestic currency,

but borrow in US dollars. A depreciation in the exchange rate against this firm would lead to deterioration in its domestic currency liabilities. This in turn can have implications for banks on their loan books.

Firm problems can also spill over to banks on their loan books which can in turn impact the availability of lending and put pressure on the financial system as a whole.

Currency risk also has implications for balance sheets of banks, foreign investors and sovereigns in emerging markets.

Some sovereigns in emerging markets may have external currency debt. Banks in emerging markets can have direct/indirect exposure to foreign currencies. Foreign investors in emerging markets may hold bonds of sovereigns in those countries issued in the domestic currency.

Thus exchange rate movements can have implications for multiple balance sheets.

I would examine transmission of currency risk to and across the balance sheets of sovereigns, corporations, banks and foreign investors in emerging markets. I will also examine scenarios where spillovers across the above mentioned institutions can pose risks to financial stability. I would also use some of the work done by Bernoth and Herwartz (2021) and Della Corte et al. (2022), and Du and Schreger (2022) on the link between corporate external currency exposure and sovereign risk.

In India, the financial sector consists of domestic government securities, external commercial borrowings by firms, banking and foreign investment into Indian financial markets. Evidence on foreign exchange exposure of non-financial firms in India has been provided in the paper by Goel et al. (2025). This paper would explore the above-mentioned issues in India in the context of the Indian financial system.

1.1 Research problem

The research questions mentioned above highlight the gaps between existing research on sovereign risk, corporate finance, banking and foreign finance and their interconnectivity. This paper would try to present evidence on transmission of exchange rate risks across the financial system, transmission of currency risk between the areas mentioned above and the implications of transmission of currency risk for financial stability.

1.2 Objectives and research questions

· Investigate the relationship between currency mismatch, sovereign risk and financial stability.

· Examine the effect of exchange rate movements on the balance sheets of corporations and sovereigns in emerging economies.

· Investigate the role of banks in transmission and amplification of currency risk.

· Analyse if sovereigns issuing bonds in local currency eliminate some currency risk or not?

· Synthesise existing literature and present a framework that captures the interconnectivity of the balance sheets of sovereigns, banks, corporations and foreign investors.

· Identify gaps in the literature and policy relevance with emphasis on India.

(1)How does currency mismatch influence the relationship between exchange rate movements and sovereign risk? (2) How does external currency exposure of corporations influence banks and the financial system? (3) What is the relationship between banks and sovereigns in the context of currency risk? (4) Does local currency

sovereign debt eliminate some currency risk or not? (5) How do global financial conditions and capital flows interact with local risk? (6) What are the implications of synthesising the existing research on India?

2.Theoretical framework

2.1 Sovereign risk and external borrowing

Sovereign risk is the risk of default or the risk of an increase in default costs due to the perception of a higher default risk, restructuring risk or a risk of non-payment by a sovereign. This risk can be influenced by fiscal policy, public debt, growth, governance, external borrowing, global financial conditions and also by the mixture of foreign and domestic currency in which sovereign debt is issued. In general, depreciation will have an impact on foreign currency liabilities because of an increase in domestic currency value for any given thing else being equal. Distress in the private sector can also affect sovereign risk through reduced activity, reduced assets held by banks or support offered to banks by the sovereign.

2.2 Currency mismatch in balance sheets

Currency mismatch in balance sheets means the impact of exchange rate movements on the borrowing and investment capacity of a firm due to mismatch of (assets/income and/or) liabilities across currencies. A depreciation can lead to a higher liability to asset ratio, lower repayment capacity and lower investment capacity. These effects may not be homogeneous. Some hedging techniques can also partially mitigate currency mismatch risk (natural hedging, foreign currency earned income, foreign currency assets, financial derivatives). Borrowing in foreign currency may not always have a contractionary effect as argued by Bleakley and Cowan (2008).

2.3 Original sin and currency denomination

Original sin refers to the historical problem faced by emerging economies in accessing external borrowing in their local currency (Eichengreen et al., 2005). Local currency sovereign debt markets can reduce some of the currency mismatch experienced by sovereigns.

There is still risk to foreign investors holding local currency sovereign debt. Local firms can also access external borrowing. Eichengreen et al. (2023) also explicitly mention that currency mismatch can change within a country but not be eliminated.

2.4 Sovereign-bank nexus

The connection between sovereigns and banks is known as sovereign-bank nexus. Sovereigns issue sovereign debt to banks. Sovereigns can also offer explicit and implicit support to banks. Sovereign distress can have an impact on banks through concentration and valuation effects. A banking crisis can have an impact on sovereigns through fiscal costs. Deghi et al. (2022) find evidence of exposure, safety nets and macroeconomic effects. The same link also exists for non-financial firms. Recently, Wezel et al. (2026) also find evidence of strengthened sovereign-bank nexus in low and middle income countries.

2.5 Global financial conditions and capital flows

Global financial conditions (e.g., global liquidity, investor sentiment, dollar liquidity, external borrowing, global interest rates) can have an impact on external borrowing and capital flows. If conditions worsen, this can lead to depreciation, portfolio shifts and refinancing issues. Bruno and Shin (2015) provide a theoretical framework for the risk-taking aspect of global financial conditions. Domestic mismatch can also have an impact on the transmission of external shocks.

3. Review Methodology

3.1 Design and scope

The design of the review is an integrative review. The aim is to integrate evidence from several areas and synthesize studies on sovereign risk, corporate finance, banks and foreign finance. A meta-analysis is not conducted in this paper. No pooled effects will be estimated. The time period considered is 2000 to 30th October 2026. Focus on 2020-2026. Focus on developing and emerging economies.

3.2 Search and selection procedure

Sources of search include Google Scholar, RePEc, EconStor, institutional repositories and publisher repositories. Publications from IMF, BIS, World Bank, Reserve Bank of India etc., are also considered. Queries can include sovereign risk/debt and exchange rate risk/currency mismatch. Corporate external currency exposure in emerging economies. Sovereign-bank nexus and currency. Local currency sovereign debt and foreign investors. India and corporate FX exposure.

The sources considered in this paper constitute a verified seed set and is not a complete search. There are no steps that include checking full text inclusion, removal of duplicates, recording of reasons for exclusion, quality assessment of included papers. No PRISMA counts are done since no complete PRISMA search has been conducted (Page et al., 2021).

3.3 Inclusion and appraisal

The evidence sought is empirical or theoretical research on articles or reports from clearly labelled institutional reports or working papers that address the research questions. Papers that are purely about exchange rate movements without connection to financial/balance sheet effects will not be included. Appraisal criteria include relevance, scope, identification, transparency, data quality, limitations and scope. Working papers will be identified as such and not treated as peer reviewed papers.

4. Literature review

4.1 Sovereign risk, exchange rates

Study by Bernoth and Herwartz (2021) deals with exchange rates, foreign currency exposures and sovereign risk in emerging markets. This study provides additional insights on how firm

foreign currency exposures matter for exchange rate sovereign risk exposure. This is a direct counter to more narrow focus on sovereign risk.

However this study is on the exchange rate sovereign risk relationship. It is not a comprehensive review of risks for banks, firms, sovereigns, foreign investors.

Della Corte et al. (2022) are dealing with sovereign risk, exchange rates from the perspective of asset pricing. They provide evidence for link between sovereign risk and credit. Information on exchange rate markets. This is focused on pricing. Not transmission of balance sheet risks across the domestic economy sectors.

Du and Schreger (2022) are particularly relevant. They show external foreign currency exposures of firms and sovereigns. They show that higher foreign currency exposures of firms are associated with higher sovereign default risk. They provide a sovereign debt model dealing with the relationship between private currency exposures and sovereign incentives. So they already provide link between firms and sovereigns. This paper is not claiming that previous literature lacks such a link. This paper rather proposes to extend the link to foreign investor risk, banking transmission.

So overall implications are that sovereign risk is partly determined by the currency exposures in the economy.

However the studies are different in terms of units of analysis and methodology. Bernoth and Herwartz deal with exchange rates, sovereign risk empirically. Della Corte et al. deal with the pricing of sovereign risk. Du and Schreger deal with sovereign exposures and firm foreign currency exposures. The complementarities of these studies provide reason for integration rather than complete lack of underlying links in the literature.

4.2 Corporate foreign currency exposures, heterogeneity of firms

Corporate foreign currency exposures can help with investment, trade, access to international capital markets. But there are risks with the currency of revenues, foreign assets. Currency of debt maturities. Hedging policies (Froot et al., 1993). A firm with foreign revenues in the currency it is borrowing can be more naturally hedged. A domestic firm with foreign currency debt can be more exposed to exchange rate depreciation.

Bleakley and Cowan (2008) provide a caveat to simplistic balance sheet stories. They provide firm level evidence for Latin America that does not support the claim that there is a uniform contractionary effect when a firm has dollar denominated debt and depreciation. Export revenues, firm characteristics matter. Heterogeneity among firms. This paper focuses on this heterogeneity. Gross foreign currency debt is not the same as net unhedged exposures.

Goel et al. (2025) provide India specific firm level evidence for non-financial firms. They deal with firm characteristics, foreign currency exposures. They also discuss exposures with respect to firm type, hedging, exchange rate exposure. This is useful for context but does not provide

treatment of the transmission of these exposures to banks or sovereign risk or exposures of foreign investors.

De Gregorio et al. (2026) deal with USD bond issuance of non-financial listed firms in emerging markets. They show that offshore debt issuance does not necessarily have a uniform negative effect on competitiveness or investment.

In fact, offshore USD debt is associated with higher cash and then investment. Depreciation is not always associated with lower investment or competitiveness. This is important as it shows that gross exposure is not the same as net currency exposure. Issuance decisions are not the same as borrowing decisions. Also cash, foreign revenues, hedging are important for net exposures.

Alfaro et al. (2025) (BIS working paper) deal with FX exposures, optimal hedging at the firm level for both emerging and advanced markets. They show that most firms can cover FX exposures with foreign assets or revenues. But in emerging markets there is a thicker tail of firms that are significantly exposed to depreciation. This provides support for differentiated treatment of FX exposures rather than uniform treatment.

So overall these studies provide evidence for the need to consider net exposures, natural hedging, financial hedging, liquidity buffers, heterogeneity of firms. Also important to recognize that net foreign currency exposures cannot be inferred only from gross foreign currency exposures.

4.3 Sovereign-bank transmission, sovereign-bank relationship

Deghi et al. (2022) deal with the sovereign-bank relationship in emerging markets post-COVID-19. They use country level, bank level, firm level data. They see three transmission channels. Banks exposure to sovereign debt. Sovereigns as safety net for banks. Transmission through non-financial firms. This is a significant caveat to the proposed research gap. It already includes corporate exposures in the transmission to sovereigns, banks.

Wezel et al. (2026) provide more evidence with more than 120 low income and emerging markets with granular data set. They provide evidence in IMF working paper that sovereign-bank relationship has strengthened post-pandemic. They also show that public debt, deposit rates, non-performing loans are correlates of stronger sovereign-bank relationship. They also discuss potential capital impacts of domestic debt restructurings. This is an institutional working paper. So it should be treated as such. Not as a peer reviewed journal article.

So we have established that banks and sovereigns are mutually exposed. Non-financial firms can be a transmission mechanism between banks and sovereigns. The remaining question that is considered in this paper is the specific currency exposures associated with this mechanism.

Specifically, how do firm foreign currency exposures affect banks. How do the currency exposures of sovereigns relate to bank exposures. How do foreign investors react to domestic

currency exposures. So this paper extends the current treatment by focusing on the risk transmission and redistribution in terms of currency exposures. It is not trying to establish the sovereign-bank-corporate transmission channel itself.

4.4 Local currency sovereign debt, foreign investor exposures

Ottonello and Perez (2019) deal with currency exposures of sovereign debt. Incentives for local and foreign exposures to sovereign debt. They deal with the trade-offs of currency exposures in sovereign debt. Risk and incentives with respect to inflation, debt dilution, insurance. Gadanecz et al. (2018) show that exchange rate risk is present in local currency sovereign debt in emerging markets. Chernov et al. (2023) deal with exchange rate risk and sovereign risk in local currency bonds in the Asia-Pacific region.

Eichengreen et al. (2023) are most important for this paper. They challenge the view that local currency debt removes currency exposure. They show that local currency debt in emerging markets and foreign investor exposures can lead to a shift in currency exposures within the economy. It does not eliminate currency exposures. So this paper cannot claim that the redistribution mechanism is novel. Rather this paper seeks to relate this finding to the exposures of firms with foreign currency exposures. It also relates this to the transmission mechanisms through banks and sovereigns discussed above.

So overall these studies provide evidence that local currency sovereign exposures can reduce direct currency exposure of sovereigns. But exposures to currency depreciation can remain for foreign investors. The extent to which this is related to capital flows will depend on the characteristics of foreign investors. Liquidity, hedging, heterogeneity of investors, global conditions. These transmission mechanisms should also be related to the exposures of firms and banks.

4.5 Global transmission, cross market exposures

Bruno and Shin (2015) deal with transmission through risk taking changes, cross market exposures. These studies help with understanding how global liquidity conditions and risk taking of intermediaries can affect the transmission of capital across markets. In an emerging market with significant foreign currency exposures, tightening conditions can interact with exchange rate depreciation, refinancing pressure.

This transmission channel can be linked to other transmission mechanisms. A change in global liquidity can affect exposures of foreign investors to local currency exposures. It can affect FX exposures of firms. It can affect funding conditions for banks. But the impact will depend on the degree to which firms have foreign revenues or liquid foreign assets. It will also depend on the depth of domestic markets. So a complete treatment must distinguish between the initial trigger and transmission mechanisms that amplify the impact.

4.6 India context

India is used as a contextual case. It is not a representative of all emerging markets. Goel et al. (2025) provide firm level evidence for Indian non-financial firms. Previous literature on sovereign risk, FX exposures of firms and sovereigns, sovereign-bank relationship provide mechanisms for comparison. For India, the focus should be on corporate external commercial borrowing, domestic currency government bonds, bank intermediation, foreign investor exposures.

This review makes no unsupported claims that India lacks firm level information, mandatory hedging, stress testing. A comparison of such policies requires a separate review of current policies for RBI, ECB, firm information and such in peer countries. At this point, a defensible conclusion is that future research should integrate India specific firm exposures with sovereign, bank, foreign investor exposures.

5. Research gap and proposed contribution

5.1 What is already established

Du and Schreger (2022) show a link between firm currency exposures and sovereign risk. Eichengreen et al. (2023) show transmission of currency exposures with the development of local currency sovereign markets. They also show redistribution of currency exposures. Deghi et al. (2022) show transmission through non-financial firms to sovereign-bank exposures. Wezel et al. (2026) provide recent evidence on sovereign-bank relationship for a large number of emerging and low income markets. Ballester et al. (2019) also provide a treatment of sovereign connectedness and contagion in emerging markets.

So we have established that sovereign-corporate transmission is not new. Sovereign-bank transmission is not new. Transmission through non-financial firms is not new. Also, transmission of currency exposures with development of local currency sovereign markets is not new. So this paper cannot make the claim that the link between sovereigns and firms is absent in the literature. It cannot make the claim that the link between sovereigns and banks is absent in the literature. It cannot make the claim that the link between firms and banks is absent in the literature. It cannot make the claim that a comprehensive review of financial contagion across emerging markets is absent in the literature. So the research gap must be more specific.

5.2 Specific gaps

The existing literature focuses on partially disjointed components. Sovereign and corporate exposures to foreign currency. FX exposures of firms and hedging. Exposures between sovereigns and banks. Exposures to foreign investors through local currency sovereign debt. Some of these exposures are linked in the studies. But there is no single comprehensive review of transmission of currency exposures across all these components. There is a need for

a comprehensive transmission review. This review should integrate all of these balance sheet exposures. It should also integrate transmission through each of these.

Also, transmission of currency exposures with the development of local currency sovereign markets is well established. Especially by Eichengreen et al. (2023). But the transmission of these exposures through foreign currency exposures of firms and banks is an open question. Local currency sovereign exposures can reduce direct exposures of sovereigns. But exposures to currency depreciation can remain for foreign investors. Also, corporations can remain exposed to foreign currency exposures. Transmission through these exposures can occur through firm repaying debt. It can occur through banks exposures. It can occur through changes in investor exposures.

Also, sovereign-bank transmissions have been shown to be transmitted through non-financial firms. But the remaining question is how net hedging and currency exposures of firm exposures affect this transmission. Also, how this changes when banks are also exposed to sovereign exposures and corporate exposures with foreign currency exposures.

There has been an advancement of India specific firm level data. But this does not by itself help with answering the question of how to integrate firm exposures to foreign currency into the sovereign-bank-investor transmission framework. A comparative analysis can identify where there is evidence for India specific data. It can identify where additional data is needed to connect India specific data with sovereign exposures, bank exposures, foreign investor exposures.

5.3 Consolidated research gap statement

Much of the current literature deals with sovereign risk, exchange rates, corporate foreign currency exposures, exposures of banks, exposures to local currency sovereign debt. But these studies have not been sufficiently integrated to deal with the transmission of currency exposures across the balance sheets of sovereigns, firms, banks, foreign investors in emerging markets.

Specifically, the development of local currency sovereign debt markets can reduce currency exposures of sovereigns. But it does not eliminate currency exposures in the financial system. Exposures can remain with foreign investors and corporations. Also corporate exposures to foreign currency exposures can affect firm exposures with exchange rate depreciation. It can affect bank exposures. It can affect sovereign exposures. India specific firm exposures to foreign currency exposures can provide some context. But it should be considered within the emerging market transmission framework. This framework should include exposures of sovereigns, firms, banks, foreign investors. So this paper aims to provide an integrative transmission framework to deal with transmission and redistribution of currency exposures across sovereign, firm, bank, foreign investor balance sheets in emerging markets. It also aims to identify implications for financial stability.

5.4 Proposed contribution and differentiation

This paper makes a proposed integrative contribution. It does not claim to make a novel theory.

First, it organizes evidence across sovereigns, firms, banks, foreign investors.

Second, it recognizes that reduction of sovereign currency exposures does not mean complete elimination of currency exposures in the financial system.

Third, it includes corporate FX exposures in the sovereign-bank transmission framework. It also recognizes that some work has been done on this transmission. Fourth, it uses India specific firm exposures as a contextual anchor. It identifies additional evidence needed to connect these exposures with foreign investors, sovereign exposures, bank exposures.

The claim to novelty can only be made after a broader search and comparison of existing reviews on sovereign-bank transmission, sovereign risk, firm exposures to foreign currency exposures, local currency sovereign bond markets, financial stability in emerging markets is completed. At this point, the present evidence is sufficient to refine the claim. But it is not sufficient to establish the absence of an existing comprehensive review.

6. Integrated conceptual framework

There are four balance sheets affected by exchange rate changes and external financial shocks. The sovereign balance sheet includes government resources, reserves, public debt by maturity and currency, and government securities held by banks. The corporate balance sheet includes foreign currency assets, foreign currency revenue and foreign currency liabilities. The corporate balance sheet also includes maturity structure and hedging. The banking balance sheet includes direct currency exposures, foreign currency exposures via loans to exposed corporations, and exposures to sovereign debt. The international investor balance sheet includes local currency exposures to sovereign and corporate debt and the associated exposures through hedging.

Exchange rate depreciation can increase the domestic currency value of foreign currency liabilities. Corporate financial distress can increase bank credit risk. Sovereign financial distress can increase banks' exposures to sovereign debt. Foreign investor losses and/or portfolio adjustments can affect capital flows and exchange rates. All of these are potential feedback effects. The strength of feedback effects depends on maturity structure, liquidity, hedging, derivatives, institutional credibility, depth of markets, reserves, bank capital and natural hedges.

The integrated framework identifies (i) source of shock; (ii) gross and net exposures by currency; (iii) transmission across sectors; (iv) risk redistribution; and (v) role of institutions and buffers in mitigating risk.

7. Conceptual propositions

· Proposition 1: The positive relationship between exchange rate depreciation and sovereign balance sheet risk is likely to be stronger when there are significant unhedged foreign currency liabilities in both public and private sectors.

· Proposition 2: Corporations with exposures to foreign currency without sufficient hedging or foreign currency revenues are likely to increase risk for corporations in a depreciation. This may increase bank credit risk.

· Proposition 3: Currency mismatch in corporations, bank exposures and sovereign debt holdings may increase financial stress transmission in the face of exchange rate changes which coincide with sovereign financing stress.

· Proposition 4: The development of domestic currency sovereign debt markets can reduce sovereign direct exposure to foreign currency.

However, it can increase exchange rate exposure to international investors. Other balance sheet vulnerabilities may remain unaddressed.

· Proposition 5: Countries with adequate buffers, deeper domestic financial markets, stronger institutions in banking and sufficient hedging mechanisms in corporations are likely to reduce transmission of exchange rate risk.

These conceptual propositions are relationships identified in the integrative framework. These are not hypotheses to be tested statistically. These are not findings in this paper.

8. Research and policy implications

8.1 Research needs

· Develop measures of net currency exposure across sectors which distinguish gross foreign exchange debt from foreign currency assets, foreign currency income and foreign exchange derivatives.

· Investigate relationship between foreign currency liabilities of corporations and bank credit risk. Control for quality of firm, sector and macroeconomic environment.

· Investigate relationship between foreign investor investment in domestic currency sovereign debt and exchange rate sensitivity and capital flows in the face of international tightening.

· Investigate relationship between external commercial borrowing and hedging of Indian corporations and bank exposures and sovereign debt holdings.

· Investigate differences across emerging markets in institutional quality, exchange rate regimes, depth of financial markets, adequacy of reserves and depth of markets.

8.2 Policy implications

First, analysis of foreign currency exposures should differentiate between gross foreign currency debt and net unhedged exposures. It should include exposures in the sovereign, corporate and banking sectors.

Second, foreign currency exposures in the form of assets, liabilities, revenues, hedging and maturity structure should be part of risk management and disclosure in corporations. This should be beyond total debt.

Third, banks should also analyze foreign currency exposures of their borrowers and their own exposures and concentration in sovereign debt. Fourth, the development of markets for domestic currency sovereign debt should be accompanied by monitoring of hedging, liquidity and exposures of foreign investors. Fifth, stress testing scenarios involving exchange rate movements, capital flows, refinancing stress and potential feedback between banks and the sovereign sector should be coordinated by policy makers.

These are research and policy needs for India. These are not claims that the current policy framework is lacking in adequate provisions. Recommendations regarding reporting requirements, mandatory hedging levels or regulatory reform would require separate analysis of the current regulatory framework of SEBI and RBI.

9. Limitations

This paper is an integrative review and conceptual synthesis. It is not a systematic review or meta-analysis. The evidence has been verified and represents a seed set. Full text eligibility and quality assessment has not been completed. All of the relationships identified in the paper may not apply to all emerging markets. Differences in institutions, exchange rate arrangements, depth of financial markets, sovereign debt structure and foreign currency exposures may result in differences in transmission of risks across balance sheets. India is used as a contextual example. No new data is estimated. The conceptual propositions require further empirical testing.

10. Conclusion

Risks to sovereigns, financial stress and currency mismatches can be related through the balance sheets of sovereigns, corporations, banks and foreign investors. Exchange rate depreciation can increase the domestic currency value of foreign currency liabilities. It can affect corporate repayment capacity. It can affect the quality of bank assets. It can affect sovereign financing. Foreign investors with domestic currency assets can be exposed to exchange rate risk and can adjust their portfolios accordingly.

The key conclusion of this review is the need to analyze these risks in an integrated framework of balance sheets. The development of markets for domestic currency sovereign debt can reduce sovereign exposure to foreign currency. It does not eliminate other exposures to foreign currency in the system. Corporations can still have foreign currency exposures. Banks can be exposed through exposures to foreign currency in their loan portfolios as well as through their sovereign exposures. Foreign investors can react to currency and liquidity conditions. Some of these relationships have been identified individually in the literature. This paper tries to integrate these relationships into a framework of four players. It tries to integrate Indian evidence about corporations into the broader context of emerging markets.

This paper provides a framework for future research. It does not try to present a novel theory or untested propositions as established facts.

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