Strong FCNR Inflows Support Rupee, Complicate Liquidity Management

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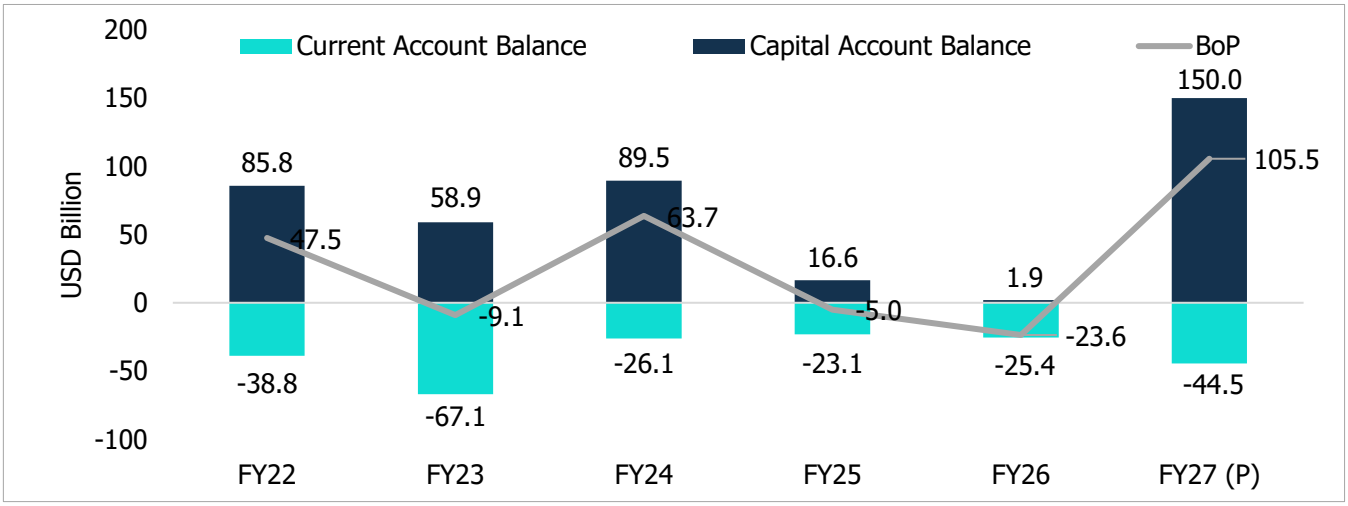
FCNR (B) Inflows Surpass Expectations to Touch USD 127 Billion

The concessional swap window for FCNR(B) deposits closed on August 31, 2026, one month earlier than initially envisaged. Inflows under the scheme touched a high of USD 127.2 billion, significantly exceeding market expectations, including our own projection of USD 70 billion. Together with USD 9.2 billion of inflows mobilised through ECBs and OFCBs, for which the concessional swap window remains open until December 31, 2026, total inflows reported by banks stood at USD 136.4 billion as of August 31, 2026. Notably, nearly half of the FCNR(B) inflows were mobilised during the final ten days of the scheme, highlighting the strong investor response.

Beyond banking-sector inflows, foreign direct investment (FDI) has also remained resilient. Net FDI (gross inflows net of repatriation and FDI abroad) rose 15.9% YoY to USD 6.1 billion in Q1 FY27, supported by a healthy 7.6% YoY increase in gross inflows. Policy liberalisation is likely to provide additional support. In March 2026, the Department for Promotion of Industry and Internal Trade (DPIIT) eased investment norms for countries sharing a land border with India. Subsequently, through Press Note 3 released in July 2026, the government permitted FDI in inventory-based e-commerce for the exclusive export of goods manufactured in India. While FDI inflows tend to be lumpy, we expect the broader uptrend to continue and accordingly revise our FY27 net FDI forecast to USD 20 billion from USD 15 billion earlier.

Reflecting stronger-than-expected banking-sector and investment inflows, we have revised our FY27 external-sector projections. We now expect the capital account surplus to rise to USD 150 billion. With the current account deficit projected at USD 44 billion (~1% of GDP), the overall balance of payments is expected to record a surplus of USD 106 billion in FY27, compared with a deficit of USD 23 billion in FY26.

Exhibit 1: BoP to Move to a Large Surplus in FY27



Source: CEIC, CareEdge; Note – FY27 are CareEdge Projections

Table 1: Summary of Balance of Payments Position

	Unit	FY23	FY24	FY25	FY26	FY27 (P)
Merchandise Trade Balance	USD bn	**-265**	**-245**	**-287**	**-337**	**-390**
Merchandise Export	USD bn	456	441	442	446	474
Merchandise Imports	USD bn	721	686	729	783	864
Services Trade Balance	USD bn	**143**	**163**	**189**	**217**	**245**
Services Exports	USD bn	325	341	388	421	455
Services Imports	USD bn	182	178	199	205	210
Transfer	USD bn	**101**	**106**	**123**	**144**	**151**
Income	USD bn	**-46**	**-50**	**-48**	**-48**	**-50**
Current Account Balance	USD bn	**-67**	**-26**	**-23**	**-25**	**-44**
	% of GDP	**-2.0%**	**-0.7%**	**-0.6%**	**-0.6%**	**-1.0%**
GDP	USD tn	3.3	3.6	3.9	4.0	4.3
Foreign Investments	USD bn	23	54	5	-9	25
FPI	USD bn	-5	44	4	-16	5
FDI	USD bn	28	10	1	7	20
Loans, Banking Capital & Other Capital	USD bn	36	35	12	11	125*
Capital Account Balance	**USD bn**	**59**	**90**	**17**	**2**	**150**
	% of GDP	1.8	2.5	0.4	0.0	3.5
BoP Balance	**USD bn**	**-8**	**63**	**-6**	**-23**	**106**
	% of GDP	-0.2	1.7	-0.2	-0.6	2.4

Source: CEIC, CareEdge; Note – Data for FY27 are CareEdge Projections; FCNR Deposits, ECBs and OFCBs are included in the "Loans, Banking Capital & Other Capital" category of the Capital Account; *After adjusting for netting and outflows under Other Capital

Exhibit 2: Forward Book of RBI

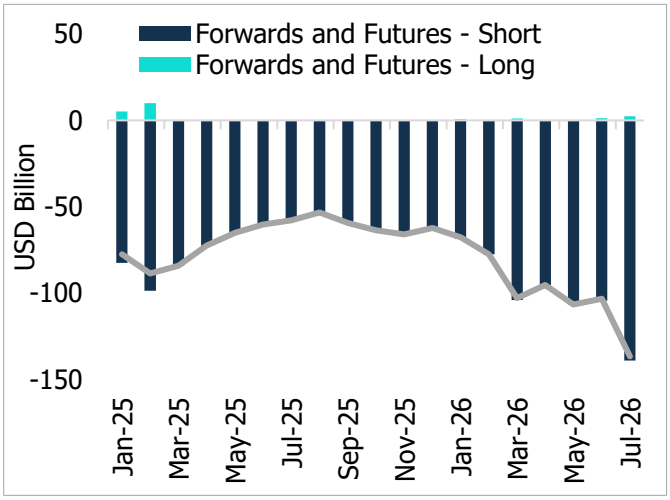
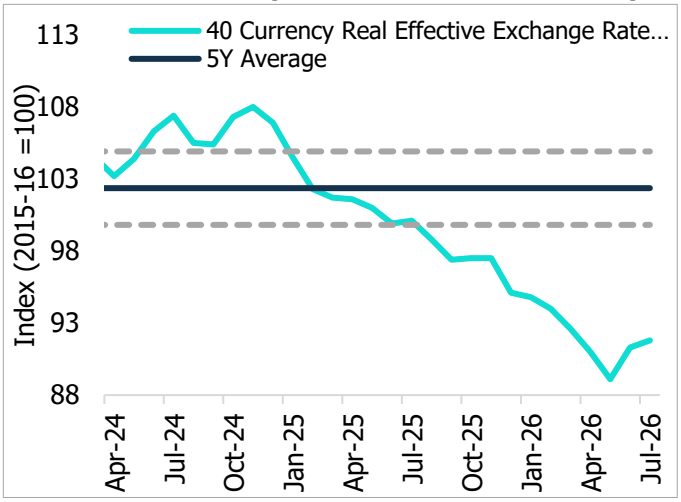


Exhibit 3: REER-Implied Undervaluation of Rupee



Source: CEIC, RBI, CareEdge

Rupee Likely to Appreciate Only Marginally

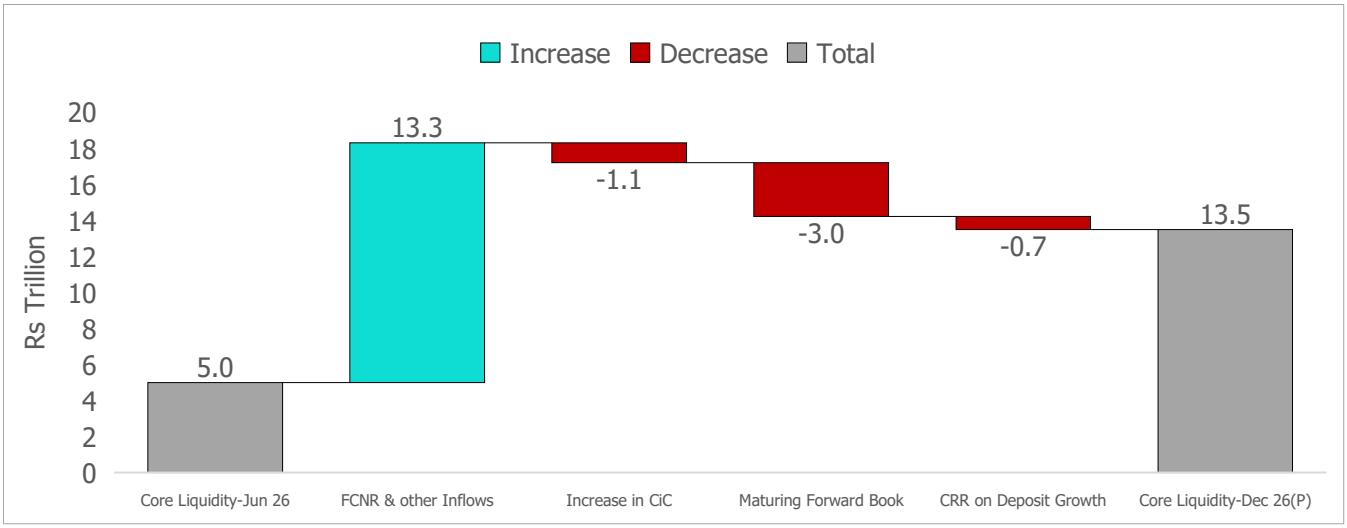
The inflows from the concessional swap window have provided the RBI with sufficient firepower to keep the rupee stable in the volatile external environment. The RBI has been actively intervening in both the spot and forward markets with its forward book reaching a record net short position of USD 136.7 billion in July 2026, up from USD

103.3 billion in June 2026 (Exhibit 2). While the rupee appreciated marginally in the last couple of weeks likely reflecting a reshaping of expectations of a persistently weaker rupee, the scope for a significant appreciation remains limited. This is because the RBI will utilise some of the inflows to unwind its forward short position. Additionally, rising domestic inflation through the year will scale back the extent of Real Effective Exchange Rate (REER)-implied undervaluation (Exhibit 3). The rupee will also likely be under pressure from higher oil prices stemming from the volatile geopolitical situation, volatile FPI flows and rising global G-sec yields. We expect the USD/INR to range between 93-94 by end-FY27.

Robust FCNR Flows to Add to Liquidity Glut

Beyond strengthening the capital account and the overall balance of payments, these sizeable inflows are also likely to lead to a surge in liquidity conditions. However, the upside to the liquidity inflows could be partly offset by seasonal currency demand and the RBI's maturing forward book. We estimate that currency in circulation (CiC) could rise by around Rs 1.1 trillion from June levels by December amid seasonal uptick in festive periods. Further, maturing RBI's short positions in the forwards market should create additional drag of around Rs 3 trillion (RBI short-forward book maturing stands at USD 22 bn in 3 months). CRR accretion on the deposit growth should further reduce core liquidity by Rs 0.7 trillion. Thus, even after adjusting for the increase in currency in circulation during the upcoming festive season and the maturity of the RBI's short dollar positions in the forward markets, we expect core liquidity to rise from Rs 8.1 trillion as of mid-August to potentially closer to Rs 13-14 trillion by December-end (4.5-5% of the NDTL), in the absence of any liquidity management operations by the RBI. Higher core liquidity implies higher banking systemic liquidity after adjusting for the changes in the government cash balance.

Exhibit 8: Expected Changes in Core Liquidity Since the FCNR Policy Announcement in June



Source: CEIC, RBI, CareEdge. Core liquidity = banking system liquidity + government cash balance. Assumptions: 3% CRR on 12% deposit growth, unwinding of USD 30 bn RBI short-forward book. CiC assumed to grow ~2.5% between June–December, based on the past 10 years average, excluding demonetisation years.

RBI's Focus to Shift to Liquidity Management

The RBI has, in the past, used multiple tools to drain excess liquidity from the system, depending on the circumstances, with varied implications for the bond and forex markets. In the current context, the RBI may initially deploy a mix of liquidity management tools, including longer-tenor VRRR operations and OMO sales, to absorb the emerging surplus liquidity. These measures could be followed by more liquidity-absorption tools such as the Incremental Cash Reserve Ratio (I-CRR) if the surplus proves persistent. However, this could counteract the benefit

of the exemption from Cash Reserve Ratio (CRR) and Statutory Liquidity Ratio (SLR) given to banks for raising FCNR deposits from abroad. Nonetheless, if the liquidity glut persists for an extended period, a hike in I-CRR can be considered.

The RBI's short forward book could be allowed to mature at its own pace and not actively reduce it to avoid weakening pressure on the currency. The possibility of forex swaps looks unlikely, as the RBI would prefer to keep reserve levels comfortable amid a volatile external environment. The Market Stabilisation Scheme (MSS) can also be ruled out as a liquidity management tool.

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