RBI may incur $9-12 bn in FCNR(B) hedging costs

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RBI's special FCNR(B) swap window could entail billions of dollars in hedging costs if inflows reach $70 billion.

The Reserve Bank of India (RBI) could incur $9-12 billion over five years in hedging costs if foreign currency non-resident (bank), or FCNR(B), deposits mobilised under its special swap window reach $70 billion, as economists expect the annual cost of hedging to be in the range of 2.5-3.5%.

The RBI has already received $52.3 billion through FCNR(B) deposits as of August 13, which would translate into a five-year hedging cost of about $6.5-9.1 billion at the same range of annual costs. Including overseas foreign currency borrowings and external commercial borrowings, total inflows under the RBI's broader concessional forex facility stood at $56.84 billion.

The 2.5-3.5% range reflects the cost the RBI is effectively absorbing by taking on the currency hedge for banks. A June analysis by Waterfield Advisors estimated the annual hedging cost at around 2.5%, equivalent to 12.5% of the amount raised over a five-year tenor. At the upper end, a 3.5% annual cost would imply an 17.5% cumulative outgo over five years.

Madhavi Arora, chief economist at Emkay Global Financial Services, has estimated that the roughly $9-10 billion cost on the inflows mobilised so far assumes a 3.5% annual hedging cost over five years.

The $70-billion scenario is not implausible given the pace of mobilisation. Gaura Sen Gupta, chief economist at IDFC FIRST Bank, expects FCNR(B) inflows to rise further as banks step up mobilisation before the facility closes. Earlier estimates from market participants had put potential inflows in the $60-70 billion range.

At $70 billion, therefore, every 1 percentage point of annual hedging cost represents $700 million a year, or $3.5 billion over five years. At 2.5%, the five-year cost would be $8.75 billion; at 3.5%, it would be $12.25 billion.

The potential cost, however, is unlikely to represent a significant hit to the RBI's balance sheet. "There will be a cost, but it will not be significant given the size of the RBI's balance sheet," said Madan Sabnavis, chief economist at Bank of Baroda. The central bank's balance sheet increased

20.6% year-on-year to ₹91.97 lakh crore ($963.5 billion) at the end of March 2026.

More importantly, the gross hedging cost does not amount to an equivalent economic loss. The dollars brought into the country add to the RBI's foreign exchange reserves, which can be invested in interest-bearing foreign assets. The income from those assets would partly offset the cost of the hedge.

"If you are looking only at the cost side, you should also look at the fact that they will invest these reserves in short-term US Treasuries where the yield is quite high," said Gaura Sen Gupta.

The accounting impact could nevertheless be visible on the RBI's books. The cost of the hedge could result in an interim loss in the central bank's forward valuation account and may require additional provisioning.

The scale of the inflows has already prompted the RBI to bring forward the closure of the special window. On Friday, the central bank said fresh FCNR(B) deposits would be eligible for the facility only if mobilised by August 31, a month earlier than the original September 30 deadline. Swaps against eligible deposits can still be availed of until September 11.

The early closure itself underlines how quickly the scheme has exceeded initial expectations. The facility was introduced in June to encourage banks to raise three-to-five-year foreign currency deposits by allowing them to swap the dollars with the RBI while the central bank absorbed the hedging cost. The measure also removed the cost disadvantage that had previously limited banks' ability to offer competitive FCNR(B) rates.

The economics are straightforward. Banks accepting dollar deposits from non-residents normally have to hedge the currency risk because they must return the principal and interest in dollars when the deposit matures. The RBI's intervention removes that cost for eligible deposits, allowing banks to offer substantially higher interest rates to depositors. Madhavi Arora had estimated in June that banks could offer 6.0-6.6% on FCNR(B) deposits with the hedging cost absorbed by the RBI.

The current exercise echoes the 2013 FCNR(B) mobilisation, although the circumstances are different. The earlier scheme was launched when the rupee was under intense pressure following the US Federal Reserve's tapering signals, while India was dealing with a large current account deficit and much lower foreign exchange reserves. The special swap window helped attract about $34 billion in FCNR(B) deposits and other foreign currency funding.

The present facility is therefore doing more than adding to the RBI's reserves. It is also giving banks access to three-to-five-year foreign currency funding that can otherwise be relatively expensive to mobilise. The question is whether the benefit of those inflows justifies the cost the central bank is taking on.

India’s foreign exchange reserves rose $14.1 billion to $707 billion in the week ended August 7, their highest level so far this financial year. Against that backdrop, the immediate objective of the FCNR(B) window — bringing in dollars and easing pressure on the external account — appears to have been achieved to a significant degree.

The more relevant measure, therefore, is not the headline $9-12 billion cost in isolation. It is whether the foreign currency raised, the income earned on the resulting reserves and the funding benefits to banks provide an adequate return for the risk and cost being assumed by the central bank.