Currencies

India's central bank raises $40bn from diaspora to support sagging rupee

CHRIS KAY AND KRISHN KAUSHIK
MUMBAI

India's drive to tap the savings of its vast diaspora has drawn stronger than expected inflows, boosting the central bank's efforts to stabilise the ailing rupee ahead of a monetary policy decision today.

The Reserve Bank of India said at the weekend that $40.8bn had come into the country since it announced a campaign in June to lure foreign exchange from the country's overseas citizens — a mobilisation that has only been deployed five times since 1990.

The inflows come as the world's most populous nation, a major Gulf oil importer, grapples with a sharp rise in energy costs from the war in Iran.

The rupee has weakened 6 per cent against the dollar this year, making it one of Asia's worst-performing currencies, and the country was on track for its third straight fiscal year of a balance of payments deficit.

Economists said the inflows were unexpectedly robust after finance minister Nirmala Sitharaman last month pressed India's state-owned banks to step up outreach to the diaspora.

Lenders have been offering preferential savings rates and leverage on deposits from Indians living abroad, allowing them to borrow extra funds against their cash.

"This is much higher than what we expected," said Madan Sabnavis, chief economist at Bank of Baroda, who estimated the total could "move towards" $60bn by September, which would account for nearly 10 per cent of India's current foreign reserves.

"A large part of this is due to the leverage that has been allowed with some banks offering up to 19 times the size of the initial deposit," he said.

"This explains why the numbers have been high, besides the very attractive rates being offered by banks," Sabnavis added.

The inflows provide greater manoeuvrability to RBI governor Sanjay Malhotra ahead of a monetary policy announcement.

Most economists expect the central bank to hold interest rates, even after annual inflation hit an 18-month high of 4.4 per cent in June after the government raised retail fuel costs.

Much of the diaspora flows came through the RBI's foreign currency non-resident deposits scheme, which runs until the end of September and absorbs the cost of hedging, allowing banks to raise interest rates offered to Indians living abroad.

Just over $4bn was also raised through swap facilities for external commercial borrowing and overseas foreign currency borrowing, which are open until the end of 2026.

India has called on diaspora to support rupee five times

Source: LSEG • Inverted scale

India's central bank has previously called on diaspora flows at vulnerable moments for the economy. The first time was in 1991 when India suffered its most critical balance of payments crisis, which eventually led the government to open up its restrictive economy.

It was last used in 2013 when India raised about $34bn to counter capital outflows from the taper tantrum.

Sonal Varma, chief economist at Nomura for India and Asia ex-Japan, attributed the scheme's success in part to the size of India's diaspora, which has swelled 70 per cent to 37mn since 2013.

India now had "a bigger pool of wealth" to target, said Varma, who estimated that the money from the scheme could hit up to $90bn.

Those flows have yet to translate to a similar rise in India's foreign exchange reserves.

Some economists and traders said the central bank might have used some of the repatriated money to defend the rupee and unwind a short forward dollar position that crossed $100bn in June.

India has shed a net $46bn in reserves since the US and Israel attacked Iran at the end of February.

They stand at $682bn as of July 24 — the latest data available — after rising by almost $10bn from mid-June when US President Donald Trump announced a shaky memorandum of understanding with Tehran that unravelled last month.

> 'This period has to be used to figure out more of a medium-term strategy on dealing with a new reality'

Miguel Chanco, chief emerging Asia economist at Pantheon Economics, said "the jury was still out" on the RBI's diaspora scheme even as the rupee "traded mostly sideways" since June.

"The authorities were also quite lucky in terms of timing as the scheme was introduced around the same time that the US-Iran MoU was being finalised, which eventually sent oil prices crashing to the benefit of India's balance of payments picture," said Chanco.

The "ultimate test", he said, would be whether the flows helped stabilise India's foreign exchange reserves.

Santanu Sengupta, chief India economist at Goldman Sachs, said in a note on Friday that the mobilised dollars were being absorbed on to the RBI's balance sheet with some lag and to create rupee liquidity gradually.

In another note last month, he said the infused dollars were unlikely to be supplied to the spot foreign exchange market and thus would have no impact on the rupee's spot rate.

The short-term inflows would also not fix India's structural balance of payments issues, though they had given the RBI "breathing room", said Varma at Nomura.

"You could argue that in the absence of this scheme, the pressure would have been a lot more," she said.

"This period has to be used to figure out more of a medium-term strategy on dealing with the new reality," Sengupta added, "where capital flow is more volatile and where oil prices are susceptible to extreme volatility."