FCNR(B) Deposits – Can Special Incentives Revive NRI Dollar Inflows?

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FCNR(B) Deposits Latest News

- To strengthen foreign currency inflows and improve external sector liquidity, the RBI has introduced a special dispensation allowing banks to mobilise fresh FCNR(B) deposits with maturities of 3–5 years until September 2026.
- Additionally, banks can swap these deposits with the RBI at concessional terms, effectively eliminating the cost of hedging foreign exchange risk.
- Experts estimate that the move could potentially **attract $50–70 billion** in foreign capital, although its success will depend largely on the interest rates offered by banks.

What are FCNR(B) Deposits?

- Foreign Currency Non-Resident (Bank) [FCNR(B)] deposits are **fixed-term** deposits maintained by:
    - Non-Resident Indians (NRIs)

    - Overseas Citizens of India (OCIs)
    - Persons of Indian Origin (PIOs)
- **Key features:**
    - Deposits are **held in foreign currencies** such as the US Dollar (USD), Pound Sterling (GBP), Euro (EUR), Japanese Yen (JPY), Australian Dollar (AUD), and Canadian Dollar (CAD).
    - Such deposits protect depositors from exchange-rate fluctuations.
    - Interest earned is **exempt** from income tax in India for eligible non-residents.
    - Interest rates are linked to international benchmark rates.

Reasons Behind Introducing New Facility

- **Sharp decline in FCNR(B) inflows:**
    - FCNR(B) inflows fell by 86% in FY26, and fresh inflows dropped to $946 million from $7.1 billion in FY25.
    - Outstanding FCNR(B) deposits stood at $33.8 billion at the end of March FY26.
    - The decline reflects – expiry of earlier regulatory incentives, lower returns compared to overseas deposit options, and strong competition from US dollar deposits abroad.
- **RBI's objective:**
    - To boost foreign currency inflows.
    - Strengthen forex reserves and external sector resilience.
    - Provide banks with a cheaper source of overseas funding.
    - Enhance liquidity without significantly increasing borrowing costs.

Reasons for FCNR(B) Deposits Currently Being Less Attractive

- **Lower interest rates offered by Indian banks:**
    - **For example**, SBI offers 3.35% [3–4 years FCNR(B) rate], HDFC bank offers 3.65%, and ICICI bank offers 3.0%.
    - In contrast, SBI offers about 6.3% on comparable domestic fixed deposits. HDFC and ICICI offer around 6.5% on rupee deposits.
- **Competition from overseas markets:**
    - US dollar deposits abroad provide higher returns.
    - **For example**, Merrick bank offers ~4.2% annualised percentage yield (APY), Morgan Stanley offers ~4.3% APY, and SBI's US Certificate of Deposit (CD) offers ~3.85%.
    - Therefore, **unless** Indian banks **raise** FCNR(B) rates by around 100 basis points (1%), NRIs may have little incentive to transfer funds to India.

Working of RBI's New Swap Facility

- **Concessional hedging support:** The RBI has allowed banks to swap FCNR(B) deposits with the central bank at concessional terms.
- **Mechanism:**
    - Banks sell US dollars to the RBI and simultaneously agree to buy them back at maturity.

    - Swap transactions will occur at the same exchange rate in both legs.
    - The swap is undertaken at par, removing exchange-rate risk.
- **Operational conditions:**
    - Facility available for deposits mobilised up to September 30, 2026.
    - The swap window remains open until October 16, 2026.
    - Banks may access the facility once every week.
    - Minimum transaction size: **$1 million**.
    - Settlement is based on the FBIL Reference Rate.
- **Significance:** The arrangement **transfers** most of the hedging burden from banks to the RBI, reducing costs and enabling banks to offer more competitive FCNR(B) rates without hurting profitability.

Additional Regulatory Relaxations

- To encourage mobilisation of foreign currency deposits, RBI has also exempted these deposits from:
    - **Cash Reserve Ratio (CRR)**: Portion of deposits banks must maintain with RBI as cash reserves.
    - **Statutory Liquidity Ratio (SLR)**: Portion of deposits maintained in liquid assets such as cash, gold, or government securities.
- These exemptions improve banks' deployable resources and lower the cost of raising FCNR(B) funds.

Trends in NRI Deposits During FY26

- **Overall NRI deposit flows**: Total NRI deposit inflows declined to $14.41 billion from $16.16 billion in FY25.
- **NRI deposits comprise:** FCNR(B) deposits, Non-Resident External (NRE) accounts, and Non-Resident Ordinary (NRO) accounts.
- **Shift towards rupee deposits:**
    - Despite the fall in FCNR(B) inflows, NRIs increasingly preferred rupee-denominated deposits.
    - **NRE deposits**: Outstanding balances increased by $7.94 billion. Total outstanding reached $98.56 billion.
    - **NRO deposits:** Increased by $5.53 billion. Outstanding balances reached $33.33 billion.
    - Consequently, total outstanding NRI deposits rose marginally from $164.68 billion to $165.65 billion.

Conclusion

- The RBI's FCNR(B) deposit scheme represents a **targeted** external-sector intervention aimed at attracting foreign currency resources and strengthening financial stability.
- The success of the initiative will ultimately depend on whether lenders can offer sufficiently attractive returns to compete with global dollar deposit markets and revive NRI participation.

Source: IE
