

India: Degrees of rupee defence

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- The RBI has adopted a multi-layered defence strategy to support the rupee this year.
- Parallels with 2013 exist, although the circumstances differ.
- Rupee gains have been accompanied with distortions elsewhere.
- Authorities are likely not done and remain ready to take further action, if needed.
- Scope of further rate increases is high. Not a panacea but a necessary step.
- If FX depreciation pressures return, a larger scale of hike or inter-meeting move might also be considered.

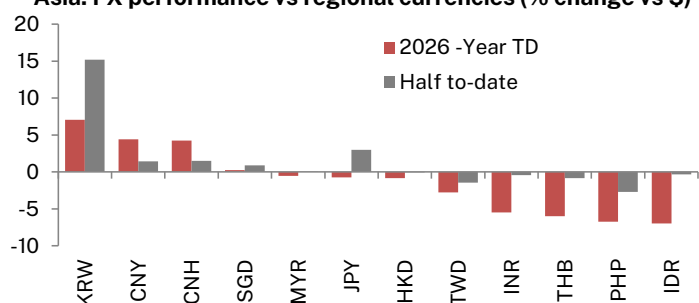
TAKING STOCK

The Reserve Bank of India (RBI) has adopted a multi-layered defence strategy to support the rupee this year.

This has entailed a combination of outright intervention in spot/ forwards, regulatory action, liquidity steps, administrative measures and moves to curb import-related dollar demand.

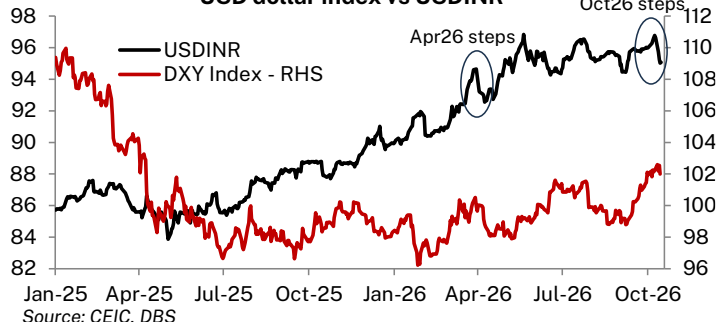
The rupee has appreciated by 1.8% against the dollar in the past five days since recent measures took effect, paring YTD depreciation to 5.5%. High oil prices, weakness in capital inflows, a firm dollar, tariffs/ geopolitical worries, energy, and risk-off sentiments have kept the INR under pressure since last year.

Asia: FX performance vs regional currencies (% change vs \$)



Source: Bloomberg, DBS; as of 15-Oct

USD dollar index vs USDINR



Source: CEIC, DBS

ECHOES OF 2013 WITH FEW DIFFERENCES

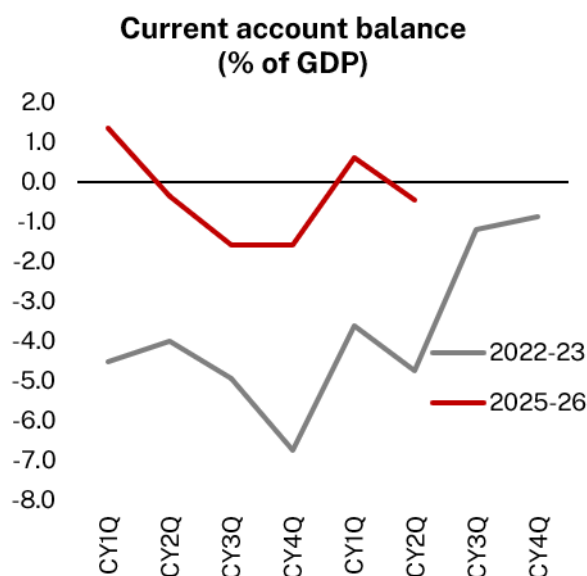
Comparisons with 2013 are apt, though the backdrop differs. As for the catalysts, markets reacted to the US Fed's taper announcement in 2013, which pushed US yields higher and led global investors to reduce exposure to vulnerable EM economies. As a result, capital inflows weakened, exposing funding mismatches for countries, including India, that were running wide current account deficits.

In 2026, markets face the spectre of elevated oil prices, geopolitical uncertainty, global competition for capital, a firm dollar (DXY appreciated +3.8% YTD), and US inflation/ deficits which have settled at levels much higher than pre-pandemic years. This has pushed up UST yields, and the US Fed kicked off its rate-hike cycle in Sep26.

Against this backdrop, **the RBI is pursuing the same objective, i.e., to ensure rupee stability, but the nature of the battle differs.** The defence strategy has shifted from 'crisis management' mode in 2013, due to weaker domestic macroeconomic balances (a wide current account gap, high inflation, a lower reserve buffer, and wide fiscal deficits), to a 'terms-of-trade shock and impact of a firm dollar' in 2026.

Flashpoints are nonetheless similar, with reliance on portfolio financing, leaving the external account vulnerable to shifts in global risk sentiment. Portfolio outflows have emerged as the

primary transmission channel through which external shocks have translated into INR depreciation pressure, compounded by high energy prices and a firm dollar.



Source: CEIC, DBS

FX PLAYBOOK

While the response framework is similar between 2013 and this year, the broad sequence and nature of macroprudential measures differ. **This year's multi-layered rupee defence toolkit has included:**

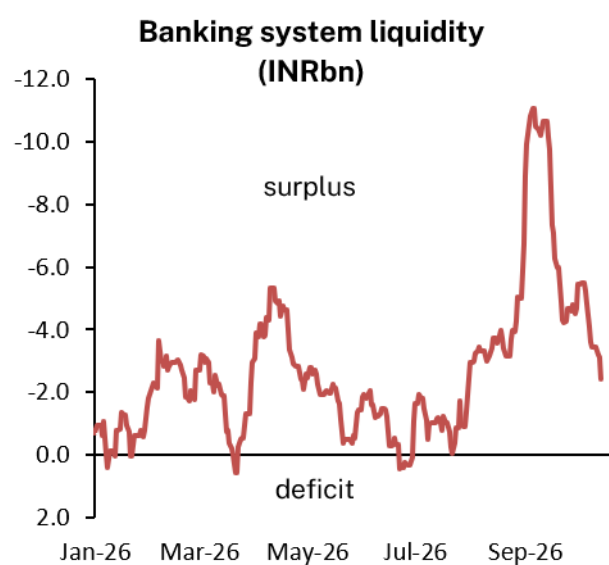
-Direct FX defence by way of intervention in the spot and forwards market. As of Aug26, the net forward dollar liabilities ballooned to \$200bn, rising by ~\$63bn vs. the month before. Recent sell/buy FX swaps are expected to lower this stock in the coming months.

-Attracting dollar inflows by way of special swap facilities for FCNR deposits, and offshore borrowings, apart from liberalising taxes around debt inflows,

amongst others. We discussed this [here](#), [here](#), [here](#) and [here](#).

Taking a proactive stance, a portion of existing FX reserves could be earmarked against forward liabilities (from maturing FCNR deposits), helping to mitigate concerns that deposit maturities or debt repayments could trigger a sharp increase in dollar demand down the line.

-Domestic liquidity management. Bonds, to some degree, are paying the price for the authorities' efforts to defend the rupee against the additional headwind of weak global conditions. INR liquidity surged on the back of the swap windows, prompting the RBI to undertake open market operations, VRRR auctions, sell-buy swaps, among others. While these have been effective in absorbing balances, bond yields have drifted higher. 10Y yields are at three-year highs and are expected to climb further (DBSf: 7.40-7.50% by year-end).



-Moderate FX demand and speculation.

Earlier in the year, the RBI had introduced changes to the banks' net open position framework, and thereafter partially rolled back a few curbs. Prudential measures on FX exposures and hedging-related measures were announced in Oct26, which included the introduction of a daily cash reserve with the RBI equal to 20% of the rupee equivalent of the notional value for INR-linked derivative contracts exceeding \$2mn used to hedge current account transactions, referred to as the Foreign Exchange Risk Reserve (FERR). Subsequent clarifications provided operational details on where the FERR would be maintained and that it would be subject to audits.

Since 12 Oct, the RBI has been providing dollars via designated banks to the three state-owned oil-marketing companies (Indian Oil, BPCL, and HPCL) to meet their daily dollar requirements, thereby diverting related spot-market demand.

On hedging-related matters, the limit for undertaking foreign exchange derivative transactions without proving an underlying commercial exposure was cut to \$5mn from \$100mn across all ADs and exchange-traded currency derivatives. Restrictions on Rebooking, i.e., authorized dealers are prohibited from allowing customers to rebook cancelled rupee-linked derivative contracts (though rollovers upon maturity remain permitted). Lastly, banks must obtain written confirmation from users that the same underlying exposure has not been hedged with another dealer. Data from CCI, cited by

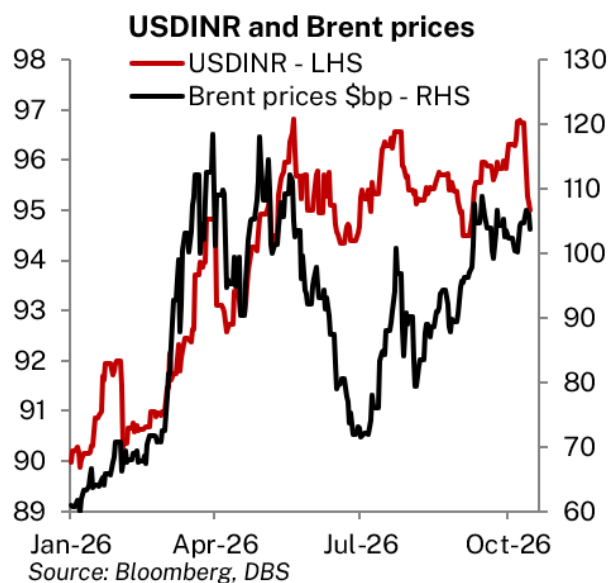
Bloomberg, pointed to importers' forward dollar purchases rising 44% on the year to a monthly average of \$64bn.

-Current account management. Efforts to contain structural FX outflows by way of higher duties and taxes on gold imports discourage non-essential purchases and production incentives to improve export competitiveness.

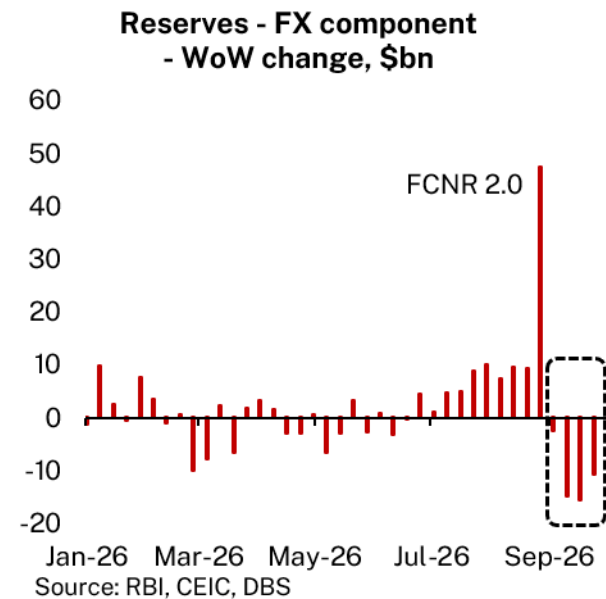
IMPACT

To assess whether the playbook has worked, we observe:

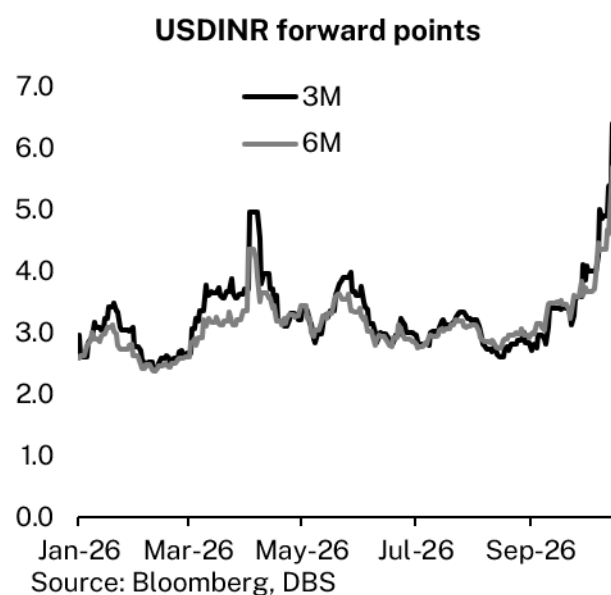
a) Rupee has enjoyed a brief respite. Despite oil prices at \$105/bbl at the time of writing and elevated global yields, USDINR fell from near 96.80 towards 95.00, owing to measures announced in Oct26 following the central bank's 25bp hike. Beyond temporary relief, global catalysts are likely to be back to the fore and weigh on the currency (see chart);



b) Sharp inflows under the swap facilities pushed the foreign reserves stock to a record high, providing policymakers sufficient buffer to navigate future shocks from a position of strength. A strong interventionist response has since led to a softening in the overall stock (see chart).



c) Macroprudential measures have led to distortions in other parts of the market. For instance, strong swap-related inflows had inorganically pushed onshore INR liquidity up sharply, necessitating absorption measures. Similarly, NOP restrictions and the more recent tighter requirements on hedging activity and counterparty transactions had some after-effects. Forward points have surged this week, with financial institutions pointing to relative illiquidity in the currency forwards market on volumes and activity basis, and fewer avenues to deal with dollar supply.



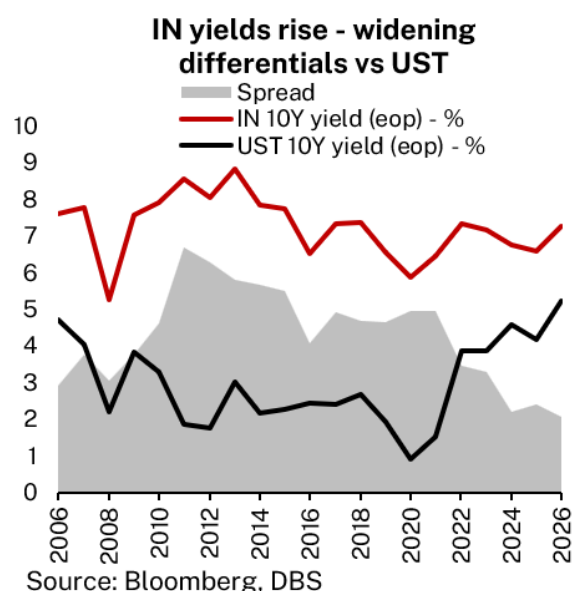
d) Swap-related windows are a timely support for the country's balance of payments position. From expectations of a third consecutive year of BOP deficit in FY27, the math has now swung to a potential surplus, even as current account worries remain. With energy prices settling north of \$100/bbl, keeping the monthly trade deficit near \$30bn, our FY27 current account deficit forecast of 1.1% of GDP faces upside risks of around 0.3-0.5% of GDP. We note the sharp jump in ECB outflows in Sep, though see that as a temporary overshoot of leverage-FCNR activity.

WHAT LIES AHEAD

Authorities are likely not done yet and remain ready to take further action, as required. RBI Governor Malhotra reiterated the authorities' serious intent of stabilising the currency in a recent interview (Moneycontrol, 13 Oct), emphasising that "The RBI is determined to do whatever is necessary to ensure orderly movement in the foreign exchange market.". He also highlighted

that recent steps were not tantamount to capital control measures that were aimed at ensuring that forex markets serve genuine hedging needs rather than speculative bets. Market participants opine that FX volumes and interest are likely to be subdued in a few pockets on the back of the recent measures, consequently stabilizing the rupee.

Unlike in 2013, when policy tightening was a part of the initial response, the 2026 strategy has prioritised targeted FX and regulatory measures. The sequencing suggests a deliberate effort to distinguish actions aimed at preserving currency stability from those intended to achieve domestic monetary objectives, with rates remaining a potential, though not immediate, tool in the defence framework.



However, global developments have altered that dynamic. Rising US yields and a gradual increase in the US Fed Funds rate (DBS baseline: a total of 75bp hikes) have compressed IN-US spreads. The recent sell-off in INR benchmark

bonds has effectively widened Gsec-UST spreads across maturities, in contrast to the compression witnessed in regional high-yielders.

The latest announcements may not fully quell speculation over further policy action.

Upcoming measures might include -

- Markets anticipate relief on the long-term capital gains tax structure on equities to draw in longer-duration inflows. This measure will boost inflows if it coincides with other factors that make domestic equities attractive for thematic investing, as global risk-free rates moderate.

- Street expectations also include steps to boost inward dollar repatriation by exporters to boost domestic dollar supply.

- Wider policy rate corridor akin to 2013.

-Policy rate response. While this might not be a panacea, it is a likely necessary condition. Raising the neutral rate might have mixed success in attracting capital market inflows; though rate-sensitive flows are likely to get a fillip as investors seek attractive rate differentials in the region.

An adequate real rate cushion would also align with the evolving domestic inflation realities, which are expected to accelerate to 6% in the Oct-Dec quarter and remain above 5% well into 2027.

Given fluid global developments, we outline three scenarios on the rate path ahead. Our baseline assumption is for 75bp hikes in this cycle (including Oct), spread between the December and February 2027 meetings. **We don't rule out an intermeeting rate hike before the December meeting, contingent on rupee movements.**

Under the second scenario, should depreciation pressures on the rupee return, the 50bp hike might be brought forward to December, with another in February, taking cumulative hikes in this cycle to 100bp. **The third scenario** is a more aggressive 150bp worth of hikes in this cycle, with 50bp front-loaded in December, and the rest spilling into 2027. **Factors that will determine whether these scenarios materialise** are the resumption and scale of rupee depreciation, oil price direction, US Fed Funds rate increases (DBSf: total 75bps) and other risk-off events.

Path ahead

Despite these measures, we see limited room for sustained INR appreciation on grounds of manufacturing/ trade competitiveness. A challenging flows portfolio flows outlook leaves the door open to further gradual rupee depreciation subject to global developments, with high sensitivity to oil price movements and risk sentiments. A strong rate response will help introduce favourable rate differentials and reduce currency volatility.

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