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EXPLAINER

FCNR(B) Deposits:

India's Foreign Currency Shock Absorber and Balance of Payments Buffer

When investors discuss India's external sector, the conversation usually revolves around foreign exchange reserves, the current account deficit (CAD), foreign portfolio flows, or remittances. Yet one instrument has repeatedly emerged during periods of external stress and assumes importance in policy circles: **FCNR(B) deposits**.

To many investors, FCNR(B) is simply a banking product available to Non-Resident Indians (NRIs). In reality, it occupies a unique position in India's financial architecture. It is simultaneously a savings instrument for the Indian diaspora, a source of foreign-currency funding for banks, and, under special circumstances - a macroeconomic stabilization tool for the Reserve Bank of India (RBI).

Understanding FCNR therefore requires moving beyond the deposit itself and examining how it interacts with India's Balance of Payments (BoP), foreign exchange reserves, RBI policy actions, and the broader ecosystem of foreign capital flows.

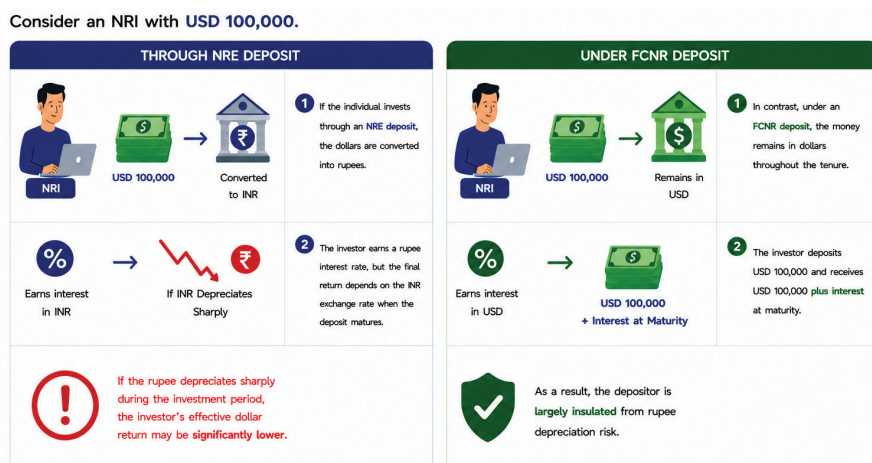
What is an FCNR(B) Deposit?

FCNR(B), or **Foreign Currency Non-Resident (Bank) Deposit**, is a fixed deposit account that can be opened by NRIs with authorized Indian banks. Unlike conventional deposits in India, FCNR deposits are maintained in foreign currency rather than Indian rupees.

Deposits can be held in major freely convertible currencies such as: US Dollar (USD), Euro (EUR), Pound Sterling (GBP), Japanese Yen (JPY), Australian Dollar (AUD), Canadian Dollar (CAD), etc.

The defining feature of FCNR deposits is that **both principal and interest are repaid in the same foreign currency in which the deposit was originally made**.

This distinction fundamentally changes who bears exchange-rate risk.



Why Does India Need FCNR Deposits?

India is a structurally growing economy with significant external financing requirements. The country needs foreign currency to pay for imports, service external obligations, finance investments, and maintain adequate reserve buffers.

Foreign exchange is earned through:	At the same time, foreign exchange is spent on:
 Merchandise exports	 Crude oil and commodity imports
 Services exports	 Gold imports
 Remittances	 Electronics and capital goods imports
 Tourism receipts	 External debt servicing
 Foreign investments	 Overseas investments
	 Profit repatriation by foreign companies

When foreign exchange outflows exceed inflows from trade and income, India runs a **Current Account Deficit (CAD)**.

That deficit must be financed through capital inflows.

This is where FCNR deposits become important.

Unlike portfolio investors who can move capital rapidly across countries, FCNR deposits tap into one of India's most stable pools of foreign savings: the global Indian diaspora.

In effect, FCNR allows India to mobilize overseas Indian savings and channel them into the domestic financial system.

FCNR Through the Lens of the Balance of Payments

To understand FCNR's macroeconomic relevance, it is useful to examine where it fits within the Balance of Payments.

The BoP records all transactions between residents and non-residents and consists of two broad components:



FCNR deposits do not represent income earned by India. They represent foreign-currency funding raised by India.

Therefore, FCNR inflows are recorded under the financial account, not the current account.

A useful way to think about this is: Exports and remittances earn foreign exchange. FCNR deposits raise foreign exchange.

Both support the BoP, but they do so in fundamentally different ways.

FCNR vs NRI Remittances: The Most Important Distinction

Because both originate from overseas Indians, FCNR deposits and remittances are often discussed together.

Economically, however, they are entirely different.

Feature	NRI Remittances	FCNR Deposits
Nature	Income transfer	Financial investment
BoP Classification	Current Account	Financial Account
Repayment Obligation	None	Yes
Maturity	Permanent flow	Temporary flow
External Liability	No	Yes
Stability	Extremely stable	Stable but repayable
FX Risk	After conversion	Minimal for depositor

Example

Suppose an NRI sends USD 10,000 to parents in India.

That money enters India as a **remittance**.

- No repayment is required.
- Household income rises.
- India's external position improves permanently.

Now consider the same USD 10,000 placed in an FCNR deposit.

India receives the dollars today.

However:

- Principal must be repaid.
- Interest must be paid.
- The dollars may leave India at maturity.

Hence, in simple terms: **Remittances are foreign-exchange earnings. FCNR deposits are foreign-exchange borrowings.**

This is why economists generally view remittances as a higher-quality and more durable external-sector buffer.

FCNR Compared with Other Foreign Capital Flows

FCNR occupies a middle ground between stable long-term capital and highly mobile portfolio flows.

FCNR vs FDI	FCNR vs FPI	FCNR vs ECBs
 FDI represents permanent risk capital.	 Portfolio investors can enter and exit Indian markets quickly.	 External Commercial Borrowings are foreign-currency loans raised by Indian corporates.
 When a multinational establishes a factory or acquires a business in India, there is no fixed repayment obligation. The investor participates in business risk and reward.	 Equity and bond investments can reverse rapidly during periods of global risk aversion.	 Both ECBs and FCNR create external liabilities.
 FCNR, by contrast, is deposit funding.	 FCNR deposits are generally locked in for a fixed tenure, making them more stable than portfolio flows.	 The difference is that ECBs are corporate borrowings, while FCNR deposits are mobilized through banks from overseas Indians.
 The money eventually matures and must be repaid.	 However, they create future repayment obligations.	

RBI's Swap Window: The Missing Link

FCNR becomes important when viewed alongside RBI's swap window.

Under normal circumstances, FCNR deposits are simply foreign-currency liabilities on banks' balance sheets.

Banks receiving FCNR deposits must:

- Hold foreign-currency assets,
- Deploy the funds abroad,
- Or hedge the currency exposure.

Each option involves cost.

During periods of external stress, RBI can introduce a **special FCNR swap facility**, transforming FCNR from a banking product into a macroeconomic policy instrument.

How the Swap Window Works



1

NRIs place fresh FCNR deposits with banks.



2

Banks receive foreign currency.



3

Banks sell those dollars to RBI.



4

RBI provides rupee liquidity to banks.



5

At maturity, the transaction is reversed.



The result is a **powerful transmission mechanism**

Diaspora savings → Bank funding → RBI reserves/liquidity support → External-sector stabilization

Why RBI Uses FCNR Swap Windows

Historically, FCNR swap windows have been activated during periods of external stress.

A notable example was the **2013 Taper Tantrum**, when expectations of US Federal Reserve tightening triggered capital outflows from emerging markets and placed severe pressure on the rupee.

RBI introduced a special FCNR swap facility that incentivized banks to mobilize foreign-currency deposits from NRIs.

The scheme successfully attracted substantial inflows and helped stabilize market sentiment.

More recently, RBI has again used FCNR-linked measures as part of broader external-sector management efforts when foreign-currency liquidity became a policy concern.

The rationale is straightforward.

	Impact	How It Helps
1.	 Augments Forex Buffers	 Incoming dollars strengthen RBI's reserve position and improve confidence.
2.	 Supports the Rupee	 Higher foreign-currency availability reduces pressure in the FX market.
3.	 Improves Banking System Liquidity	 Banks receive rupees in exchange for dollars, easing liquidity conditions.
4.	 Encourages Deposit Mobilization	 By reducing hedging costs, RBI makes FCNR deposits more attractive for banks to raise.

This is why FCNR swap windows are typically deployed during episodes of external stress rather than normal economic conditions.

Benefits and Risks of FCNR

FCNR is a highly effective stabilization tool, but it is not without trade-offs.

Benefits	Risks
• Rapid mobilization of foreign currency • Access to a large and loyal diaspora savings base • Reduced pressure on forex reserves • Improved market confidence • Enhanced banking-system liquidity	• Future repayment obligations • Rollover risk • Maturity concentration • Potential pressure on reserves when deposits mature • Dependence on temporary financing rather than structural flows

The key point is that FCNR improves today's external position by creating tomorrow's obligation.

For policymakers, it is therefore a bridge - not a permanent solution.

Understanding India's External Funding Mix

Imagine India as a household.

Remittances = Salary Income	A family member working abroad sends money home every month. • No repayment required • Recurring support • Improves long-term finances
FCNR Deposits = Loan from a Relative	A relative lends money for three years. • Immediate liquidity improves • Financial stress reduces • Repayment is eventually required
FDI = Equity Partner	Someone invests in the family business. • No fixed repayment • Shares business risk
FPI = Stock Market Investor	Someone buys shares in the business. • Can enter quickly • Can exit quickly

This analogy captures why policymakers assign different weights to different forms of external financing.(The above is for explanation purpose only.)

Why FCNR Matters

India's external sector is strongest when it is supported by a diversified mix of foreign-exchange sources.

Structural Flows	Cyclical Flows	Emergency Buffers
These form the long-term foundation: • Merchandise exports • Services exports • Remittances • FDI	These fluctuate with global conditions: • FPI equity • FPI debt • ECBs • FCNR deposits	These are activated during periods of stress: • Foreign exchange reserves • RBI intervention • FCNR swap windows • Special diaspora mobilization programs

FCNR sits at the intersection of the second and third categories. It is more stable than portfolio capital but less permanent than FDI or remittances.

Conclusion:

FCNR(B) deposits occupy a unique and often underappreciated position in India's external financing architecture.

At one level, they are a foreign-currency fixed deposit for NRIs. At another, they are a strategic channel through which India can mobilize diaspora savings, augment foreign-currency liquidity, and stabilize markets during periods of stress.

Their importance becomes even greater when combined with RBI's swap window, which transforms FCNR deposits from a banking product into a macroeconomic policy tool capable of strengthening reserves, easing liquidity conditions, and reducing pressure on the rupee.

Yet FCNR should never be confused with remittances. Remittances are permanent, non-debt-creating inflows that strengthen the current account. FCNR deposits are repayable financial-account liabilities that provide temporary support while creating future obligations.

Ultimately, FCNR is best viewed as **India's foreign-currency shock absorber**—a mechanism that helps bridge external funding gaps, bolster confidence, and buy time for more durable sources of foreign-exchange earnings such as exports, remittances, and FDI to reassert themselves. In an increasingly volatile global environment, that role makes FCNR one of the most important—and least understood—tools in India's external-sector toolkit.

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