

# Has RBI found magic tool to boost banks' cash? Success of \$5 billion swap to tell

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In an unusual move, the Reserve Bank of India will buy dollars from banks for three years and offer them rupees in return.



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The success of India's \$5 billion swap auction Tuesday will decide whether it will become a popular instrument in the central bank's liquidity tool box.

In an unusual move, the Reserve Bank of India will buy dollars from banks for three years and offer them rupees in return. The move will bulk up the central bank's foreign-exchange reserves while injecting cash into the banking system to ease the liquidity crunch typically seen before the fiscal year-end in March.

"Maximum demand may come from private banks that need rupee funding to expand their balance sheets," said Ashish Vaidya, head of trading at DBS Bank Ltd. in Mumbai. The RBI may accept bids at about 15 basis points below the rate lenders use for setting prices on forward-rate agreements and derivatives, he said. The so-called MIFOR rate stands at about 6.15 per cent for the three-year tenor at present.

While Governor Shaktikanta Das said last week that the uncommon liquidity tool has been well received, there's concern that using the forex swap may reduce the need for the central bank to buy debt from the market. The RBI has bought three trillion rupees of bonds this fiscal, supporting the market at a time when concerns about the government's record \$100 billion borrowing plan has cooled demand for debt. Das declined to say if more such swaps were planned.

The swap announcement led to a crash in the dollar-rupee forward premiums, lowering hedging costs for foreigners at a time when they are piling into local assets after at least four opinion polls showed Prime Minister Narendra Modi's ruling coalition may get close to the 272 seats needed for majority in elections that begin on April 11.

"The RBI is saying it will shuttle between the traditional tool, which is the bond market, and the forex market depending on where it is comfortable on the valuation front," said Anindya Banerjee, a currency strategist at Kotak Securities Ltd. in Mumbai. "When they see bond yields are too high for comfort, they will come in the bond market with OMOs. If the rupee is expensive, they will step in the FX market through swaps."

## NRI Deposits

The auction will be held between 9:30 a.m. to 11 a.m. local time. The instrument has no liability on the RBI unlike in 2013, when the authority subsidized banks on the interest rate they offered to mop up more than \$30 billion in deposits from non-resident Indian to salvage the rupee.

Tendering is likely to be strong and the RBI may accept \$4 billion to \$5 billion, DBS' Vaidya said. The rupee opened 0.1 per cent higher to 68.8675 per dollar ahead of the auction.

Market participants are required to place their bids in terms of the premium that they are willing to pay to the central bank for the tenor of the swaps, expressed in paisa terms up to two decimal places as the auction cut-off is based on the premium.

"The cutoff has to be 10-15 basis points lower," Kotak's Banerjee said. "Otherwise, why would the banks will be interested at all." There may not be much interest from speculators unless the swaps were offered at 30-50 basis points below the MIFOR rate, DBS' Vaidya said.

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