SBI RESEARCH

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IMPORTED INFLATION AT 8.1% ..CRUCIAL TO ENSURE RUPEE MOVES SIDEWAYS WITH LESS VOLATILITY.. FCNR(B) DEPOSITS FRONTLOADED..AT $8-$9 BN CURRENTLY.. DEFT MANOUVERING IN FORWARD MARKET A SINE QUA NON

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Headline CPI inflation firmed up to 4.38% YoY in Jun'26, up 45 bps signaling a steep jump from 3.93% in May'26, with the rise primarily driven by higher food prices and a sharp acceleration in transport and services inflation. Core CPI (ex food/ fuel) also increased by 36 bps to 4.20% in Jun'26. Even as per new classification, i.e., Core inflation (ex food plus fuel household and transport) exhibited a rise and stood at 4.21% in Jun'26. Both rural and urban areas witnessed rise in inflation. Rural inflation rose from 4.25% in May'26 to 4.74% in June'26, whereas urban inflation increased from 3.53%in May'26 to 3.92% in June'26. **Imported inflation for the month of June increased to 8.13% from 7.23% in the previous month. Looking at the trend, CPI inflation is likely to average at 5.0% in FY27, with Q2 at 5.1%, Q3 at 5.7% and Q4 at 5.1%. Understanding the imported inflation component and calibrating it against the exchange rate dynamics thus assumes significance when viewed from fx mobilization scheme launched by the Central Bank in June.**

Built upon the ramparts of its successful 2013 edition but much carefully calibrated by the regulator this time the FCNR(B) flows are likely to be frontloaded this time. **With the disadvantage of any credible data in public domain, we believe that FCNR(B) flows could be in the range of $8-$9bn on systemic level currently. There are at least 4 reasons to believe why this time it is different regarding FCNR(B) flows.**

First, entire hedging cost on fresh FCNB deposits (principal) is borne by the RBI, providing Banks much respite on cost/ spread front. **In fact, the Governor statement post MPC itself had laid down the architecture.**

Second, clarity on SBLC and leverage has been front loaded this time ensuring an early initiation and building of momentum (as against 2016 when ~60% of inflows had come in last month).

Third, **a longer runway of ~4 months this time** allows Indian Banks and their foreign counterparts / correspondent banks to take stock of the evolving situation and finetune/tweak the structure/covenants appropriately.

Fourth, focus in 2026 is more on 5-year mobilisation as compared to 3-years (or, below) mobilisation that was the only option in 2013, ensuring stability in capital flows management and avoid redemption volatility, evident in end-2016.

Despite flows from these sources and good buying seen from FPIs through June'26 especially in debt segment ($7.1 bn) driven by GoI offers on tax treatment, the impact on rupee has not been as expected though FCAs have gone up marginally.

Crunching O/S net forward positions of the Central Bank (data available till May'26) where RBI actions to defend the rupee have been evident in total short positions swelling more than $100 bn (first in March and then in May) even when both Spot and Forward positions signal increased demands from merchants in recent 3 months, **a logical interpretation should thus be the Central Bank prudently engaging in Forward operations and concentrating on the near/shorter end of the curve to deter build up of any unwanted pressure (in particular from NDF quarters). While the outstanding positions in May (latest available data) showed net short of ~$20 bn in 1-Month, market trends indicate a good position at the short end of the forward cover could have been exited in recent days in this bucket as the commodity pressure was eased in late June/early July. This may be the reason, why the rupee has stayed at the current levels. We believe that despite global mayhem deepening, this maneuverability should ensure a Gladiator defense mechanism of the rupee** Analyzing hedging behavior, the emergence of GIFT city as a formidable financial sector and Clarity on SBLC and leverage should augment and fortify the rupee with stability ingrained sans volatility.

We expect a prolonged pause in rates in FY27.

FCNR(B) DEPOSITS HAS PICKED UP PACE

- The foreign deposit mobilization scheme'2026, largely built upon the ramparts of its successful 2013 edition but has been carefully calibrated by the regulator this time to ensure seamless flows despite geopolitical aggressions.
- **The response to the overarching scheme, comprising of FCNR(B) deposits, ECB raising and OFCBs issuances has been encouraging,. With the disadvantage of any credible data in public domain, we postulate, While FCNR(B) flows could be in the range of $8-9 bn on systemic level, the ECBs could be hitting ~$5 bn upwards (including the likely concrete inflows in pipeline) and OFCBs could be ~$3 bn during the currency of the targeted scheme till date.**
- We observe some material differences between the two schemes of 2013 and 2026, that could act as the pillars for sustained higher flows during the present regime
- **Firstly,** the advantage derived through Swap cost could be anchoring appetite for higher funds flows, benefitting all stakeholders. The implicit hedging costs were significantly higher during 2013 and RBI had fixed the swap cost at 3.5%. In comparison, over the entire currency of say a 3-5 year deposit, the **entire hedging cost on fresh FCNB deposits (principal) is currently borne by the RBI, providing Banks much respite on cost/ spread front. In fact, the Governor statement post MPC itself had laid down the architecture.**
- **Secondly,** leverage and SBLC remain the most crucial aspect of this deposit scheme (as in 2013) and clarity at an early stage should make material impact. **The clarity towards leverage had come with a delay during 2013** issuance (in second half of October though the scheme was launched in September 2013, running till November 2013). **The Halla-baloo ensured backloading of most of the FCNR(B) flows, at around ~60% during the fag end. This time, a good amount has already started trickling in the first month, gaining momentum and indicating that the middle months could be the most important mop-up months (adjusted for West Asia led volatility, of course) due to front loading of flows**.
- **Thirdly,** there is a longer runway for deposit mobilization, say ~4 months, allowing Indian Banks and their foreign counterparts / correspondent banks to take stock of the evolving situation and finetune/tweak the structure/covenants appropriately
- **Fourthly,** focus in 2026 is more on 5-year mobilisation as compared to 3-years (or, below) mobilisation that was the only option in 2013. This pragmatic step should ensure stability in capital flows management and avoid redemption volatility after a shorter period, say just 3 years.
- **Taking a walk down the memory lane, there was a significant redemption pressure towards end 2016,** and despite the regulator managing it quite efficiently, building up orderly liquidity injections/ OMO purchases, there was some pressure on the exchange rate as also overall liquidity position, which a 5 year deposit concentration alleviates effectively. It's evident that the present scheme, with a concentration of deposits in 5 years bucket, would also need meticulous planning in 2031.
- **Apart from the flows through designated schemes, India has received higher capital inflows post the taxation relaxation given by the GoI to portfolio investors in debt securities. Total FII inflows since 8 June amounts to $7.1 bn of which 87% or ~$6.2 bn are Debt flows.**
- **Defying expectations, however, rupee has not strengthened much as expected and continued moving in a narrow range, signaling a chasm.**
- Meanwhile, foreign currency assets of RBI shows increase (by $ 4.4 bn during 19 June 2026—3July 2026).

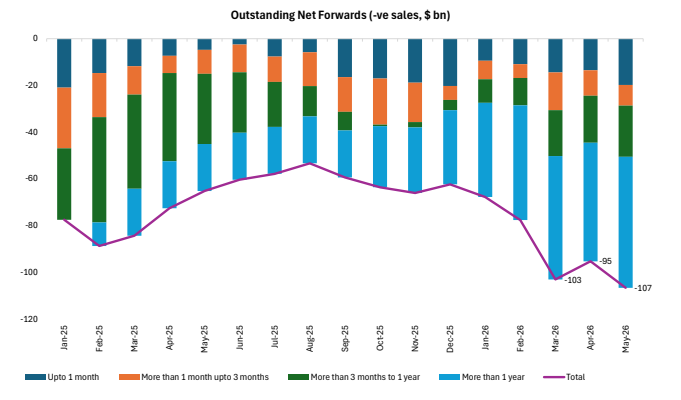
WHY THE RUPEE HAS NOT STRENGTHENED?

- **Outstanding net forward position of RBI shows increase in outstanding net forwards to $106.6 bn in May 2026 from $95.3 bn in April 2026. Share of short term forwards (up to 3 months) increased to 26.9% in May 2026, with 1 month maturity rising to 18.6% compared to 14.2% in April 2026.**
- Meanwhile, forward excess demand in merchant market which jumped in March-2026 continues to remain high since then. Also, the spot excess demand has also turned significant during April and May, leading to higher total excess demand in the merchant segment.

- A logical interpretation should thus be the Central Bank prudently engaging in market making activities, engaging in both Spot and Forward operations and concentrating on the near/shorter end of the curve to deter build up of any unwanted pressure (in particular from NDF quarters). **While the outstanding positions in May (latest available data) showed net short of ~$20 bn in 1-Month, market trends indicate a good position could have been exited in recent days in this bucket as the commodity pressure was eased in late June/early July. Thus, the rupee did not strengthen in the interregnum even though at least $15 bn of capital inflows has come in in the last month.**
- We believe that despite global mayhem deepening, this maneuverability should ensure a Gladiator defense mechanism of the rupee
- A crucial factor to watch should be the analysis of hedging behavior where exporters and importers need to be in sync (recent data shows enhanced hedging by exporters boosting the current levels as cap). **Another point to notice is the success of GIFT city in establishing itself as a truly Global Financial hub, competing with likes of DIFC (Dubai) and ADGM (Abu Dhabi) in garnering overseas funds, or facilitating leverage through innovative products.**
- However, with the credit spreads are spiking (OFCBs can be a collateral damage of this development as indicated by some call-offs of proposed issues), some regulatory authorities may not understand the scheme in full, and spread on the leveraged loan itself may come under duress with benchmark yields across DMs signaling hardening biases as the conflict in West Asia comes full circle, at higher pedestal. **Clearly, the stakes are high and so are the prospects of Rupee becoming a winner that takes home all, with greater stability ingrained.**

CPI Inflation (Base: 2024) increased to 4.38% in June '2026

- Headline CPI inflation firmed up to 4.38% YoY in Jun'26 from 3.93% in May'26, marking a 45 bps increase. The rise was primarily driven by higher food prices and a sharp acceleration in transport and services inflation.
- **Transport inflation recorded a whopping 256 bps increase, rising to 4.3% from 1.8% in May. This was followed by a 117 bps jump in Restaurants & Accommodation Services inflation to 6.9%, while Food & Beverages inflation climbed 53 bps to 5.1%, emerging as the key contributors to the uptick in headline inflation.**



Turnover in Foreign Exchange Market ($ mn)_Excess demand (sale -purchase)								
Month	Merchant			Interbank			Grand Total	IB SWAP Excess Demand
	Forward Excess Demand	Spot Excess Demand	Total Excess Demand	Forward Excess Demand	Spot Excess Demand	Total Excess Demand		
May-26	44,812	8,033	52,845	-46	-26,966	-27,012	25,833	-49,715
Apr-26	39,632	10,491	50,123	-4,727	-21,667	-26,394	23,729	-57,398
Mar-26	48,655	-329	48,326	-1,742	-33,937	-35,679	12,647	-63,625
Feb-26	22,952	-4,258	18,694	-15,177	-11,862	-27,039	-8,345	-70,884
Jan-26	28,601	6,106	34,707	-15,808	-15,952	-31,760	2,947	-66,094
Dec-25	27,329	-1,023	26,306	-4,342	-17,077	-21,419	4,887	-41,725
Nov-25	35,268	6,715	41,983	1,880	-15,948	-14,068	27,915	-43,742
Oct-25	23,711	11,134	34,845	-9,232	-17,193	-26,425	8,420	-19,858
Sep-25	21,599	11,635	33,234	-6,109	-17,621	-23,730	9,504	-42,543
Aug-25	16,546	5,251	21,797	-6,990	-6,194	-13,184	8,614	-56,337
Jul-25	7,724	4,907	12,631	5,940	-11,378	-5,438	7,193	-93,381
Jun-25	14,909	-3,625	11,284	3,471	-9,213	-5,742	5,542	-64,931
May-25	17,282	-2,078	15,204	-5,696	-3,718	-9,414	5,790	-55,835
Apr-25	20,446	1,918	22,364	-1,416	-4,233	-5,649	16,715	-46,339
Mar-25	35,125	-12,296	22,829	21,995	-22,121	-126	22,703	-94,706
Feb-25	26,253	1,068	27,321	-964	-39,400	-40,364	-13,043	-45,392
Jan-25	26,256	4,410	30,666	-5,172	-46,154	-51,326	-20,660	-29,805
Source: RBI, SBI Research								

India's CPI Inflation (% YoY)						
Division-wise	Feb-26	Mar-26	Apr-26	May-26	June'26	Chg (in
Headline CPI Inflation	3.21	3.40	3.48	3.93	4.38	45
Food and beverages	3.4	3.7	4.0	4.5	5.1	53
Paan, tobacco and intoxicants	3.5	4.2	4.8	4.8	4.8	-1
Clothing and footwear	2.8	2.8	2.8	3.0	3.2	24
Housing, water, electricity, gas and other fuels	1.5	2.0	1.7	1.7	2.0	26
Furnishings, household equipment and routine household maintenance	1.4	1.4	1.6	1.9	2.2	29
Health	1.9	1.8	1.6	1.5	1.4	-8
Transport	-0.1	0.0	0.0	1.8	4.3	256
Information and communication	0.2	0.3	0.5	0.3	0.4	12
Recreation, sport and	2.2	2.3	2.1	2.0	1.7	-23
Education services	3.3	3.3	3.2	3.0	3.3	34
Restaurants and accommodation services	2.7	2.9	4.2	5.7	6.9	117
Personal care, social protection and miscellaneous goods and services	19.7	18.7	17.7	18.5	16.7	-174
Source: MOSPI						

- Providing some relief, Personal Care, Social Protection & Miscellaneous Goods and Services witnessed the sharpest moderation, declining by 174 bps to 16.7%.
- Core CPI (ex food/fuel) also increased by 36 bps to 4.20% in Jun'26. Even as per new classification, i.e., Core inflation (ex food plus fuel household and transport) exhibited a rise and stood at 4.21% in Jun'26.

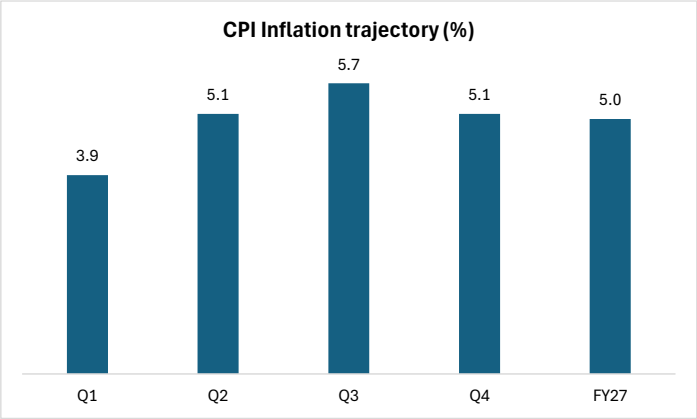
Rural-Urban inflation

- Both rural and urban areas witnessed rise in inflation. Rural inflation rose from 4.25% in May'26 to 4.74% in June'26, whereas urban inflation increased from 3.53%in May'26 to 3.92% in June'26
- Inflationary pressures in both rural and urban India were primarily driven by Transport by 256 bps in both rural and urban areas, followed by Restaurants and accommodation services with 128 bps in rural and 107 bps in urban.
- Food and Beverages remained another significant contributor to inflation, with rural inflation at 5.21% compared with 4.79% in urban areas.
- Interestingly, Personal care, social protection and miscellaneous goods and services has witnessed greater declines in both rural (181 bps from 19.53% in May'26 to 17.71% in June'26) as well as urban areas (164 bps from 17.07% in May'26 to 15.43% in June'26).
- **Looking ahead, CPI inflation is likely to average at 5.0% in FY27, with Q2 at 5.1%, Q3 at 5.7% and Q4 at 5.1%.**

India's CPI Inflation (% YoY)

Division-wise	RURAL			URBAN		
	May'26	June'26	Chg (in bps)	May'26	June'26	Chg (in bps)
Headline CPI Inflation	4.25	4.74	49	3.53	3.92	39
Food and beverages	4.64	5.21	57	4.38	4.79	41
Paan, tobacco and intoxicants	4.61	4.61	0	5.35	5.31	-4
Clothing and footwear	3.49	3.78	29	2.16	2.32	16
Housing, water, electricity, gas and other fuels	1.96	2.42	46	1.59	1.75	16
Furnishings, household equipment and routine household maintenance	2.24	2.54	30	1.43	1.73	30
Health	1.44	1.41	-3	1.57	1.44	-13
Transport	1.81	4.37	256	1.68	4.24	256
Information and communication	0.36	0.55	19	0.21	0.28	7
Recreation, sport and culture	2.24	2.07	-17	1.72	1.43	-29
Education services	2.77	2.67	-10	3.14	3.78	64
Restaurants and accommodation services	5.47	6.75	128	5.99	7.06	107
Personal care, social protection and miscellaneous goods and services	19.52	17.71	-181	17.07	15.43	-164

Source: MOSPI



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Contact Details:
Dr. Soumya Kanti Ghosh
Group Chief Economic Adviser
State Bank of India, Corporate Centre
M C Road, Nariman Point, Mumbai - 400021
Email: soumya.ghosh@sbi.co.in,
gcea.erd@sbi.co.in
Phone:022-22742440