

# India Flash

## RBI tightens rupee liquidity to stem currency pressures

Amidst persistent currency depreciation pressures that have accelerated since early May (around 10% against the US dollar) the Reserve Bank of India (RBI) yesterday announced measures to tighten rupee liquidity. The measures include limits on banks' overnight borrowing from the RBI at the repo lending rate (7.25%), an increase in the interest rate on borrowings beyond Rs 750 bn (equivalent to \$12.6 bn), and open market operations to tighten liquidity. These measures were driven by a desire to stem capital outflows and arrest an ongoing decline in fx reserves, which have declined by around \$16 billion since end-April to USD 280.17 bn at present, equivalent to 7 months of imports. The measures make it more costly to short the currency, and come on top of recent measures to stem the deficit in the balance of payments such as curbing gold imports and tightening fx derivatives rules. India's short term overnight rates jumped 200 bps today (9.25%), and the rupee appreciated by around 1% to 59.2 per USD.

- **The RBI has toed a fine line to alleviate external funding risks while containing spillovers on growth.** It remains to be seen whether the measures will prove effective over the longer term, especially as they may have a dampening effect on already slowing GDP growth.
- **RBI's concern on currency depreciation reduces the likelihood of interest rate cuts in the very near-term** Therefore, our expected 25bp cut is likely to be postponed until such pressures subside (WPI inflation was 4.9% y/y in June, just below the RBI's 5% tolerance level). Given the government's renewed policy reform momentum, we maintain a sanguine outlook on growth prospects, with our projection of 5.7% for 2013, albeit subject to downside risk.

Chart 1  
**Declining import cover limits scope for FX intervention**

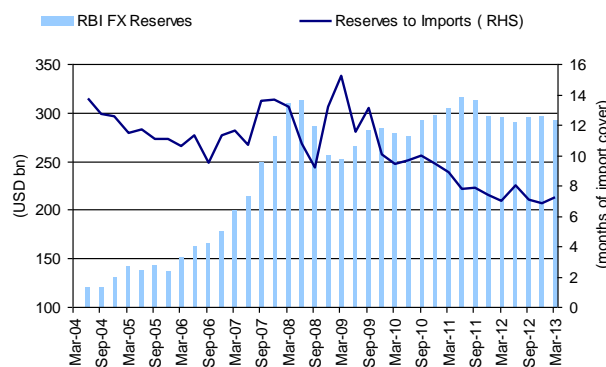
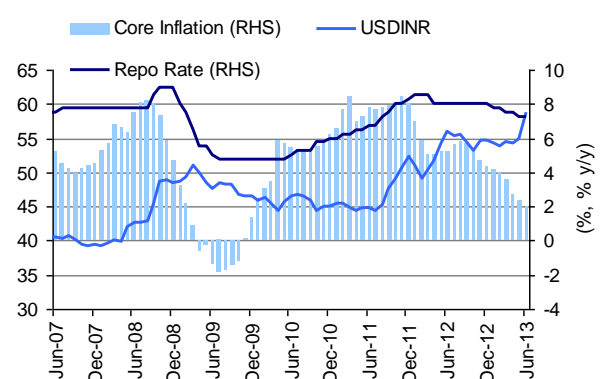


Chart 2  
**Currency pressures may restrict scope for RBI easing**



Source: RBI, BBVA Research

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