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MORE POLICY STEPS MAY BE WARRANTED BY THE GOVERNMENT AND RBI ...RUPEE LIKELY TO REMAIN IN APPRECIATING TERRITORY... GLOBAL MARKETS, HOWEVER, REMAIN ENGULFED IN TURBULENCE...

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The waning pressure on the domestic currency, recovering smartly from a largely exogenous factors-induced haze, is a welcome omen, reaffirming the relevance of central banks in an age of hyper-turbulence. However, with multiple global fault lines and conflicts open simultaneously, there is little room for complacency. This puts the onus on central banks to build durable safeguards through unconventional yet tactical measures, while remaining mindful of the limits of policy intervention.

First, **we believe that Global bond yields could edge higher**. The US 10-year Treasury yield witnessed a sharp intraday spike on 14 October, crossing 5.32%, following higher-than-expected US inflation data that revived expectations of further monetary tightening by the Federal Reserve. Although yields subsequently retreated to around 5.19%, the episode underscores growing nervousness in global bond markets. India's 10-year G-sec yield has also risen to around 7.38%, The RBI in conjunction with government has done a remarkable job in managing yields. The average spread between India's and the US's 10-year government bond yields over the last 25 years has been 408 bps with the spread between Indian and US 10-year yields standing at approximately 220 bps. We believe that India's 10 year yield will likely touch 7.6% which will aid in price discovery in the future as well. The upcoming FOMC meet is live with respect to rate decision.

Second, the rupee could remain in an appreciating territory. The USD/INR forward implied yield opened at 4.60%, around 42 bps higher than yesterday's close. Higher hedging costs make dollar funding more expensive and could encourage corporates to shift towards INR-denominated borrowing, supporting demand for the rupee. We therefore believe the rupee could maintain an appreciating bias, although external uncertainties remain significant. The RBI has taken salutary steps to stabilize market conditions and can act up to a point, **but further measures by the government on the taxation front, particularly concerning G-secs and ECBs clarity on AI policy, could help deepen domestic borrowing avenues and support capital flows.**

Third, non-essential LRS outflows warrant immediate attention. SBI Research, in its *FY27 Outlook report dated 29 April 2026,* had called for curtailing non-essential LRS outflows. The revised data show general-purpose travel expenditure at $665.8 million in July 2026 against $148.5 million for studies abroad (4.5 times), while the June ratio exceeded 5 times ($488.3 million against $96.8 million). During the five months up to July, Studies Abroad expenditure stood at $2.47 billion, against $6.36 billion under Travel. The Gifts category contributed around $1.2 billion, compared with $2.6 billion in FY26. These trends reinforce the case for reviewing non-essential outflows to conserve foreign exchange.

Fourth, ODI outflows require closer scrutiny. Combined ODI debt and equity outflows, which remained within $15 billion between 2008 and 2024, rose to $27.2 billion in FY25 and $27.8 billion in FY26, against $13.4 billion and $13.7 billion in the preceding two financial years, respectively. Resident-individual ODI under LRS amounted to $2.6 billion in FY26, within the annual limit of $250,000 per individual. China's annual foreign-exchange quota system could offer useful lessons, particularly in addressing potential risks involving jurisdictional routing through unlisted investment structures.

Fifth, an asymmetric corridor adjustment could provide additional monetary tightening. The RBI could initially raise the MSF rate by 50 bps, from 5.75% to 6.25%, followed by a 25 bps repo rate hike in December to 5.75%, taking the MSF rate to 6.50%. This would deliver a cumulative 75 bps increase in the MSF rate while limiting the repo adjustment to 25 bps, tightening overnight liquidity conditions and exerting upward pressure on short-term money-market rates. The peak policy rate could settle around 6.0%, in line with the inflation trajectory.

Sixth, India's AI policy needs a credible, time-bound implementation roadmap. A roadmap covering data governance, accountability, compliance and infrastructure is essential to translate India's AI ambitions into investible opportunities. Without clear timelines and credible implementation, capital flows into India's AI ecosystem are unlikely to materialise at the desired scale. **Overall, we believe that while the rupee could retain an appreciating bias, global financial markets are likely to remain volatile amid persistent geopolitical uncertainties, elevated US yields and evolving inflation dynamics. The RBI has done a stupendous job and now the government must step up in reducing structural frictions on taxation front, ECB policy, ODI and AI policy.**

RUPEE DEPRECIATION: BOP PERSPECTIVE

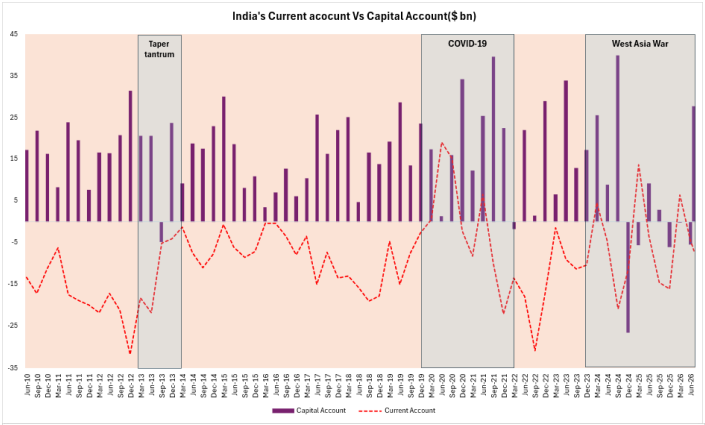
- The historical episodes of sharp rupee depreciation have mostly coincided with strain on current account deficit (CAD). This implied that vulnerability of rupees was mostly on account of CAD pressure in the past and less due to pressure on capital accounts.
- **However, recent trends in capital account in BOP show a structural shift in in the series with capital account turning into deficit. Between the period June 2010 to Sep-2024 there were two-episode capital account deficits which are also separated a decade apart. But after Dec 2024, capital account deficits have become a persistent feature. There is no comparable episode of successive capital account deficit prior to Dec 2024**.
- Such trend shits therefore present different set of policy choices than in the past.
- Such dramatic tend shift in BOP balances was also visible in Japan which enjoyed a current account surplus up till the higher energy prices resulted in CAD resulting in exceptional intervention by BOJ to support yen.
- **Thus, defense of rupee from now on is two front battel addressing both vulnerability in capital and current accounts**.

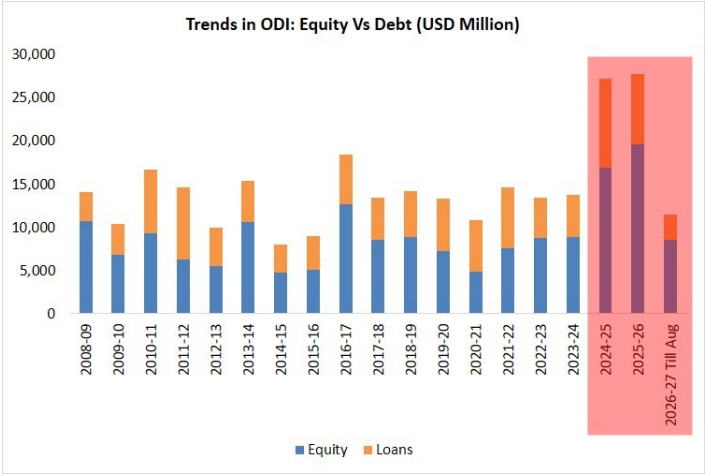
TRENDS IN CAPITAL ACCOUNTS

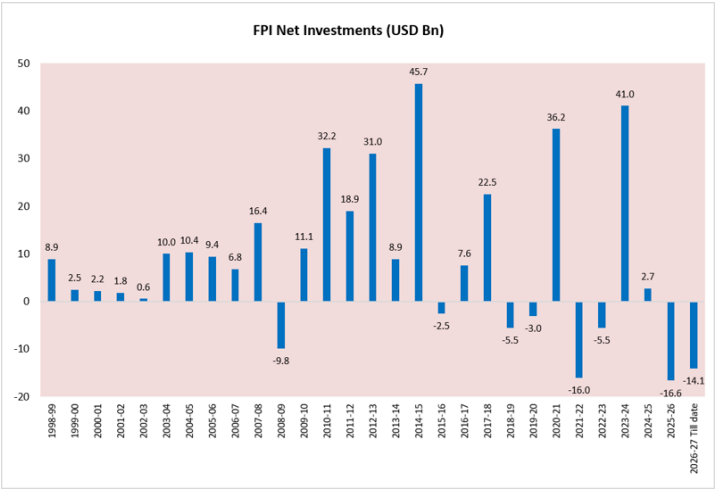
- This trend warrants close look at the capital account entries that have been taken for as given.
- **ODI trends**: The recent trends in ODI show that between the period 2008-2024, the ODI debt equity combined was within $15 billion. This has shifted sharply since then, averaging more than $16 billion.
- The Net FII flows strongly correlate with shifts in capital account. The recent shift since Dec 2024 is due to this factor. The FII outflow has been on account of many factors notably the valuation concerns, relative valuation vis-à-vis tech stocks in other markets and taxation.

THE HAZE IN AI POLICY

- India's recurring episodes of capital outflow invite a broader examination of how convincingly the country is positioning itself for the next wave of global investment. Artificial intelligence is increasingly shaping expectations of productivity, profitability and technological leadership.







- Certainty in vision and policy is the need of hour to attract capital in this area as it is the next engine of growth. As competition for AI-linked capital intensifies, regulatory predictability will increasingly matter alongside computing capacity, reliable power and skilled labour. Singapore has complemented governance principles with testing and assurance tools; the United States has prioritised AI infrastructure and faster permitting; the United Kingdom has linked its strategy to investment zones and regulatory coordination; and the European Union has established risk-based obligations, while adjusting implementation timelines.

- Their experience underscores the value of rules that businesses can understand and implement. For India, a credible, time-bound roadmap covering data, accountability, compliance and infrastructure could strengthen the investment proposition and help domestic firms capture a larger share of AI-driven value creation.

INDIA LRS: AN OVERVIEW

- India's Liberalised Remittance Scheme (LRS) balances individuals' overseas spending and investment needs with the country's approach to capital-account liberalisation. It permits resident individuals, including minors, to remit up to US$250,000 per financial year, covering April–March.
- The allowance combines permitted spending on travel, education, medical treatment, gifts and family maintenance with investments in overseas securities, property and bank accounts. It applies collectively across banks and purposes, rather than separately to each transaction. PAN, declarations and bank compliance checks are required, while overseas investment must independently satisfy FEMA rules.
- Remittances for overseas forex trading and margin calls are prohibited. Higher education and medical expenses can exceed the standard ceiling against prescribed documentation.
- China's US$50,000 annual foreign-exchange purchase quota is narrower and does not generally permit overseas property or securities purchases. South Africa combines a R2-million discretionary allowance with a R10-million foreign-capital allowance subject to tax clearance. The United States, United Kingdom and Germany generally have no comparable annual personal remittance quota, although reporting, sanctions and anti-money-laundering requirements remain. India therefore occupies an intermediate position between tightly controlled and broadly open systems.

PEAK POLICY RATE LIKELY TO SETTLE AT 6% ...NEED FOR AN ASYMMETRIC LAF CORRIDOOR

- The historical experience indicates that the peak policy rate has generally reflected the magnitude and persistence of inflationary pressures, with the extent of monetary tightening moderating as the inflation environment improved.
- During Dr. Raghuram Rajan's tenure, inflation peaked at 11.51%, prompting the repo rate to reach a high of 8%. Subsequently, the peak repo rate moderated to 6.5% under both Dr. Urjit R. Patel and Shri Shaktikanta Das, even as peak inflation stood at 3.7% and 7.8%, respectively.
- **Based on our estimates, with inflation projected to peak at around 6.8% in November 2026, the historical relationship points towards a potential peak repo rate of approximately 6.0%, implying an additional cumulative tightening of 50 bps from the current rate of 5.5%.**
- **The RBI could adopt a calibrated tightening approach through an asymmetric corridor adjustment, raising the MSF rate by 50 bps from 5.75% to 6.25% in the interim. This could be followed by a 25 bps repo rate hike in December, taking the repo rate to 5.75% and the MSF rate to 6.50%.**
- Such a sequential approach would tighten overnight liquidity conditions immediately while allowing a measured adjustment in the benchmark policy rate.
- This would deliver a cumulative 75 bps increase in the MSF rate, from 5.75% to 6.50%, while limiting the immediate repo rate adjustment to 25 bps. The asymmetric corridor would provide an additional tightening signal and exert upward pressure on short-term money-market rates.

Peak Inflation and policy rates in Governor's tenure

Governor	Period	Peak rate	Peak Inflation
Dr. Raghuram G. Rajan	Sept 4, 2013 to Sept 4, 2016	8(Oct'13 and Jan'15)	11.51(Nov 13)
Dr. Urjit R. Patel	Sept 4, 2016 to Dec 11, 2018	6.5(Aug to Dec 18)	3.7(Sep'18)
Shri Shaktikanta Das	Dec 12, 2018 to Dec 10, 2024	6.5(Feb'23 to 06 Dec'24)	7.44(Jul'23)
Shri Sanjay Malhotra	Dec 11, 2024 onwards	6 (SBI estimates)	6.74(Nov'26, SBI Estimate)

INDIA-US 10 YEAR G-SECS YIELD

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US and India 10 Year G-secs Spread in bps		
Average	409	from 2001 to 14 Oct 26
Median	432	May-22
Min	33	May-04
Max	697	Nov-11
as on 15 th Oct	220	-
Average in Oct 26	203	
Average in Sep	206	
Source: SBI Research		

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