



SBI Research

Monetary policy in times of uncertainty requires inflationary expectations to be firmly anchored...This directly implies the crucial importance of ensuring an orderly exchange rate movement in current times..through a well-crafted package with sufficient agility

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- ❑ Brainard returns to the policy making stage when RBI Governor Sanjay Malhotra in his speech at Princeton University on April 18, 2026 referred his principle of attenuation
- ❑ So, what the Governor said:

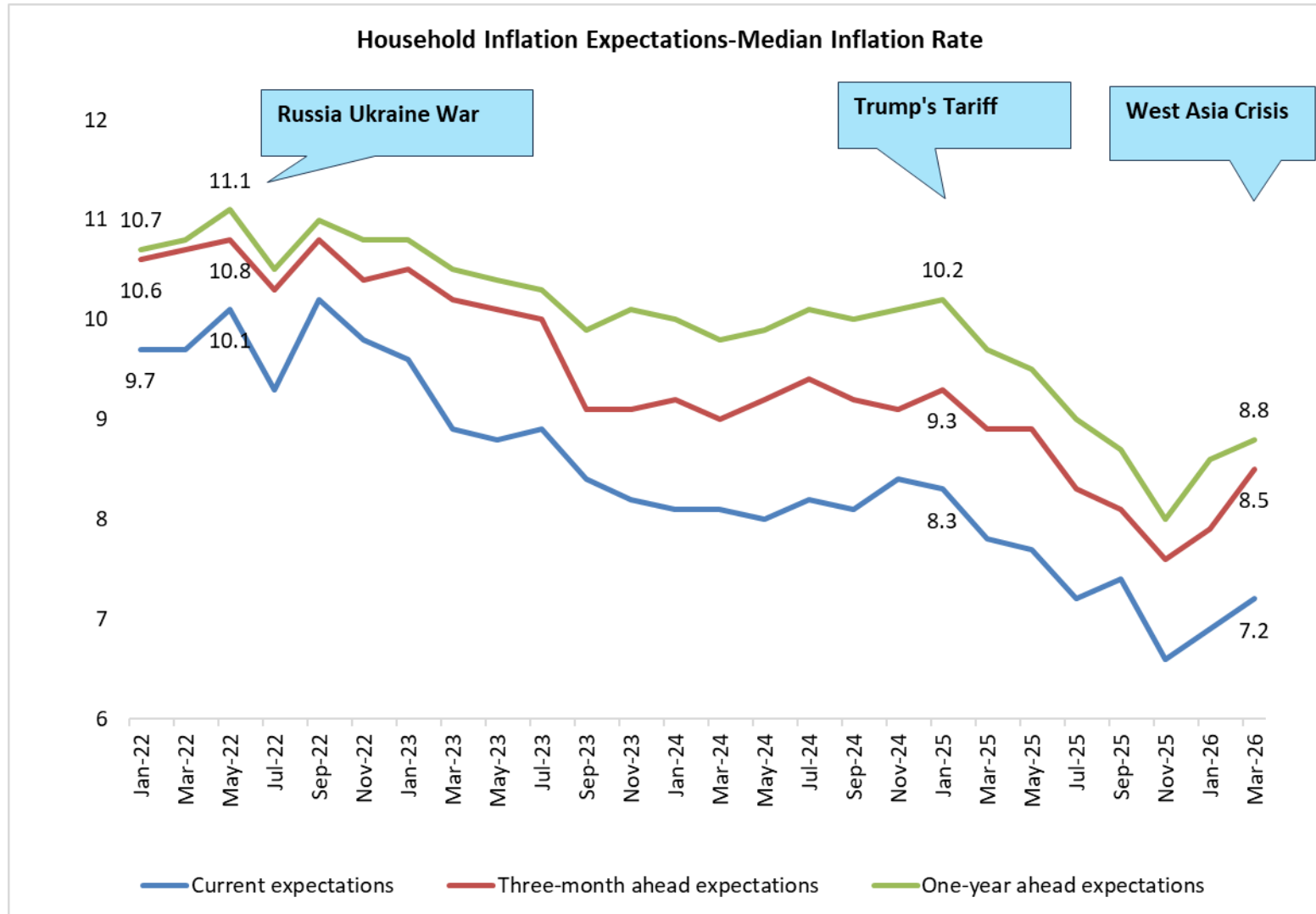
*“Since, uncertainty is central to monetary policy, the broader guiding principles of our policy-making do not change. It is only their application, which changes. **The first principle is to prioritise robustness over optimality. It involves risk management. We try to understand the risks arising out of the uncertainties, assess their probabilities, quantify their impact and then devise a policy that maximises best policy outcomes of price stability and growth. Another principle that we keep in mind is the Brainard’s principle of attenuation. If the central bank is unsure of the magnitude of the effect of a change in its instrument, it should change that instrument less than it would, were if it was sure.....There is a corollary to the Brainard’s principle. If central banks do not react under uncertainty or react gradually, as the Brainard principle would suggest, it could be difficult to manage inflation expectations. Therefore, anchoring inflation expectations becomes crucial, which is another important objective that we pursue through various tools including providing forward guidance.**”*

What does this all mean?

So, What is Brainard's Principle of Attenuation (in Simpler Words 😊)?

- ❑ William C. Brainard's seminal 1967 paper, "***Uncertainty and the Effectiveness of Policy,***" established that when policymakers are uncertain about the precise impact of their policy instruments (multiplicative uncertainty), they should act more **cautiously or conservatively (attenuation principle)**
- ❑ This principle suggests smaller, more gradual policy adjustments to avoid unintended, destabilizing economic consequences. Because of this uncertainty, the optimal policy response to shocks is weaker than it would be if the effects were known with certainty
- ❑ Thus, the main thrust of Brainard's argument is that in an uncertain world, multiple instruments can target a single objective. The argument is similar to the spirit of Samuelson's correspondence principle
- ❑ Using a quadratic utility function, Brainard first shows that the response coefficient of the policy instrument is significantly influenced even by "moderate uncertainty" and that the optimal value of policy instrument depends crucially on use of more information than what the policy makers may conceive
- ❑ **Interestingly, as Brainard argues, at times, it may actually pay for the policy maker to go the "wrong" way!**

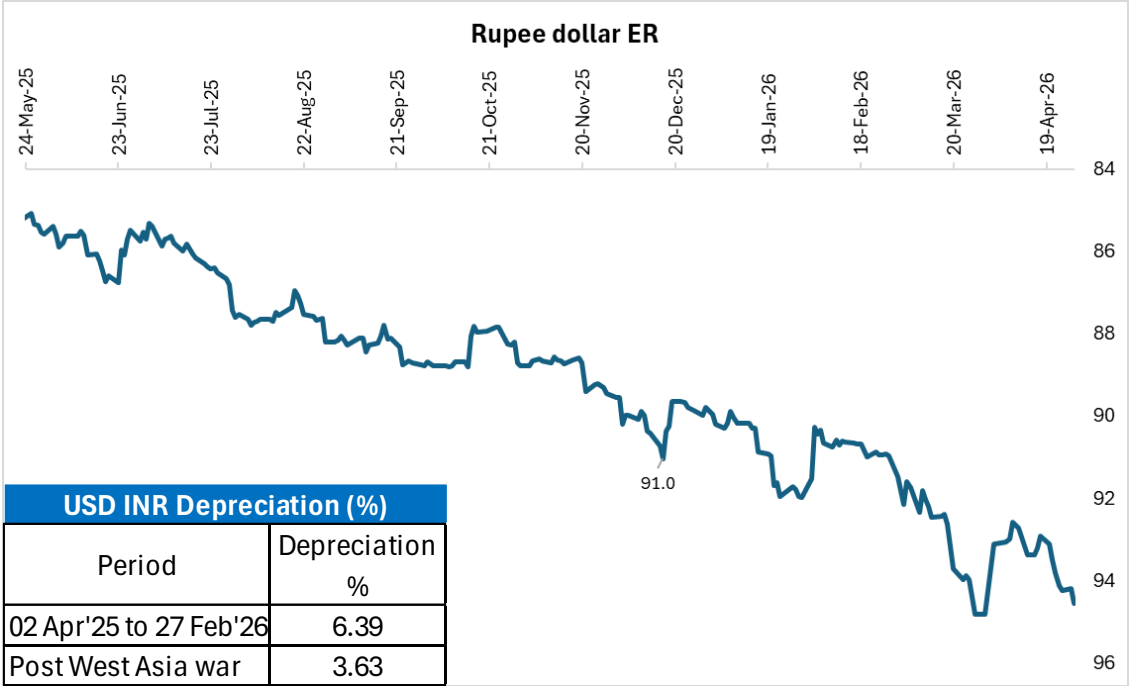
- ❑ *However, a 2023 Banque De France paper titled “A Pitfall of Cautiousness in Monetary Policy” argues that, for central banks too much caution can backfire because if people expect the central bank to respond weakly, inflation expectations can move further away from target, forcing the central bank to act later anyway, but from a far worse position. Thus Brainard’s (1967) principle - creates a "cautiousness bias" that de-anchors inflation expectations*
- ❑ *In principle, while caution works for temporary, small shocks, it fails for persistent shocks. A gradual, cautious response as underlined in Brainard could create long-term damage, whereas aggressive action keeps expectations better anchored.. *The paper further argues that society would be better off appointing a central banker who discounts concerns over uncertainty relative to society, even if this means responding to unforeseen shocks too aggressively**
- ❑ **In uncertain times, a good central bank should be cautious about false precision, forceful against high-cost tail risks, systematic enough to preserve credibility, flexible enough to adapt, and transparent enough that uncertainty about the economy does not become uncertainty about the central bank itself.. This is exactly what might have been conveyed by RBI Governor in his recent speech at Princeton University and hence this communication may be also construed as a forward guidance**



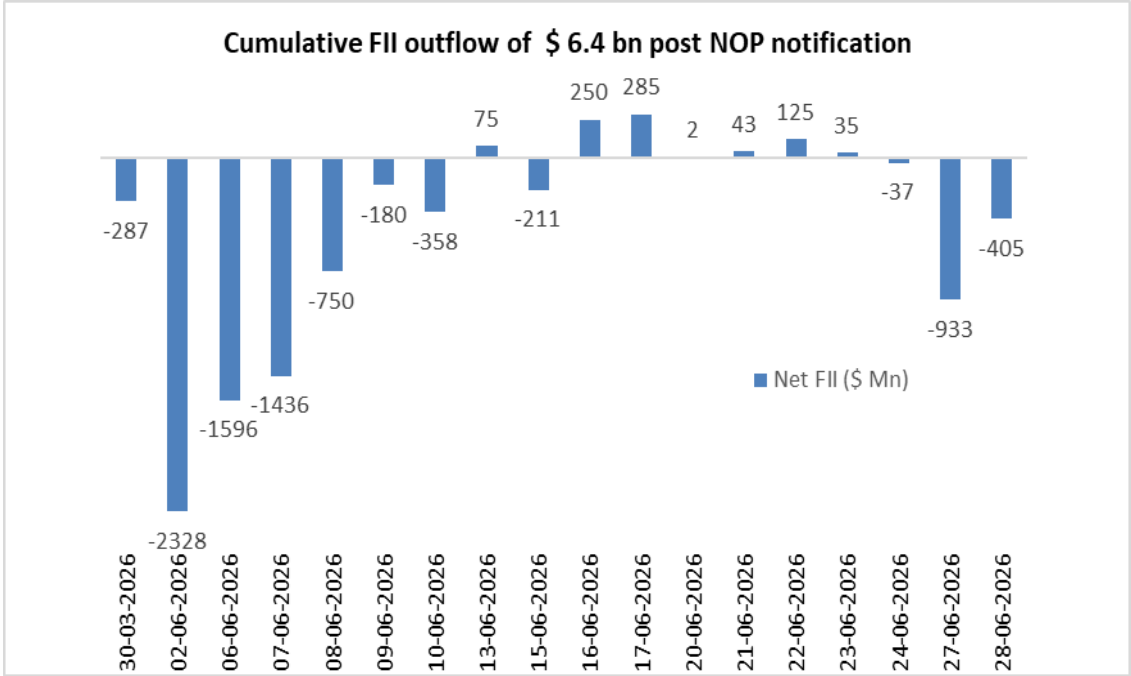
Four out of Six MPC members flagged the risks of unanchored inflationary expectation though without directly referring to Brainard

Member	Minutes
Shri Saugata Bhattacharya	More worrying, inflation expectations signal risks of rising inflation . While one-year ahead expectations in the March 2026 RBI Household Inflation Expectations Survey remain relatively anchored, 3-month ahead expectations rose sharply by 60 basis points (bps). Perceptions of annual inflation in rural and semi-urban households rose by 50 basis points. The IIM Ahmedabad Business Inflation Expectations Survey (BIES) shows a very sharp increase in one year ahead inflation.
Prof. Ram Singh	The level of uncertainty on the external front in general and the West Asia conflict in particular is high at this point. There seem to be many unknown unknowns whose direct and indirect economic impacts are unquantifiable. Under these circumstances, it seems prudent for the Monetary Policy to be data driven with a focus on keeping inflation expectations anchored
Shri Indranil Bhattacharyya	Monetary policy has limited ability to quell the direct effects of a supply-induced inflation shock; it only has operational relevance once second-round effects are apparent. These effects are manifested in rising prices and wages when inflation expectations get un-anchored , which is not evident at present. Whether it would materialise and to what extent depends on the durability and geographical spread of the conflict and its attendant impact on inflation expectations. As long as expectations remain anchored, looking through the shock is optimal since any pre-emptive response merely sacrifices output without delivering any significant gain on the inflation front.
Shri Sanjay Malhotra	If the conflict remains unresolved for a long duration, it can make the task of central banks arduous in their endeavour to rein in inflation expectations while minimising growth sacrifice .

Exchange Rate Depreciation leads to higher imported inflation



Perennial capital outflows further put pressure on Rupee and it may depreciate further



The current Rupee depreciation is not in line with India's macro fundamentals! It is therefore imperative to control the second-round effects

...& hence ensuring that inflationary expectations does not get de anchored..we need a structural solution to India's BOP deficit

- ❑ Overall BOP projected to be in negative territory in FY27 (-\$28 bn) with trade balance projected to be negative as well
- ❑ The capital account is projected to be in surplus of \$26.5 bn on the assumption of positive flows next year
- ❑ Exchange rate can not be construed a shock absorbing mechanism in perpetuity, as increased levels of uncertainties and volatilities render it to transform into a pass-through mechanism of imported inflation seeping through multiple channels, anchoring inflationary expectations and defeating at times the very purpose of prudent, and agile monetary policy making...
- ❑ **It is thus imperative that a comprehensive set of measures are required given that BoP could be negative for the third consecutive year**

India's BoP Estimation(\$ bn)				
	2008-09	2024-25	2025-26(P)	2026-27(P)
Overall Balance of Payments	-20	-5	-48	-28
CURRENT ACCOUNT	-27.9	-23.4	-31.5	-54.1
As % of GDP	-2.6	-0.6	-0.8	-1.3
Export	189.0	441.8	442.0	466.0
Import	308.5	729.0	775.0	829.1
Oil	-	185.8	175.8	240.8
Gold	-	58.0	72.0	75.0
Trade Balance	-119.5	-287.2	-333.0	-363.1
Service Export	106.0	387.5	418.3	451.0
Service Import	52.0	198.7	204.9	215.0
Service Trade balance	53.9	188.8	213.4	236.0
Transfers	44.8	123.4	137.3	132.0
Income	-7.1	-48.4	-49.2	-59.0
CAPITAL ACCOUNT	7.4	16.8	-16.1	26.5
Foreign Direct Investments	22.4	1.0	5.0	5.0
Portfolio Investments	-14.0	3.6	-16.6	6.0
Others including loans/ capital/ Rupee debt service	-0.9	12.3	-5.0	15.0

Source: RBI,SBI Research

- ❑ The strain on BoP front has front loaded the question of launching a **Deposit mobilization scheme** reminiscent of 2013, while also evoking success of RIB (1998) and IMD(2000) that had amassed sizeable flows in times of duress
- ❑ However, factoring the realities of yield curves across DMs (and its decoupling from policy rates), any such scheme needs to weigh in all the possible '*what if*' scenarios on cost of funds (on resource mobilization front), hedging cost structure and lending costs for borrowers vis-à-vis opportunity costs
- ❑ Basis initial estimates, a 3-year foreign currency deposit sourced at say around 6.5-7.0% yield (sufficiently enticing for targeted investors to lock in funds), post hedging cost of 3 years, may spike to terminal single digits, if not early double digits at lending table, check mating the very desirability of such funds at the end users' level
- ❑ Also, the fact that in 2013, the super low effective cost of funds across DMs (yields in US were sub-1% for matching durations) had created a 'virtuous' leverage cycle wherein many Financial Institutions outside India had provided loans ballooning own corpus of depositors, with post credit cost (paid to FIs) return of such depositors-investors inching around 8-10%, creating a carry trade like situation.... The upheavals in most financial centers is restrictive of such practices (from both yields as also risks perspective) and hence depositors need a strong passionate emotional connect for anchoring the Viksit Bharat narrative as also exciting returns
- ❑ **While a scheme soliciting funds from the diaspora is definitely workable, that may also be designed to showcase the connect of the large diaspora spread globally and driving the innovation bandwagon, it has to be calibrated suitably across Corpus (a smaller corpus may entice higher demands while signaling no panic), yield (optimal from deployment angle too), tenor (no Hot money) and tax friendly treatment for investors**

- ❑ Tax treatment, and certainty for investments in G-Secs for various categories of investors has a Doppelgänger effect and there is a felt need to rationalise the tax treatment to entice patient capital allocators
- ❑ Investments in equity/debt & immovable property have doubled on YoY basis. Remittances for deposits abroad have grown by ~25% YoY. These purpose codes along with large ticket discretionary remittances may be restricted, as also undesired repatriation through NRO SB route
- ❑ Under Section 194LD of the Income-tax Act, 1961, a concessional TDS rate of 5% (plus applicable surcharge and cess) applies to interest payments made to FIIs and QFIs on their investments in G-sec and Rupee Denominated Bonds, valid for interest payable up to July 1, 2023. After July 1, 2023, the rate reverts to 20% under Section 115AD, subject to DTAA benefits. For a global pension fund, this uncertainty is viewed as a **"regulatory risk"** that must be priced in, often resulting in a higher risk premium or reduced allocation to India. **A stable, domestic lower TDS rate under Section 194LD may allow funds to invest directly in Indian G-Secs without setting up complex structures in treaty-favourable jurisdictions (like the Netherlands or Singapore)**
- The annual LRS limit of USD 2,50,000 may be temporarily reduced for select categories towards controlling the outflows. Remittances under LRS should be allowed only for emergency purposes such as medical, education, family maintenance etc. and dissuaded for categories like travel (~55% share)
- ❑ **Also, frictions embedded in Mobilization of domestically held gold scheme viz. customs duty payment may be revisited for simplification**

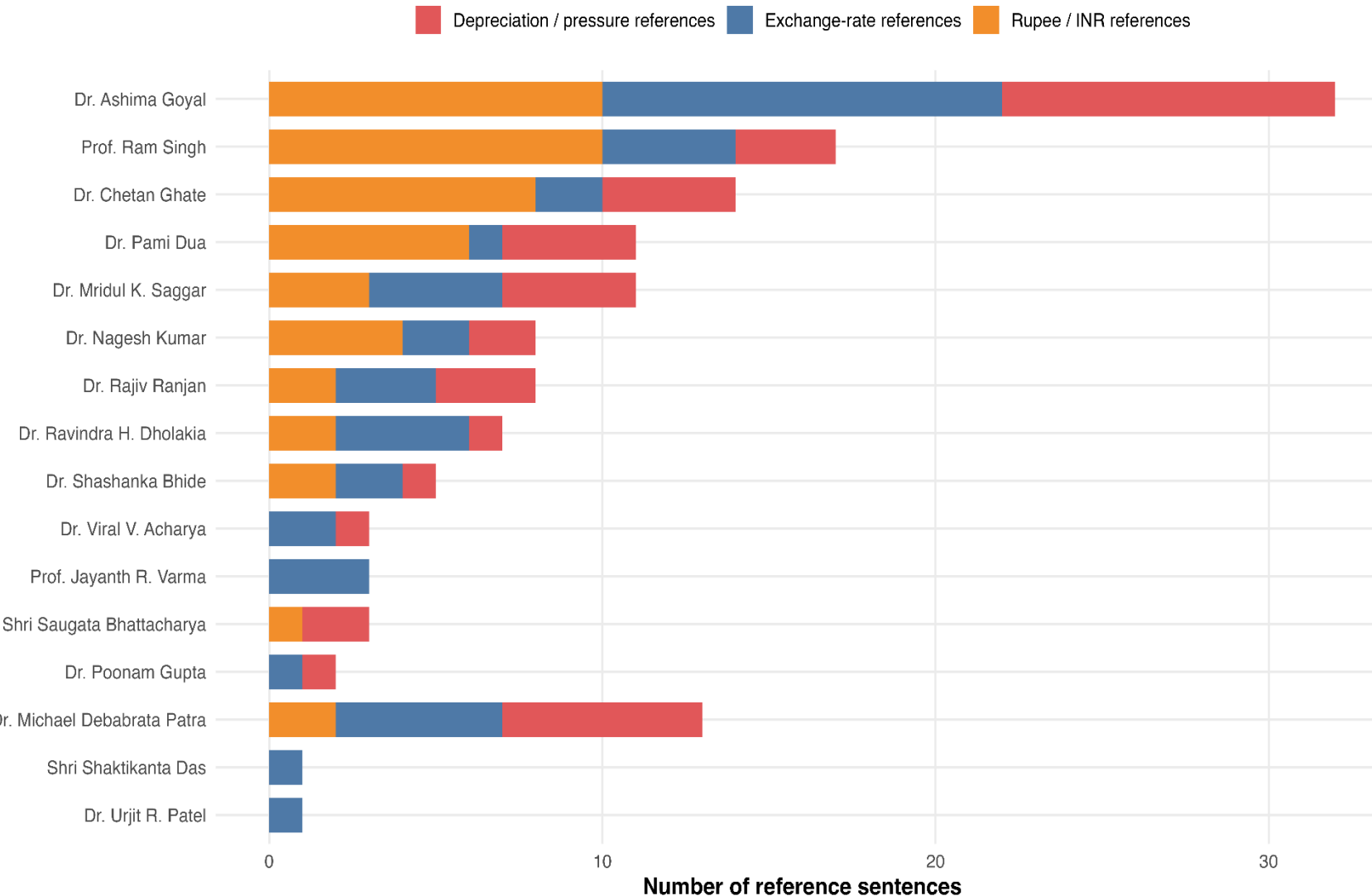
What Does the MPC minutes reveal regarding exchange rate?

...Insights from most recent MPC Minutes reveal exchange rate depreciation figured in the discussion among external members only

- ❑ We identified sentence-level references in member statements to exchange rate, rupee / INR, and depreciation / pressure language. Sentences were defined using punctuation-based splitting after cleaning the PDF text.
- ❑ A single sentence could count in more than one thematic bucket if it simultaneously referred to, for example, both INR and depreciation. Therefore, the charts should be interpreted as measures of theme intensity rather than unique sentence counts.
- ❑ *Upshot : FX / rupee discussion in MPC minutes is episodic and rises during macro-financial stress episodes — especially when external shocks such as oil-price spikes, capital-flow volatility, current-account pressure, or imported inflation become more relevant for the inflation-growth trade-off. The latest 2025–26 cluster is strongly linked to the West Asia conflict and its spillovers through crude prices, logistics disruption, dollar strength, and CAD pressure*

Which MPC members speak most about exchange rate / rupee depreciation?

Stacked counts of sentence-level references in member statements across all available minutes, including April 2026.



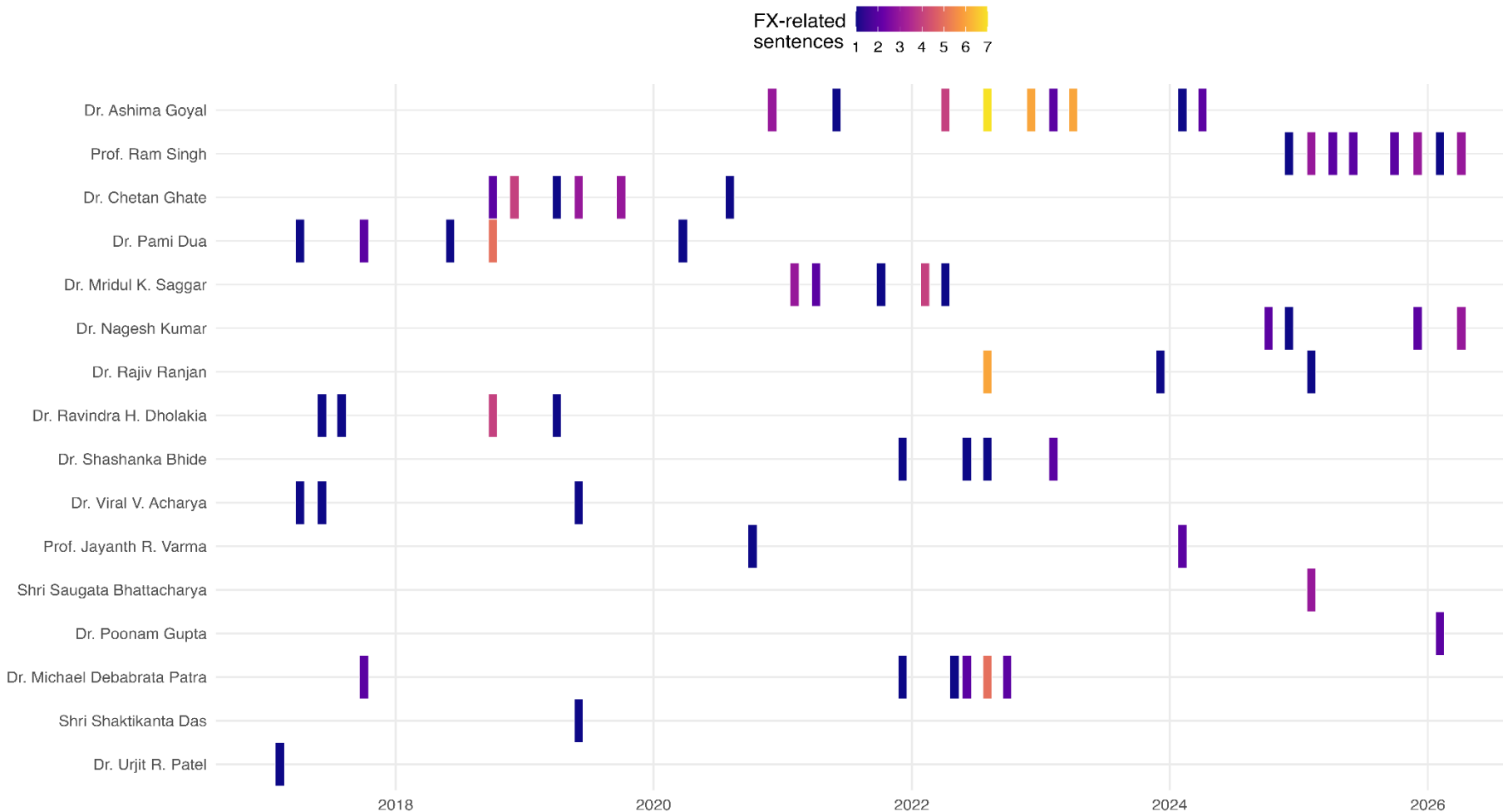
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- **Ashima Goyal** is the most persistent voice on this theme in the corpus
- **Ram Singh** rises very quickly in the latest external-member cohort
- **Michael D. Patra, Mridul Saggar, and Rajiv Ranjan** are the main recurring voices
- **Governors themselves are not the dominant discussants on this theme**

When did members speak about exchange rate or rupee depreciation?

Heatmap of sentence-level reference counts by meeting and speaker.



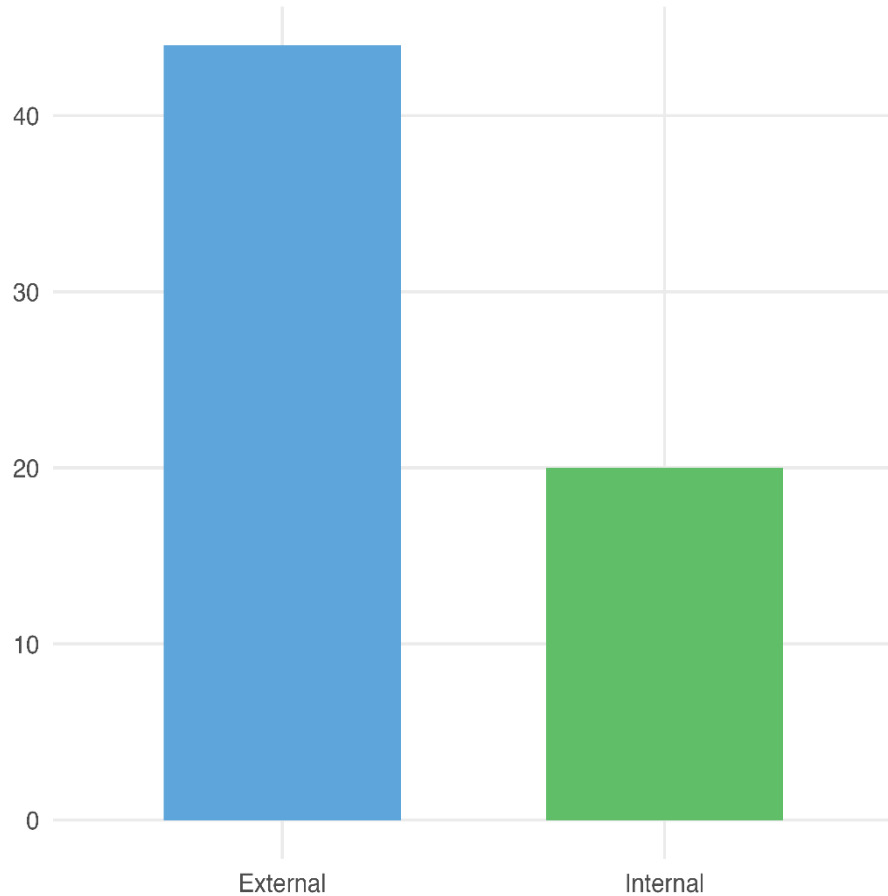
- *FX / rupee references are episodic, not constant*
- *They cluster around stress periods: 2018–19, 2021–24, 2025–26*
- *Internal members also become active in FX-themed discussion during stress phases, especially around 2022–24*

West Asia conflict → oil shock + logistics shock + stronger dollar + capital outflow risk + CAD pressure → more explicit rupee / exchange-rate discussion by external members.

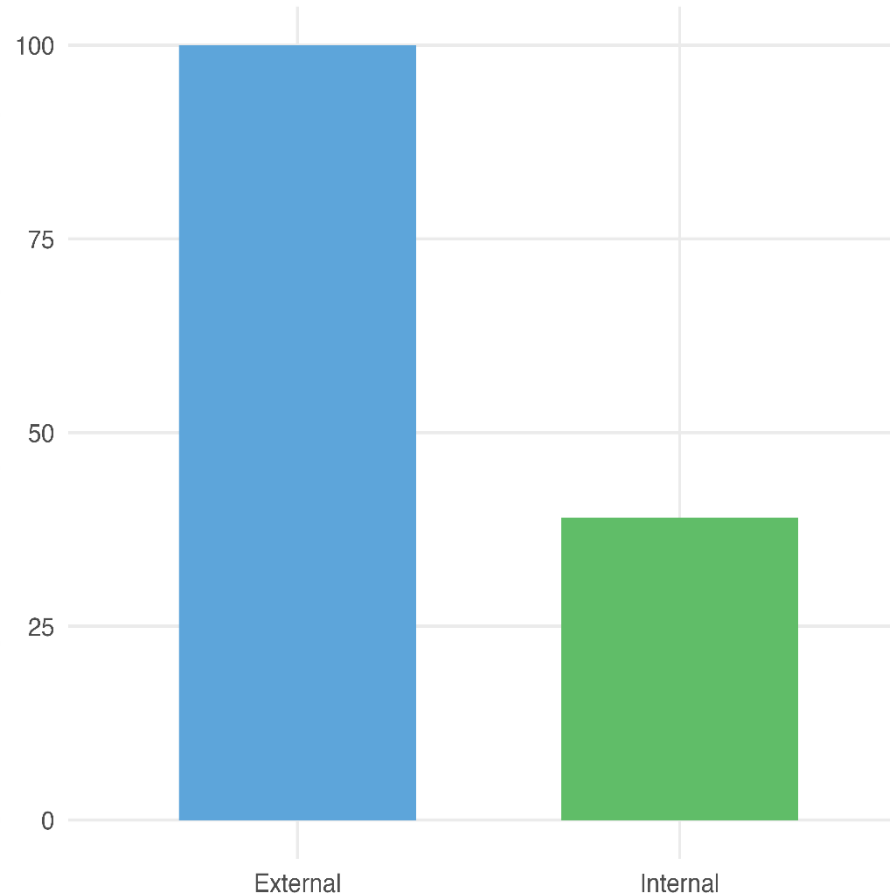
Internal vs external MPC members on FX / rupee themes

Simple split to check whether FX references are concentrated in one side of the committee.

Speaker-meeting rows with FX references



Total FX-related sentences



FX-related discussion is episodic, concentrated in stress periods, and disproportionately driven by external MPC members



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Contact Details:

Dr. Soumya Kanti Ghosh

Member, 16th Finance Commission &
Group Chief Economic Advisor
State Bank of India, Corporate Centre
Nariman Point, Mumbai - 400021

Email: soumya.ghosh@sbi.co.in

gcea.erd@sbi.co.in

Phone:022-22742440

✉ :@kantisoumya