The FCNR (B) deluge

Five questions that matter

Economic Update ▸ Liquidity Management ▸ September 11, 2026

Emkay

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USD inflows under the subsidized FCNR(B)+ scheme have exceeded expectations by a wide margin, sparking wide-ranging debate on the implications for markets, policymakers' stance and balance sheets, and the broader economy. We address five questions we have frequently encountered in most client conversations.

#1 How much liquidity is 'too much'

FCNR(B)+ inflows have far exceeded expectations, taking banking/durable liquidity to Rs11trn+/14trn+. With $136bn already mobilized vs our earlier $90bn estimate, the real issue is the ~$45-50bn (~Rs4.3-4.7trn) excess, which could leave liquidity materially above the RBI's ~0.8-1.0% NDTL comfort zone by end-FY27. While this has lowered banks' funding costs and eased NIM pressures, the system excess now likely calls for more durable sterilization. Lower funding costs should support banks' profitability even as excess liquidity is subsequently absorbed. Notably, tightening from such elevated surplus levels need not squeeze the system, but instead allow the RBI's rate and liquidity bias to move in sync ahead.

#2 How does this change our liquidity forecast math

We now estimate end-FY27E system/durable core liquidity at ~Rs7.1/8.6trn (~2.2/2.7% of NDTL), well above RBI's 0.8-1.0% comfort zone, and a sharp shift from our pre-August estimate of sub-0.8% by end-FY27. The key swing factor is BoP, now seen above $100bn (vs ~$45-50bn earlier), alongside a sizable CIC leakage of ~Rs5trn (12.1% of GDP), skewed toward 2H on pre-UP election spending and inflation. The **excess glut stands at ~1.35% of NDTL** (~Rs4.3trn) above comfort — needing durable sterilization, not just temporary tools. The simplest visible lever may be to let >90% of FY27 forward maturities run off, to naturally bring liquidity back to ~1% of NDTL, though at some cost to FX markets and RBI's book.

#3 Sterilization toolkit – Which tool for which liquidity problem

A blended approach—calibrated to the durability, effectiveness, and incidence of cost of each tool—appears most sensible.

VRRRs – Quick and reversible, but a poor fit for a multi-year problem: banks resist locking funds beyond a few days, and overnight rates remain stuck sub-repo. Widening access to non-banks (MFs, insurers), à la the Fed's RRP, could make it more effective.

FX sell/buy swaps – Push **the problem into the future** rather than solve it, carrying rollover risk and an all-in cost <7% annualized (3.4% forward premia + 4% opportunity cost on foregone USD returns), with large auctions already pressuring forward premia.

OMO sales – Durable+effective; also easing RBI's bloated balance sheet, with ample room in 3-5Y maturities (Rs3.9/8.4trn over 3/5Y). But it adds bond supply/pushes up yields.

CRR/I-CRR hikes – Blunt but durable and directly targets M3 growth. However, a 1% hike absorbs only half the excess, penalizes banks disproportionately, including non-FCNR participants, and risks a confusing signal too soon after last year's CRR cut.

MSS/CMBs – Scalable, but shifts the cost to GoI's books at a time of fiscal strain (Brent: >$100/bl), making government buy-in uncertain. With the RBI already holding ample securities and the SDF available, its original rationale is weaker today.

#4 What is the least costly way to manage the liquidity deluge

There are no free lunches: Someone has to bear the cost, be it banks, the RBI, GoI, or bondholders. The least-cost strategy is likely a mix of tactical VRRR/SDF, selective FX operations, and, as persistence becomes clearer, a more durable CRR/OMO sale. Our cost assessment for absorbing each 0.5% of NDTL ranks **CRR as the costliest** for banks, closely followed by FX swaps and OMOs. MSS is cheaper from the RBI's perspective, but GoI bears the cost, while SDF is cheapest but neither durable nor sufficiently scalable. RBI may finally lean on CRR despite its bluntness, given that it is most potent for containing M3 growth.

#5 How should policymakers maximize the upside and manage the risks

Maximise returns on this dollar debt – This inflow is a future dollar liability, so funds must be deployed productively to offset that cost. Given India's past struggle to attract durable foreign capital, this pool of savings offers a chance to reset. Using it well could strengthen India's positioning for quality capital flows in the long term.

Watch credit quality and inflation – The credit multiplier could further boost an already-strong cycle (pre-FCNR credit growth already ~17%), so credit quality and risk build-up need monitoring, alongside inflation risk, given the ongoing cyclical demand upturn.

Domestic demand-driven CAD risk – Demand-led growth could lift import demand, widening the CAD. Liquidity gains may skew toward consumption/investment rather than financial savings, adding to this risk.

Key Highlights:

- We estimate end-FY27 system/durable core liquidity at ~2.2%/2.7% of NDTL
- The excess durable glut above RBI's comfort at ~1.35% of NDTL
- Overnight VRRRs and sell-buy swaps, a poor fit to anchor overnight rates
- The RBI may eventually lean on CRR/OMOs despite the higher cost

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The FCNR(B) deluge – Five questions that matter

The USD inflows under the subsidized FCNR(B)+ scheme have exceeded expectations by a wide margin. This surge has sparked wide-ranging discussion across multiple levels, about what it could mean for markets, for policymakers' stance, and balance sheets, and for the broader economy. We address below some of the questions we have frequently encountered in conversations with most clients.

#1 How much liquidity is 'too much'

The liquidity landscape has changed dramatically in recent months, with banking system liquidity surplus hovering at around Rs11trn, while estimated core/durable system liquidity (banking liquidity + government surplus) has crossed the Rs14.5trn mark, or ~**5% of NDTL**. With banks' FCNR swap window with the RBI (covering deposits accumulated by 31-Aug-26) closing on 11-Sep-26, further upside is likely in the absence of intervention. Near-term, this has delivered cheap funding — a clear benefit for banks, with the RBI absorbing the FX risk. Funding costs had risen sharply over the past two years, squeezing banks' NIMs. With FCNR deposits now available, banks' reliance on wholesale funding has eased: CD issuance has stalled, and 12-month CD rates have fallen to ~6.75-7.0%.

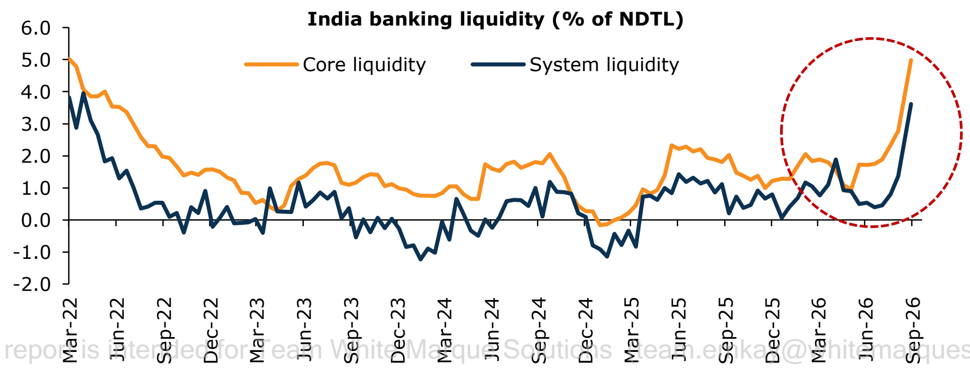
Recall that FY27 so far has largely been characterized by surplus liquidity (1Q average of Rs2.1trn; FYTD average of Rs2.6trn), with WACR/TREPS rate generally hovering below the repo rate in most months. Until recently, the RBI showed little discomfort with this, consistent with its recent historical stance of tolerating a soft-targeted surplus of ~1% of NDTL during easing/neutral cycles. This was evident in the August MPC, where the Governor showed no real unease — by then, ~$57bn had already been received via FCNR+ flows, and at that run-rate, a target of $80-90bn appeared to be within the RBI's expectations, especially given the neutral stance and broadly dovish tone.

This aligned with our own assessment at that time: with an estimated $80-90bn in FCNR flows, core liquidity would likely peak in 2QFY27 before normalizing in 2H as currency leakage rose and near-term RBI swaps matured. We had estimated a FY27 BoP surplus of $50bn on this basis, and argued that the RBI would lean on temporary absorption tools rather than blunter tightening measures (see *RBI Preview: A Cautiously Constructive Hold; 3-Aug*).

However, actual flows through 31-Aug-26 stood at ~$136bn, with possibly $10bn still to come via ECBs by 31-Dec-26. The real policy concern, therefore, is not the total quantum of ~$136bn — it is the excess of roughly $45-50bn (~Rs4.3-4.7trn) over earlier estimates. This is the portion that is ~1.5% of the current NDTL and that likely requires a more durable sterilization response, particularly if the RBI wants to prevent the liquidity surplus from remaining materially above its revealed comfort zone of 0.8-1.0% of NDTL.

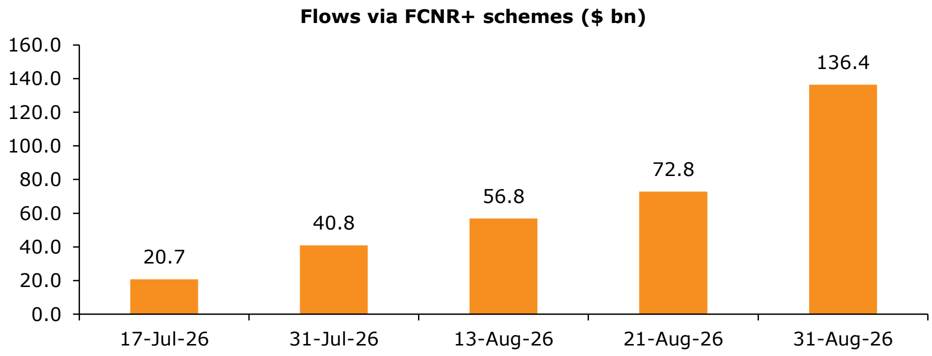
The good part is that as any tightening is likely to start from a position of surplus liquidity, the system will not feel a real squeeze. Also, from a signaling standpoint, the RBI would tend to act consistently with its policy framework, rather than taking steps that appear contradictory. This essentially implies that the RBI's recent rate bias (skewed to hike), policy stance (neutral-to-hawkish), and liquidity stance (skewed to tighten) may all align in the same direction incrementally.

Exhibit 1: Banking liquidity has surged in recent weeks on the back of higher-than-expected FCNR+ flows



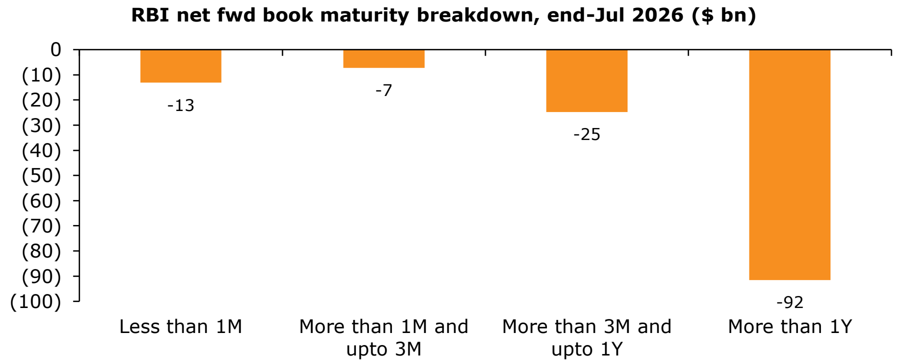
Source: CEIC, Emkay Research; Note: the latest data for core liquidity is an Emkay estimate

Exhibit 2: Nearly half the FCNR+ flows came in the last 10 days of the FCNR window



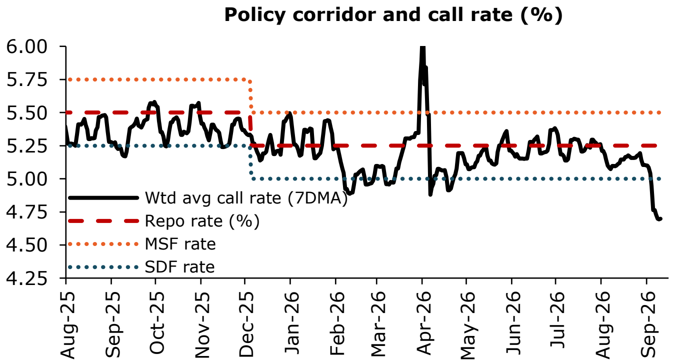
Source: RBI, Emkay Research

Exhibit 3: RBI's short forward book is heavily skewed toward >1Y



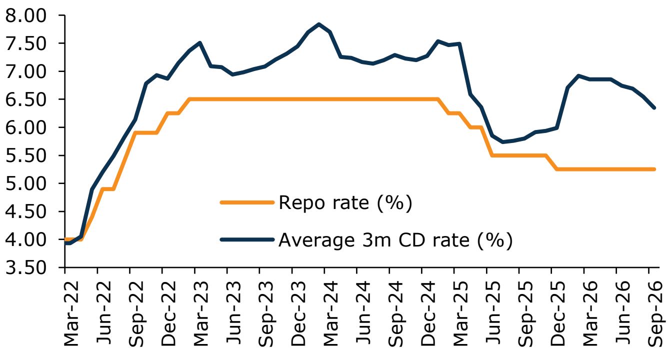
Source: CEIC, Emkay Research

Exhibit 4: Call rates have dropped even below the SDF rate, due to the liquidity glut…



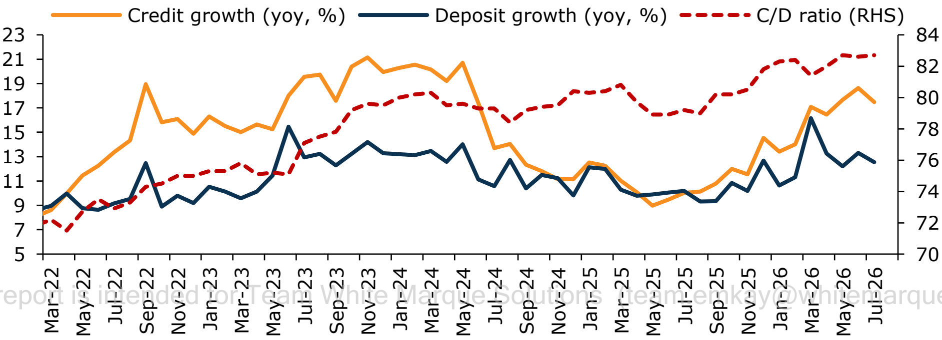
Source: Bloomberg, Emkay Research

Exhibit 5: …which has also helped pull down CD rates, which though are still elevated



Source: RBI, Emkay Research

Exhibit 6: C/D ratio stabilized at around 82%, as credit growth outpaced deposits; but this may change due to FCNR+ flows



Source: CEIC, Emkay Research

#2 How does this change our liquidity forecast math

Based on our updated estimates for the key drivers of core system liquidity—CIC, CRR buildup, RBI bond redemptions and interest income, RBI intervention/BoP, and the estimated maturity profile of the RBI's forward book, we now estimate end-FY27 system/durable core liquidity at ~Rs7.1/8.6trn, respectively. This implies a surplus of roughly **2.3%/2.7% of NDTL**. This is well above the RBI's comfort level of 0.8-1.0% of NDTL and a significant change from our pre-August MPC estimates, which had pointed to system liquidity falling below 0.8% of NDTL by end-FY27.

The biggest swing factor is, unquestionably, the BoP, which we now estimate at >$100bn versus ~$45-50bn previously. At the same time, CIC leakage is likely to be substantial at around Rs5.1trn (~12.1% of GDP; ~12.5% yoy), with ~80% of this concentrated in 2H, driven by festive season spending, pre-UP election spending, and higher inflation.

The simplest low-hanging option available to the RBI would be to let >90% of the FY27 short forward positions on its book mature (outstanding net shorts maturing in 12M or less as of Mar-26 were $50bn; this stands at $45bn as of Jul-26). This alone could bring the liquidity surplus broadly in line with the comfort zone of 1% of NDTL, without the RBI needing to deploy other tools aggressively. That said, such an approach comes with its own costs for FX spot and forward markets (discussed later) and the RBI's accounts. Notably, while near-term swaps will be allowed to mature, they are likely to be largely replaced by longer-tenor swaps within the RBI's forward book to offset the FCNR+ flows.

Exhibit 7: We estimate excess liquidity surplus (beyond the RBI's comfort level) of Rs4.3trn by end-FY27

FY27 Liquidity forecast	
End-FY26	***Rs bn***
System Liquidity (End-March-26)	3,092
Estimated Govt surplus	1,976
Core Liquidity (End-March-26) 3DMA	5,068
FY27E	***Rs bn***
Currency in circulation leakage	-5,100
CRR maintenance	-1,060
Estimated RBI Forward book maturity	-1,180
Maturing RBI holdings of Gsecs	-700
Interest earned by RBI on Gsec holdings	-788
RBI Dividend	2,870
BoP Surplus/Deficit	9,975
RBI OMOs + other primary liquidity infusion/absorption	***???***
Estimated System Liquidity (End-March-27)	**7,109**
Estimated Govt surplus	1,500
Estimated Core Liquidity (End-March-27)	**8,609**
RBI comfort: 0.8-1% of NDTL (mid-point)	**2,859**
Estimated Liquidity Overhang	**4,250**

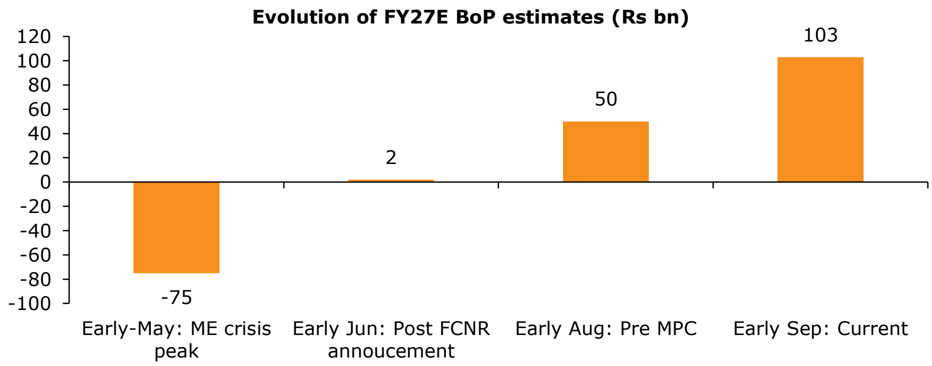
Source: CEIC, Emkay Research estimates

Exhibit 8: Our current liquidity forecast is much higher than earlier in the year…

Evolution of our estimates of system liquidity for end-FY27E (Rs bn)	System Liquidity (+surplus/-deficit)	Core Liquidity (+surplus/-deficit)	*Govt Surplus*
Early-May - ME crisis peak	-3,499	-2,499	1,000
Early Jun - Post FCNR annoucement	1,939	2,939	1,000
Early Aug - Pre MPC	2,951	4,451	1,500
Early Sep - Current*	7,109	8,609	1,500

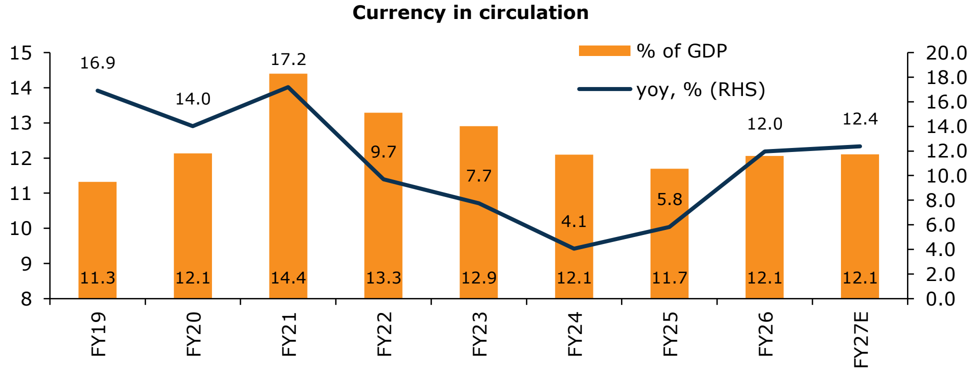
Source: Emkay Research estimates; Note: The current forecast (Sep-26) assumes no RBI primary infusion; Prior estimates assume RBI primary infusion to the tune of Rs2.5-5trn

Exhibit 9: …driven by evolving BoP estimates as FCNR+ flows picked up



Source: Emkay Research estimates

Exhibit 10: CIC is expected to remain sizable at 12.1% of GDP in FY27E, implying ~Rs5.1trn of CIC leakage during the year



Source: CEIC, Emkay Research estimates

#3 Sterilization toolkit – Which tool for which liquidity problem

A potentially inflationary liquidity injection of this magnitude, if left unsterilized, risks distorting money-market rates and complicating the RBI's liquidity management. As established earlier, the real pain point is not the total inflow but the ~Rs4.5trn excess requiring durable management. The standard toolkit includes VRRR, forex sell/buy swaps, CMBs/MSS, and OMO sales. Crucially, there is no clean option here: someone bears the cost, be it banks, the RBI, the fiscal account, or bondholders. Defending FX (and rates) is never truly free of costs – it merely shifts the bill between agents. Whichever tool the RBI picks out, some cost or criticism will follow. The choice of instrument therefore matters not just for the quantum of liquidity absorbed, but also for where the cost lands, how durable the absorption is, and what signal it sends for monetary and financial conditions.

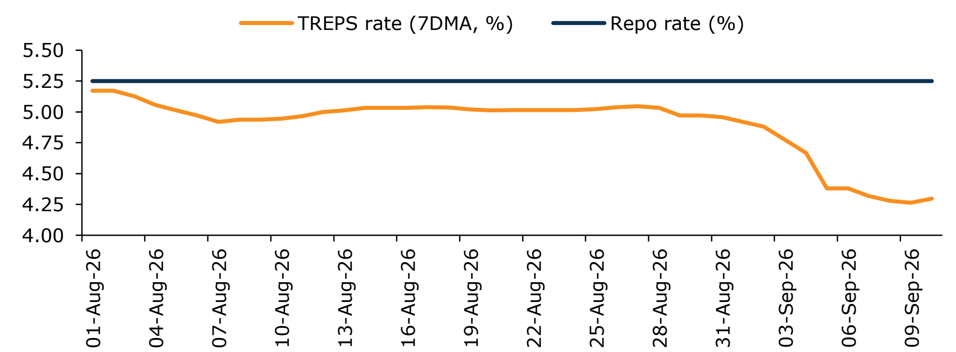
(i) VRRRs — A failed strategy for absorbing durable liquidity: The RBI's first line of defense has been VRRRs—a quick, flexible, and reversible, yet poor fit for a problem likely to persist for years. Banks have also resisted locking funds away for more than a few days, even with premature-withdrawal sweeteners offered on longer-tenor VRRRs. Rolling overnight or flexi-VRRRs have failed to keep overnight rates aligned with the policy rate, which has slipped firmly below the repo rate (and is in fact nearly sub-5%). A more effective approach would be widening VRRR access to non-bank participants – mutual funds, insurers, and other money-market players – somewhat similar to the Fed's RRP facility, which admits money-market funds and government-sponsored enterprises (GSEs) as counterparties. A broader participant base could also encourage arbitrage between call and collateralized markets, improving transmission of RBI's liquidity operations while making VRRRs a more meaningful absorption tool.

Exhibit 11: RBI VRRR auctions have not been fully subscribed since late August, with non-overnight VRRRs seeing especially muted demand

Date	Tenor	Notified amount (Rs bn)	Amount accepted (Rs bn)	Amount accepted/amount notified
20-Aug-26	1 day	500	500	100%
20-Aug-26	1 day	1,000	1,000	100%
21-Aug-26	3 day	1,500	960	64%
24-Aug-26	1 day	1,500	492	33%
24-Aug-26	***7 day***	***2,500***	***920***	***37%***
25-Aug-26	2 day	1,750	985	56%
27-Aug-26	1 day	2,000	1,426	71%
28-Aug-26	3 day	3,000	1,525	51%
31-Aug-26	1 day	4,000	2,498	62%
31-Aug-26	***15 day***	***6,000***	***1,346***	***22%***
01-Sep-26	1 day	4,000	2,598	65%
01-Sep-26	***7 day***	***6,000***	***1,143***	***19%***
02-Sep-26	1 day	5,000	4,598	92%
03-Sep-26	1 day	1,500	347	23%
03-Sep-26	1 day	6,000	5,187	86%
04-Sep-26	3 day	1,500	604	40%
04-Sep-26	3 day	7,000	5,420	77%
07-Sep-26	1 day	5,000	3,534	71%
07-Sep-26	***30 day***	***7,000***	***2,593***	***37%***
08-Sep-26	1 day	5,000	4,176	84%
09-Sep-26	1 day	5,000	4,616	92%
10-Sep-26	1 day	6,000	3,967	66%

Source: RBI, Emkay Research

Exhibit 12: The TREPS rate has dropped well below repo due to the deluge of liquidity

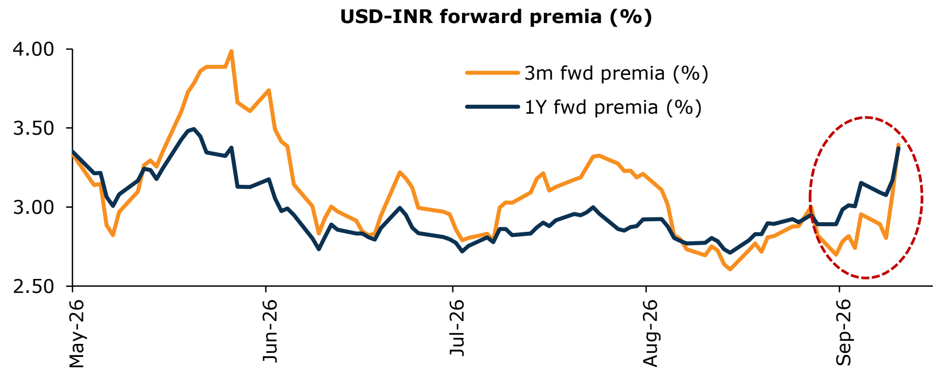


Source: CEIC, Emkay Research

(ii) RBI's FX sell/buy swaps — A short-term fix, but with a cost: Sell/buy swaps push the liquidity problem into the future rather than eliminating it. RBI could use 3/6 to over 12-month swaps to sterilize large inflows without directly tapping domestic bond instruments. But large auctions risk pushing up forward premia (something that played out in the last 2 days) if the market struggles to absorb the flows, thus raising hedging costs and potentially increasing RBI's own rollover cost. The key weakness, thus, is that sterilization here is temporary and carries rollover/maturity risk.

The more visible direct cost of a sell/buy swap is the forward premium paid to banks, currently ~3.4% annualized (which shot up in the last few days, led by the RBI's forward intervention). But there is also an opportunity cost for RBI: selling USD reserves in the first leg means forgoing ~4.0-4.2% annualized risk-free USD returns (roughly the average UST yield up to one year) and pushing the effective all-in economic cost above 7% annualized. Additionally, the swap subsidy embedded in FCNR buy/sell transactions amounts to a near-zero-return trade for the RBI, adding further to the cost of using FX swaps as a sterilization tool. In other words, while FX swaps may be operationally convenient and less disruptive to the domestic bond market in the near term, they are neither a permanent sterilization solution nor a cheap one.

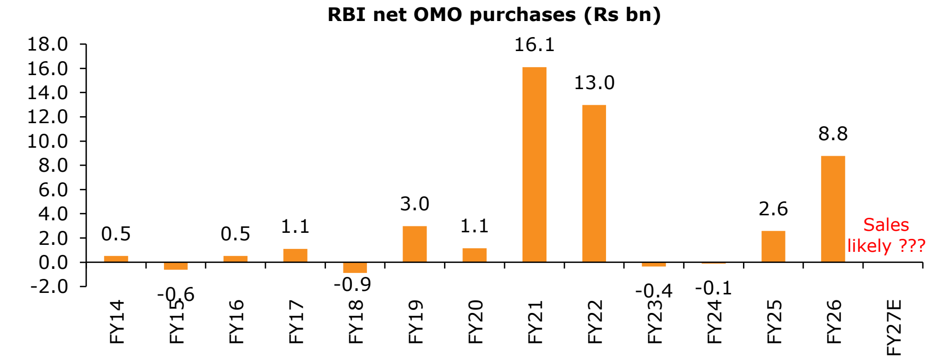
Exhibit 13: USD-INR forward premia have spiked in the last few days



Source: Bloomberg, Emkay Research

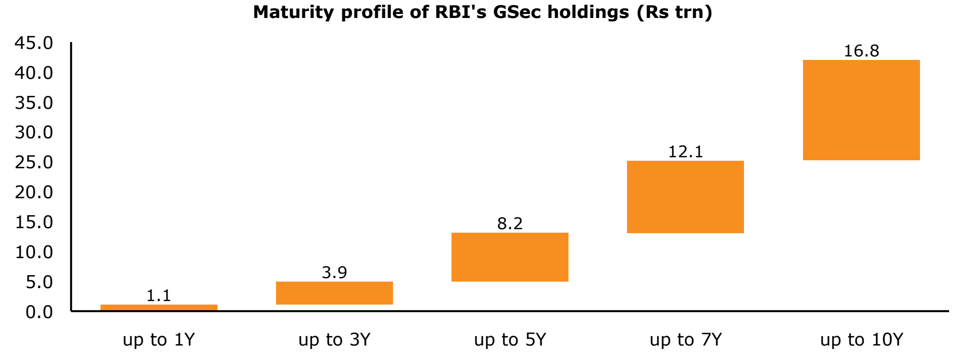
(iii) OMO sales – Durable and effective, but a slightly blunt tool: A more outright and blunt tool that works well to durably absorb liquidity while also easing some of the balance-sheet bloat that the RBI has accumulated over the years (RBI purchased Rs11.4bn of GSecs via OMOs in the last two fiscal years). Given that much of the current liquidity injection is expected to reverse over a 3–5 year horizon, the sales would likely focus on 3-5Y securities, broadly matching the tenor of the liquidity inflow. This should also find relatively healthy demand from banks, which have a natural preference for shorter-duration, high-quality assets. With Rs3.9/8.2trn in cumulative maturities over the next 3/5 years, respectively, the RBI has ample room in its book to offload. The trade-off: greater bond supply hitting the market, pushing up yields and borrowing costs for the GoI and other market issuers. In effect, this could tighten broader financial conditions and potentially deliver some of the same macro-financial effects as a rate hike, despite the policy rate itself remaining unchanged.

Exhibit 14: RBI has been a heavy GSec buyer in the last couple of years



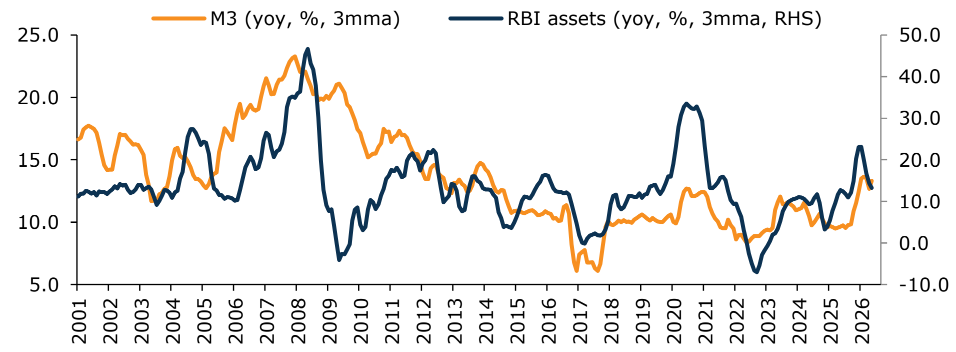
Source: CEIC, Emkay Research

Exhibit 15: Nearly half the RBI's GSec holdings are set to mature within five years



Source: Emkay Research estimates

Exhibit 16: Money supply (M3) is highly correlated with the RBI's balance sheet and, hence, a reduction in the balance sheet (via OMO sales) will curb M3 growth



Source: CEIC, Emkay Research

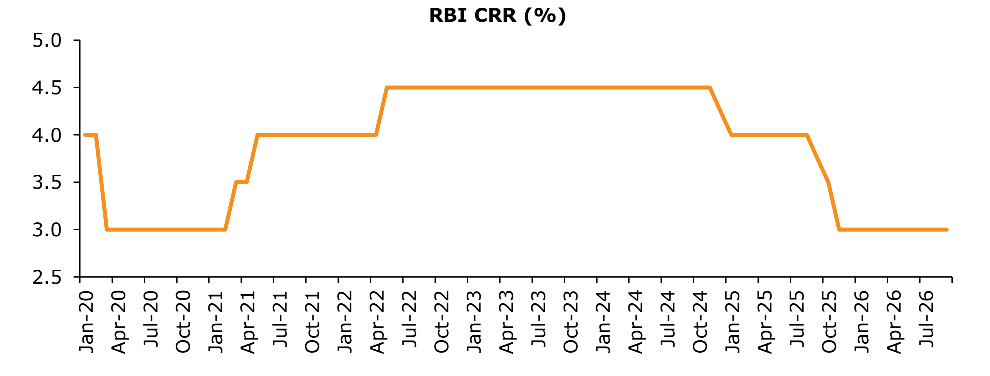
(iv) CRR/I-CRR hikes – Effective, durable, but particularly blunt: An even blunter but effective way to absorb this liquidity overhang, while retaining the option to reverse the measure when liquidity conditions eventually normalize over the next few years. At current levels, a 1% CRR hike could absorb Rs2.9-3trn, covering about 65% of the estimated Rs4.5trn excess liquidity by end-FY27; however, on an immediate basis, it covers only ~27% of the current Rs11trn surplus. Notably, the RBI had cut CRR by 100bps in a staggered manner, to 3% only last year, having deemed that level appropriate for the banking system going ahead. Reversing course so soon could therefore send a confusing policy signal.

More importantly, the cost here falls on banks — and ironically penalizes even those that stayed out of, or participated minimally in, the FCNR-driven liquidity surge. This is particularly awkward given that the FCNR deposits were specifically granted a CRR/SLR exemption to encourage mobilization.

An Incremental-CRR hike (similar to the mechanism deployed in 2023) would create an even starker inconsistency: it would disproportionately penalize banks that actively participated in the FCNR window, despite their deposits having been exempted from statutory reserve requirements as an incentive.

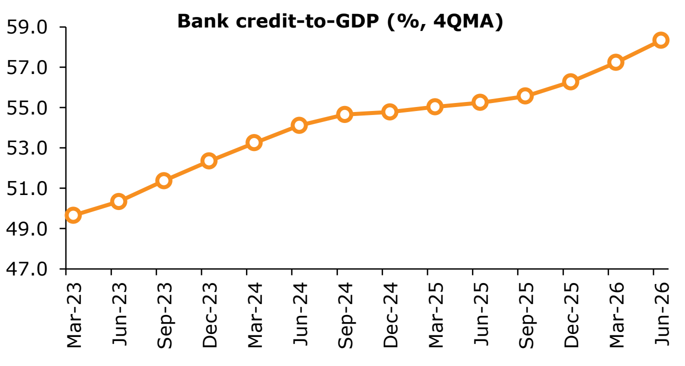
Either approach would likely draw significant pushback and criticism from the banking system for the RBI, and send confusing signals about the stability of the RBI's policy framework. More importantly, the resulting increase in banks' effective funding costs could weigh on credit growth and tighten financial conditions, making CRR/I-CRR hikes a particularly blunt instrument for addressing what is, at its core, an externally driven liquidity shock. That said, it is the only instrument that will directly target M3 growth materially, especially as current credit growth remains at a cyclical high of 18%.

Exhibit 17: CRR was reduced to 3% only last year



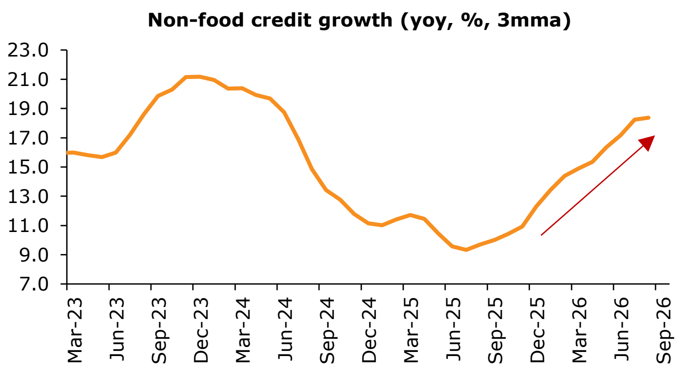
Source: RBI, Emkay Research

Exhibit 18: Bank credit-to-GDP has been steadily rising over the past 3 years



Source: RBI, Emkay Research

Exhibit 19: Credit growth has seen a cyclical pick-up since the turn of the year



Source: RBI, Emkay Research

(v) MSS/CMBs – Scalable, but fiscally costly: The Market Stabilization Scheme (MSS) can absorb liquidity at real scale, using government papers to lock funds away from the banking system. But it requires the government and RBI to move in tandem, as MSS securities add directly to the government's debt stock and carry a genuine fiscal cost, in the form of interest expense. MSS was last deployed during demonetization in FY17, having first been used in FY08-09 ahead of the GFC. The tool was originally designed to ensure that RBI had sufficient securities to offer banks as collateral for reverse repo operations, particularly when its own security holdings were running low. That rationale carries little weight today, given the RBI's bloated balance sheet and the availability of the uncollateralized SDF window. Moreover, with fiscal conditions already under strain (Brent again hovering at above $100/bl), the government is likely to be reluctant of taking on additional cost when the RBI has other tools at its disposal.

#4 What is the least costly way to manage the liquidity deluge

There is no cost-free clean-up here — someone bears the cost, be it the RBI, bondholders, banks, or the fiscal account. That said, durable absorption should focus specifically on the excess surplus, as the remainder will naturally unwind over the year. A blended approach, calibrated to how durable different portions of the liquidity surplus are, seems most sensible.

While VRRRs and sell-buy swaps have been the first line of defense, both are poor long-term solutions for durability and rate-anchoring. Rolling VRRRs can serve a tactical purpose but are not a durable solution, and are unlikely to help align overnight rates with repo. FX swaps offer more durable-looking absorption but are ultimately temporary, carry an all-in annualized cost of ~7%, and the key weakness—sterilization is temporary, creating rollover/maturity risk—remains. However, whether short-tenor sell-buy swaps or letting the $45bn <12M forward book mature, forward premia could face upward pressure. Though this is likely to concentrate in the sub-1Y segment of the curve rather than spreading uniformly.

To that extent, we see merit in the RBI also leaning on the blunter CRR tool, criticism notwithstanding, given that it targets M3 growth more directly. OMOs and MSS, while also blunt, are less effective at reining in broad money expansion than CRR: bonds sold via OMOs/MSS remain tradeable and usable as collateral, making them only a partial substitute for excess liquidity/reserves in the banking system.

On net, our cost assessment for absorbing 0.5% of NDTL (annualized gross cost) ranks CRR as the costliest for banks, followed by sell-buy swaps and OMO sales for the RBI. For OMOs, foregone coupon income is a straightforward direct cost, while realized capital gain/loss depends on sale price versus book value. MSS appears less expensive for the RBI, as the government bears the cost instead, while SDF is the cheapest option, though neither durable nor sufficiently effective at this scale.

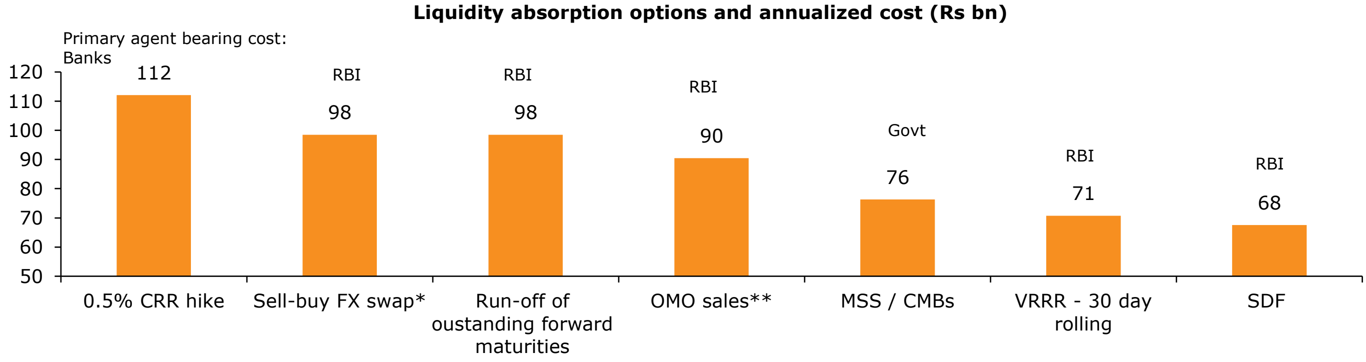
All in all, after evaluating the effectiveness, durability/timing, and incidence of cost, there is no single optimal instrument. The least-cost strategy is likely a mix—tactical VRRRs/SDF in the near term, selective FX operations where market conditions permit, and more durable absorption through CRR/OMO as the persistence of the surplus becomes clearer.

Exhibit 20: Summary of the RBI's liquidity absorption options

Liquidity measure	Annualised gross cost of 0.5% NDTL absorption (Rs bn)	Primary agent to bear cost	Secondary agent to bear cost	Mode of impact	Nature of durability
0.5% CRR hike	112	Banks – zero return on CRR balances + Opportunity cost of lending + higher marginal cost of intermediation + pressure on NIMs	Consumers / corporates through higher borrowing costs and potentially tighter credit	Permanent withdrawal of lendable resources; higher lending rates / lower credit supply; NIM compression	Super high - hits the M3 directly
Sell-buy FX swap*	98	RBI – cost of forward premium paid on the swap + opportunity cost of USD asset returns (Excludes realised/notional capital gain/loss)	Banks / corporates through higher forward premia and hedging costs	Liquidity absorption + upward pressure on forward premia	Moderate
Run-off of oustanding forward maturities	98	RBI – economic cost of replacing/rolling forward FX position + opportunity cost of USD asset returns (Excludes realised/notional capital gain/loss)	Banks / FX users /Corporates through impact on forward premia	Natural liquidity absorption on maturity; withdrawal of RBI forward-dollar supply without a new fiscal or regulatory burden.	Natural / self-reversing
OMO sales**	90	RBI (ultimately Govt) - foregone coupon income but realised capital gain/loss depends on sale price vs book value	Banks/financial system through absorption of liquidity and potentially higher G-sec yields; Govt - Lower RBI income -- potentially lower transfer to Govt.	Permanent withdrawal of liquidity + reduction in RBI G-sec holdings + loss of future coupon income; may push bond yields higher	High - but technically stays in the system as tradeable bonds with banks
VRRR - 30 day rolling	71	RBI – interest paid on absorbed liquidity	Banks – receive risk-free return but lose alternative deployment opportunity	Temporary liquidity absorption; no structural impairment of banks' lending capacity	Non-durable
SDF	68	RBI – interest paid on deposits placed with RBI; Non collaterlised, banks earn interest	Banks – foregone alternative deployment, though funds remain liquid/risk-free	Temporary liquidity absorption; RBI remunerates banks at SDF rate	Non-durable
MSS / CMBs	76	Govt – interest/fiscal cost of sterilisation securities	Banks / financial system through absorption of investible funds and possible crowding-out	Liquidity absorption through government securities; adds to public debt/fiscal cost	Moderate to high

*Source: Emkay Research estimates; Note: *Excludes realized/notional capital gains/losses once the contracts expire; **Excludes realized capital gain/loss which depends on sale price vs book value of GSecs; #All-in costs may not include all second-order net impacts*

Exhibit 21: CRR hike and OMO sales are among the costliest liquidity absorption options for the RBI



*Source: Emkay Research estimates; Note: *Excludes realized/notional capital gains/losses once the contracts expire; **Excludes realized capital gain/loss which depends on sale price vs book value of GSecs; #All-in costs may not include all second-order net impacts*

#5 How should policymakers maximize the upside and manage the risks

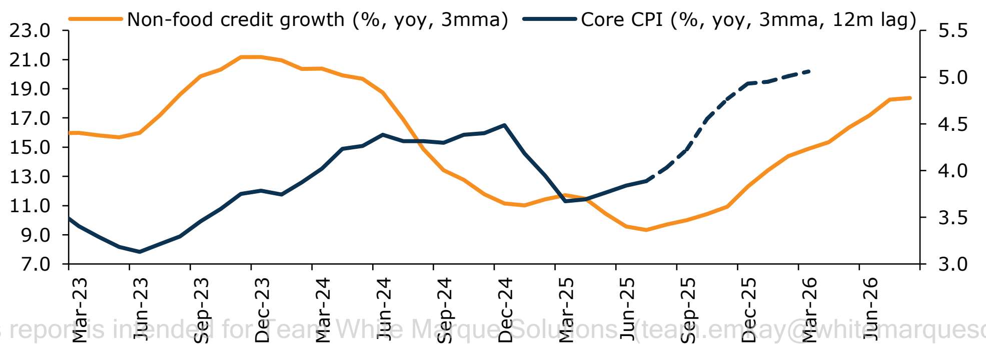
Near-term, this has delivered cheap funding — a clear benefit for banks (that have been feeling pressure on NIMs over the years), with the RBI absorbing the FX risk. Lower funding costs should support banks' profitability over time, even as the RBI eventually absorbs the excess liquidity through tools like VRRRs.

(i) **Maximize economic returns on this dollar debt:** However, the macro implications need to be viewed through a broader lens – this represents a future dollar-denominated debt liability. The funds raised must therefore be deployed judiciously and productively to offset the associated first-order costs. More importantly, this large inflow arrives against a backdrop where India has struggled to attract durable foreign capital in the past — with FPIs demanding higher risk premia, particularly amid narrowing growth differentials with other EMs. Used well, this large pool of foreign savings could provide an opportunity to reset, with productive investment and outcomes helping strengthen India's longer-term positioning for quality capital flows.

(ii) **Keep an eye on credit quality and inflation multiplier effect**: On that front, while the boost to broad money could further support the already strong bank credit cycle through the multiplier effect, the quality of credit creation, and any build-up of undue credit risk, etc, needs close monitoring, especially with pre-FCNR credit growth already running at 17%. Inflationary implications also warrant attention, given the cyclical upturn already underway on the demand front (arguably led by both consumption and investment).

(iii) **Domestic demand driven CAD-risks:** Over the medium term, demand-led growth could lift import demand alongside domestic activity, widening the import bill — a demand-driven widening of the CAD cannot be ruled out. The liquidity injection will expand domestic deposits, but this may translate disproportionately into higher consumption/investment than financial savings, adding to CAD risk.

Exhibit 22: The surge in credit growth could lead to higher core inflation in the next 12 months



Source: CEIC, Emkay Research; Note: Core CPI from Aug-26 onward is a forecast

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SELL	>15% downside

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