Oil Shocks, Capital Outflows, and Optimal Central Bank Policy*

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November 19, 2026

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Abstract

How should an oil importer combine monetary policy with foreign exchange intervention (FXI) when oil prices rise and capital flows out? I study an economy with imported oil, domestic-currency debt, and global intermediaries with limited position capacity. An oil shock alone can create the financial pressure that makes both instruments valuable for policymaking. Although monetary policy alone can also ease that pressure, households must give up more than optimal consumption to finance the higher oil bill. Hence, FXI offers another way to meet the financing need in addition to monetary policy, even after accounting for spending and changes in the value of inherited debt. Calibrated to India, the joint policy cushions consumption and depreciation under both oil-only and combined shocks of oil price rise and simultaneous capital outflow. I also find that access to FXI matters: the impact of a one-quarter delay is costly when the delayed plan exhausts intermediary capacity. Later intervention cannot undo the consumption adjustment and bond returns required to finance the initial trade.

Keywords: oil shocks; capital outflows; optimal monetary policy; exchange rate management; foreign exchange intervention; financial intermediation.

JEL codes: E52; E58; F31; F41; Q43.

*This paper is a chapter of my Ph.D. dissertation at the University of Minnesota. I thank V.V. Chari and Neil Mehrotra for their support and guidance during this project. I also thank Benjamin Malin, Thomas Tallarini, Sauhard Srivastava, Amol, other participants of the Economic Analysis Group at the Federal Reserve Bank of Minneapolis, and the Minnesota Jamboree for their comments and suggestions. All errors are my own. This is a working paper draft; comments and suggestions are welcome. First draft: September 9, 2026.

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1 Introduction

For an oil-importing economy, a rise in the world price of oil means giving up more national income to buy the same fuel. The Russia-Ukraine conflict in 2022 and the Middle East conflict in early 2026 brought a second difficulty into focus: the higher bill comes due well before many households or firms can change how much oil they use (Adrian et al., 2026). As fuel costs feed into consumer prices and the higher import bill puts pressure on the current account, the central bank must decide how much to tighten monetary policy. That choice becomes harder when foreign investors are selling domestic assets at the same time: a higher interest rate restrains spending across the economy, while a sale of foreign reserves supplies the foreign currency needed to pay for imports. When should an oil importer use both instruments, and how much does it matter whether it intervenes immediately?

India illustrates why these shocks are worth studying together. In March 2022 the price of the Indian crude basket rose by twenty percent in a month, while foreign portfolio investors sold a net half a trillion rupees of Indian securities. Four years later, in March 2026, the basket rose from $69 to $113 per barrel and net sales reached 1.26 trillion rupees. The two pressures have coincided outside these episodes as well. Between January 2013 and September 2026, the basket rose at least ten percent in fifteen months; in ten of them foreign investors were net sellers across asset classes (Figure 1).

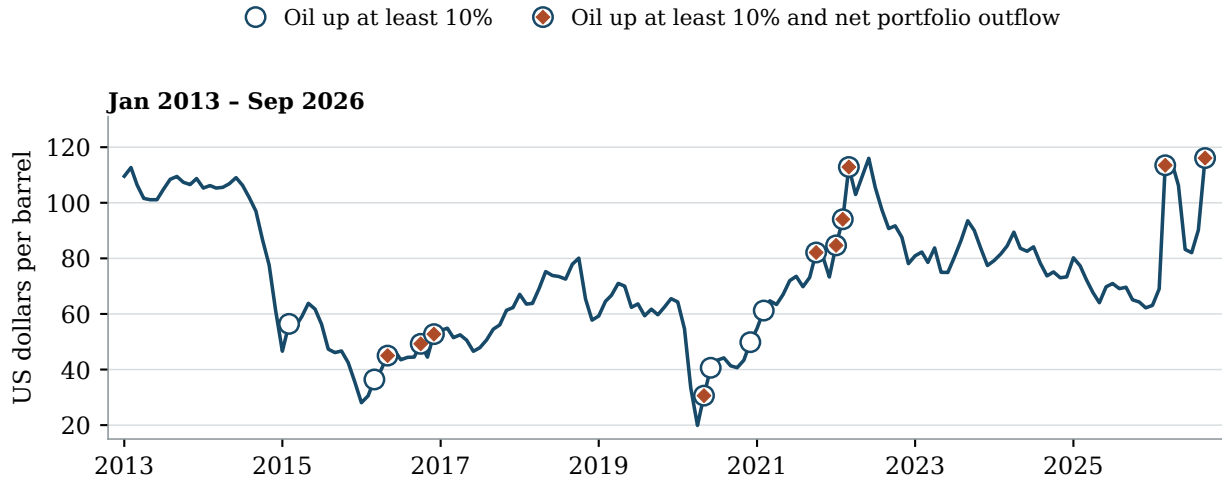

Figure 1: Oil prices and foreign portfolio outflows in India

Monthly Indian crude-basket prices, January 2013–September 2026. Circles mark price increases of at least ten percent from the previous month. Diamonds mark net foreign portfolio sales across all reported asset classes in those months. The published basket weights changed in March 2026. Sources: Petroleum Planning and Analysis Cell (2026), Central Depository Services (India) Limited (2026), and SEBI's April and October 2026 bulletins.

The two shocks meet in the domestic bond market. An importer that finances part of a higher oil bill needs a buyer for domestic debt, and a foreign investor selling domestic bonds needs a buyer as well. I study a small open economy where households consume imported oil, firms use it in production, and intermediaries obtain foreign funding to hold domestic-currency bonds. Their required return increases with their position and can rise further when they reach a position limit. Monetary policy changes the spending and prices that determine the financing need. Sterilized foreign exchange intervention (FXI) changes the financing position directly by exchanging reserves for domestic bonds.

The currency and maturity of outstanding debt matter for that adjustment. Depreciation lowers the foreign-currency payment on a domestic-currency coupon, while the interest rate affects the price at which the remaining claim trades. An oil importer can therefore meet part of its higher bill through a reduction in foreign payments on inherited debt. The central bank takes the contractual portfolio as given and allows its current value to adjust in equilibrium. The policy question is how to combine this adjustment with household spending and the financing supplied by intermediaries and official reserves.

I begin with a complete two-period economy with preset domestic prices and flexible wages. All financial claims are settled in the second period. Monetary policy selects domestic expenditure in both periods subject to household saving and the interest-rate bound; wages, imports and portfolios satisfy private optimality and the two external budgets. Holding monetary conditions fixed, I show when a first-period oil increase raises the intermediary premium even though direct foreign investors have not reduced their bond target. The higher production oil bill induces lower import spending and revalues inherited debt, but repayment in the second period prevents those adjustments from absorbing the entire financing need. The remaining position raises the return intermediaries require. A simultaneous reduction in the foreign-investor mandate reinforces the premium response under the same monetary conditions.

The two-period economy also establishes a separate policy result. Starting from optimized monetary policy alone, a reserve sale can raise welfare without requiring the same change in domestic spending as another monetary adjustment. I derive a sufficient condition that weighs the intertemporal financing benefit and the change in future foreign payments against the valuation of inherited claims. This makes explicit why a positive premium can create a role for FXI, and why lowering the premium is not itself the policy objective. The monetary and reserve instruments affect several parts of the allocation together.

For the quantitative analysis, I extend the economy to an infinite horizon, implement monetary policy through a bounded interest-rate path, allow firms to reset prices at

different times and use convex labor disutility. Energy use, financial portfolios, reserves and shock persistence are calibrated to Indian data. The financial shock captures the bond component of the portfolio sales in Figure 1: direct foreign investors reduce the foreign-currency value of domestic bonds they want to hold. The mandate path is identical across policies. Realized aggregate sales also depend on bond prices, the exchange rate and purchases by foreign-owned intermediaries, and I report those transactions separately.

I compare a Taylor rule, optimized monetary policy without FXI, and joint monetary and reserve policy. Under the oil-only shock, reserve sales allow a larger import bill and a smaller initial consumption contraction while keeping intermediary positions within capacity. When the oil shock coincides with the portfolio shock, joint policy reduces the first-quarter consumption fall from 1.077% to 0.664% and depreciation from 16.504% to 9.718%, relative to optimized monetary policy alone. Welfare includes both these immediate effects and the future payments and reserve income associated with the policy plan.

The final result concerns timing. A central bank required to wait one quarter can announce its future intervention immediately, but the foreign currency is unavailable for the initial trade. Waiting is costly when the delayed plan requires financing beyond intermediary headroom. In the calibrated combined shock they reach their position limit immediately, and postponement sacrifices 57.8% of the welfare gain from adding FXI. The oil-only delay also has a positive, smaller cost. Without access to reserves in the first quarter, households must cut consumption further and offer higher returns to foreign bondholders. Future intervention is already anticipated in this comparison; it does not supply the reserves needed to settle the initial trade.

The paper proceeds as follows. Section 2 relates the analysis to work on commodity shocks and foreign exchange intervention. Sections 3 and 4 describe the two-period economy, characterize implementable allocations and state the policy problem. Section 5 establishes the oil-to-premium channel and the value of the additional intervention margin. Sections 6 and 7 introduce the infinite-horizon economy and its calibration. Section 8 presents the policy and timing comparisons, and Section 9 concludes.

2 Related literature

This paper connects the literature on monetary policy in commodity-exposed economies with the literature on foreign exchange intervention (FXI). I study an oil-importing small open economy where households consume oil, firms use it in production, and domestic prices are sticky. Because intermediaries have limited room to hold domestic-currency

bonds, the central bank faces two questions when oil becomes more expensive: how much domestic spending should adjust, and how should the country finance the rest of the oil bill?

2.1 Commodity shocks and monetary policy

For an oil exporter, a fall in the oil price cuts export earnings and demand from the oil sector. Bergholt et al. (2019) trace this transmission through Norway's domestic supply chains; Omotosho (2022) studies how capital and the oil intensity of production affect the monetary response. Hevia and Nicolini (2013, 2015) examine how the exchange rate should adjust when the prices of exported and imported goods move and domestic prices or wages are slow to respond. Catão and Chang (2013) show that the ranking of monetary rules also depends on what the country imports and exports and how well it can share risk abroad.

For an importer, higher energy prices reduce purchasing power. Bodenstein et al. (2008) distinguish the response of core inflation from that of headline inflation; Bodenstein et al. (2011) show how the wealth transfer to exporters shapes trade and the real exchange rate. In Chan et al. (2024), labor and imported energy are complements. Higher energy prices reduce labor's share of income, and borrowing-constrained households cut spending. My question is how an importer finances its purchases even after spending falls.

Drechsel et al. (2019) connect commodity prices to borrowing conditions for producers in an exporting economy. Drechsel et al. (2026) extend the framework to economies that both import and export commodities, including emerging-market importers. I follow their treatment of the imported commodity as both a consumption good and a production input. In my model, the premium on a domestic-currency bond depends on how much debt intermediaries must carry. It can rise with the oil price even if direct foreign investors keep their bond target unchanged.

Some work on commodity exporters already brings the exchange rate and reserves into the policy problem. Jin and Xiong (2021) show how fiscal stress after an oil-price fall limits exchange-rate stabilization in Russia. In Faltermeier et al. (2022), reserve accumulation during a commodity boom protects tradable production when firms learn by doing. Aktuğ and Rezghi (2026) study an exporter that receives oil income, uses oil in production, and has financial intermediaries. An oil-price shock changes those intermediaries' currency exposure and gives FXI a role even without a financial shock. For the importer I study, the pressure comes from a higher oil bill. The two-period model shows when spending

cuts and the lower foreign-currency value of outstanding debt leave part of that bill for intermediaries to finance.

2.2 Foreign exchange intervention

When intermediaries have limited capacity to bear currency risk, portfolio orders move exchange rates and expected returns (Gabaix and Maggiori, 2015; Maggiori, 2022). Cavallino (2019) derives the optimal intervention response to shifts in foreign demand for domestic assets. Other work identifies distinct reasons why currency markets matter for policy: the cost of sterilization under capital controls (Chang et al., 2015), banks' demand for foreign-currency liquidity at settlement (Bianchi et al., 2021), and the effect of central bank trades when investors anticipate only a limited number of rounds of market adjustment (Iovino and Sergeyev, 2023). The currency of trade invoicing also shapes exchange-rate transmission (Mukhin, 2022) and the case for floating when trade prices are set in a dominant currency (Egorov and Mukhin, 2023).

Itskhoki and Mukhin (2023) give a benchmark in which monetary policy closes the output gap and FXI removes the distortion in currency markets. In the oil-importing economy, the interest rate also affects the value of outstanding long bonds, and a reserve sale changes how much new debt intermediaries must finance. These links mean that both instruments influence what households consume and what the country later pays abroad. Fanelli and Straub (2021) show how the national cost of intervention depends on who receives the returns on currency positions, while Fanelli (2026) shows how the international portfolio determines the insurance that debt revaluation provides. The two channels enter the oil experiment through the payment due on inherited bonds and the premium earned on new ones.

Basu et al. (2025) study interest rates, FXI, capital controls and macroprudential policy together, finding a role for intervention when foreign demand shifts in shallow currency markets. In my model the available capacity of intermediaries is the additional debt they can hold before reaching their position limit. An oil shock alone can use up that capacity, and a simultaneous cut in the foreign bond target can exhaust it in the first quarter. In the Indian calibration, immediate joint intervention then improves on both the Taylor rule and the optimized interest rate alone. Waiting instead requires more initial adjustment and raises the return promised to foreign bondholders.

3 Model

The economy imports oil for consumption and production, exports a contracted quantity of its domestic good, and borrows through domestic-currency bonds. Households can trade domestic claims. Global intermediaries are foreign-owned and have access to foreign funding, while a separate group of foreign investors holds domestic bonds according to a portfolio mandate. The central bank conducts monetary policy and can exchange foreign reserves for domestic bonds.

There are two periods, indexed $t = 0, 1$. The first-period shock occurs after domestic prices have been set; policy can respond in that period. All remaining claims are paid in the second period. Domestic prices are preset at $P_{H,t} = 1$ in both periods, and wages are flexible. The foreign manufactured-good price is the numeraire, $P^*_M = 1$. The world oil price P^O_t is in foreign-good units, and S_t is domestic currency per unit of foreign currency. A rise in S_t is depreciation. These normalizations leave the domestic price of imports, and hence the real exchange rate, free to adjust.

3.1 Households

A unit mass of identical households consumes the domestic good $C_{H,t}$, imported manufactures $C_{M,t}$ and imported oil $C_{E,t}$, and supplies hours N_t. Preferences are

$$\mathcal{W} = \sum_{t=0}^{1} \beta^t \left[(1-\alpha) \log C_{H,t} + \alpha(1-\omega) \log C_{M,t} + \alpha\omega \log C_{E,t} - \chi N_t \right] \tag{1}$$

Here $\beta \in (0,1)$ discounts future utility, $\alpha \in (0,1)$ is the import expenditure share, $\omega \in (0,1)$ is oil's share within imported consumption, and $\chi > 0$ scales the disutility of work. Write C_t for the corresponding unit-elastic consumption aggregate and P_t for its expenditure price index; $\log C_t$ equals the three weighted log terms up to a constant.

The household holds H_0 units of a domestic long bond priced at Q^B_0 and B^S_0 units of a one-period domestic claim priced at $Q^S_0 = 1/I_0$, where I_0 is the gross domestic interest rate between the two periods. The short claim pays one in the second period; the long claim pays L. Inherited long-bond face H_{-1} pays a coupon of one and leaves $\delta_B \in [0,1)$ surviving units. With $z_t = C_{M,t} + P^O_t C_{E,t}$ denoting import expenditure in foreign units, the two nominal budgets are

$$\begin{aligned} C_{H,0} + S_0 z_0 + Q^B_0 H_0 + Q^S_0 B^S_0 = {} & W_0 N_0 + \Pi^F_0 + (1 + \delta_B Q^B_0) H_{-1} \\ & + T_0, \end{aligned} \tag{2}$$

$$C_{H,1} + S_1 z_1 = W_1 N_1 + \Pi^F_1 + L H_0 + B^S_0 + T_1 \tag{3}$$

W_t is the wage, Π_t^F firm and export-contract profits, and T_t the net public transfer. The household chooses consumption, hours and its domestic portfolio subject to these budgets and $H_0 \geq 0$. It cannot invest in the foreign safe asset. All domestic claims are settled in the second period. Let ν_t be the marginal utility of domestic nominal income. Household optimality gives

$$C_{M,t} = (1-\omega)z_t, \qquad C_{E,t} = \omega z_t / P_t^O, \tag{4}$$

$$S_t z_t = \frac{\alpha}{1-\alpha} C_{H,t}, \qquad W_t = \frac{\chi}{1-\alpha} C_{H,t}, \tag{5}$$

$$\nu_t = \frac{1-\alpha}{C_{H,t}}, \qquad \nu_0 = \beta I_0 \nu_1 \tag{6}$$

Households allocate spending across goods and across periods in the same optimization problem. The intratemporal demands determine the composition of expenditure; the Euler equation determines its intertemporal allocation.

3.2 Monetary policy

With domestic prices preset, I represent monetary policy by its control of aggregate domestic expenditure $(C_{H,0}, C_{H,1})$. This is a reduced-form policy assumption: the central bank can select these expenditure levels among allocations that satisfy household and firm optimization and all budgets. Households continue to choose their own consumption, labor and saving. The implied interest rate must satisfy

$$I_0 = \frac{C_{H,1}}{\beta C_{H,0}} \tag{7}$$

and the common rate bound stated below. Monetary policy alone and joint policy have the same expenditure choices; joint policy also chooses a reserve trade. Specifying both expenditure levels closes the final period, when there is no subsequent interest rate. The infinite-horizon model instead implements monetary policy through a sequence of interest rates and its continuation rule. The analytical comparison identifies the additional intervention margin under the stated demand-control assumption; the quantitative comparison evaluates that margin under the rate-based policy restrictions.

3.3 Firms

Firms produce the domestic good using labor and imported oil $X_{E,t}$. The oil input is distinct from household oil consumption $C_{E,t}$. Technology has constant elasticity of substitution

(CES):

$$Y_t = A\left[(1-\mu)N_t^{(\nu_E-1)/\nu_E} + \mu X_{E,t}^{(\nu_E-1)/\nu_E}\right]^{\nu_E/(\nu_E-1)} \tag{8}$$

$A > 0$ is productivity, $\mu \in (0,1)$ is the oil-input weight, and $\nu_E > 0$ is the elasticity of substitution between labor and oil. At $\nu_E = 1$, the technology is $Y_t = AN_t^{1-\mu}X_{E,t}^{\mu}$. Bars denote reference values. Calibration chooses A and μ to reproduce the observed oil cost share and reference output; the CES weight need not itself equal that cost share. Export contracts specify a fixed quantity $\bar{X}$ of domestic goods and fixed foreign receipts $\bar{X}^*$. Domestic goods clearing requires $Y_t = C_{H,t} + \bar{X}$. Once prices have been set, firms meet these orders by choosing

$$\min_{N_t, X_{E,t} \geq 0} W_t N_t + S_t P_t^O X_{E,t} \quad \text{subject to (8) and} \quad Y_t \geq C_{H,t} + \bar{X} \tag{9}$$

Let mc_t denote marginal cost in units of the domestic good. Since $P_{H,t} = 1$, it is also the nominal cost of one more unit of output. Cost minimization gives

$$W_t = mc_t \frac{\partial Y_t}{\partial N_t}, \qquad S_t P_t^O = mc_t \frac{\partial Y_t}{\partial X_{E,t}} \tag{10}$$

Revenue is determined by orders at preset prices, so minimizing input costs also maximizes profits conditional on those orders. Domestic producers and export-contract holders together distribute

$$\Pi_t^F = C_{H,t} + S_t \bar{X}^* - W_t N_t - S_t P_t^O X_{E,t}$$

to households. Their profits need not be zero. Fixed export contracts remove a policy margin through export quantities and receipts, while retaining the imported-oil bill.

3.4 Financial markets

3.4.1 Domestic bonds and foreign investors

The economy inherits domestic-currency bonds. One unit pays a coupon of one in the first period and leaves $\delta_B \in [0,1)$ units of a remaining claim. Each remaining unit pays a fixed domestic-currency amount L in the second period and expires. This is the finite-horizon counterpart of the long bond used in the infinite-horizon model. With positive household holdings, its ex-coupon price and foreign-currency returns satisfy

$$Q_0^B = \frac{L}{I_0}, \qquad R_0^B = \frac{1 + \delta_B Q_0^B}{\bar{Q}^B S_0}, \qquad R_1^B = \frac{L}{Q_0^B}\frac{S_0}{S_1} = I_0 \frac{S_0}{S_1} \tag{11}$$

The opening exchange rate is one. The foreign gross safe return is constant at $r = 1/\beta$, and the reference contract satisfies $L = r\bar{Q}^B = 1 + \delta_B \bar{Q}^B$. Inherited face values are given before policy is chosen. Their current value is determined by S_0 and Q_0^B; neither is fixed by an insurance payment. Taking the inherited portfolio into the policy problem in this way follows Fanelli and Straub (2021); Fanelli (2026).

Financial positions and net exports are measured in foreign-good units. Let B_t^F denote the domestic-currency face held by direct foreign investors. Their first-period mandate is

$$F_0 = \frac{Q_0^B B_0^F}{S_0}, \qquad F_0 \leq \bar{F} \tag{12}$$

An investor shock reduces F_0, the foreign-currency value investors wish to hold. Oil-only experiments set $F_0 = \bar{F}$. The mandate distinguishes a shift in foreign bond demand from the subsequent transactions that achieve it: bond prices and the exchange rate determine the face value bought or sold. It is the mandate, not aggregate realized sales by all nonresidents, that is held fixed across policy comparisons.

3.4.2 Global intermediaries

A unit mass of price-taking, foreign-owned intermediaries finances domestic bonds in the foreign safe market.[1] Each intermediary faces the same prices, marginal fee and position limit; with unit mass its position D_0 is also the aggregate position.

Define the premium on a new position as $\psi_0 = R_1^B/r - 1$. Each intermediary solves

$$\max_{D_0} \ \psi_0(D_0 - \bar{D}) - \frac{\gamma}{2}(D_0 - \bar{D})^2 \quad \text{subject to} \quad -D^{\max} \leq D_0 \leq D^{\max} \tag{13}$$

Here $\bar{D} > 0$ is its normal position, $\gamma > 0$ is the marginal-fee slope, and $D^{\max} = \ell K$ is its position limit. K is usable intermediary capital and ℓ is exposure allowed per unit of capital. Owners receive gains and cover losses while maintaining usable capital. A negative position is a short sale. Subtracting $\psi_0 \bar{D}$ from gross earnings does not affect the choice because prices and $\bar{D}$ are taken as given.

The quadratic charge is a private fee paid within the foreign financial sector. It affects intermediaries' willingness to hold domestic bonds but does not directly use domestic goods or enter household utility. The economy pays the promised bond return abroad, including the premium; these payments enter its external budget. This distinction between

[1] Cavallino (2019); Fanelli and Straub (2021); Basu et al. (2025) allow both domestic- and foreign-owned intermediaries. Appendix J introduces that ownership split and reports the corresponding policy comparisons. The oil-financing mechanism, welfare gain from FXI and positive combined-shock cost of delay survive, with different magnitudes.

private intermediation incentives and national payments follows the accounting in Fanelli and Straub (2021).

Let $\lambda_0^+, \lambda_0^- \geq 0$ be the multipliers on the two position limits. The strictly concave problem gives

$$\begin{aligned} \psi_0 &= \gamma(D_0 - \bar{D}) + \lambda_0^+ - \lambda_0^-, \\ \lambda_0^+(D^{\max} - D_0) = 0, &\qquad \lambda_0^-(D^{\max} + D_0) = 0 \end{aligned} \tag{14}$$

Within capacity, the premium increases with the position. At the upper limit, further financing pressure must be absorbed by prices and other portfolios. The extra premium then includes the value of scarce intermediary capacity.

3.5 Market clearing and the external budget

Let R_t be official foreign reserves and $\bar{G}$ a predetermined nonreserve foreign position. The latter represents an inherited balance-sheet item, not a foreign asset that households can freely choose. Let B_{-1}^G be inherited government bond face and B_t^{CB} the face held by the central bank. A reserve sale is a purchase of domestic bonds:

$$R_0 = R_{-1} - Z_0, \qquad Q_0^B(B_0^{CB} - \delta_B B_{-1}^{CB}) = S_0 Z_0 \tag{15}$$

The central bank's earnings are remitted to the fiscal authority. Writing this remittance as Π_t^{CB}, its cash budgets are

$$\Pi_0^{CB} + Q_0^B(B_0^{CB} - \delta_B B_{-1}^{CB}) + S_0 R_0 = B_{-1}^{CB} + S_0 r R_{-1}, \tag{16}$$

$$\Pi_1^{CB} = L B_0^{CB} + S_1 r R_0 \tag{17}$$

A negative remittance is a fiscal transfer to the central bank. With the predetermined position $\bar{G}$ included in the public account, the fiscal budgets are

$$T_0 + B_{-1}^G = \Pi_0^{CB} + S_0(r-1)\bar{G}, \tag{18}$$

$$T_1 + \delta_B L B_{-1}^G = \Pi_1^{CB} + S_1 r \bar{G} \tag{19}$$

Lump-sum transfers adjust to satisfy these budgets. In the final period the public sector redeems every remaining bond and settles its foreign assets.

Goods and domestic bonds clear according to

$$Y_t = C_{H,t} + \bar{X}, \qquad B_0^S = 0, \tag{20}$$

$$B_{-1}^G = H_{-1} + B_{-1}^{CB} + \frac{F_{-1} + D_{-1}}{\bar{Q}^B}, \tag{21}$$

$$\delta_B B_{-1}^G = H_0 + B_0^{CB} + \frac{S_0}{Q_0^B}(F_0 + D_0) \tag{22}$$

The common N_t is both household labor supplied and firms' labor input. Imported manufactures equal $C_{M,t}$, and total oil imports equal $C_{E,t} + X_{E,t}$; their foreign-currency payments enter net exports. Foreign lenders supply the intermediaries' funding at r. The remaining foreign-exchange clearing condition is the external budget below.

Define net exports and the foreign-owned domestic bond position by

$$NX_t = \bar{X}^* - z_t - P_t^O X_{E,t}, \qquad V_t = F_t + D_t \tag{23}$$

National net foreign assets before the shock and after first-period trading are

$$A_{-1} = R_{-1} + \bar{G} - F_{-1} - D_{-1}, \qquad A_0 = R_0 + \bar{G} - F_0 - D_0 \tag{24}$$

Both direct investors and intermediaries hold claims on the domestic economy. Aggregating the private and public budgets gives

$$A_0 = rA_{-1} + NX_0 - (R_0^B - r)V_{-1}, \tag{25}$$

$$0 = rA_0 + NX_1 - r\psi_0 V_0 \tag{26}$$

The first equation finances current trade and the return on inherited claims. The second settles every remaining claim, including the reserve position, after second-period trade. It imposes solvency at the end of a finite economy; it does not impose reference consumption or employment. There is no second-period intervention decision hidden in this settlement.

3.6 Competitive equilibrium

Definition 1 (Competitive equilibrium)**.** Given inherited portfolios $(H_{-1}, B_{-1}^G, B_{-1}^{CB}, F_{-1}, D_{-1}, R_{-1}, \bar{G})$, the contract (δ_B, L) and opening bond price $\bar{Q}^B$, preset prices $P_{H,t} = 1$, shocks (P_0^O, P_1^O, F_0), and monetary expenditure settings $(C_{H,0}, C_{H,1})$ with reserve trade Z_0, a competitive equilibrium consists of allocations $\{C_{H,t}, C_{M,t}, C_{E,t}, N_t, X_{E,t}, Y_t\}_{t=0}^1$, prices $\{S_t, W_t, P_t, mc_t\}_{t=0}^1$, portfolios $(B_0^S, H_0, B_0^{CB}, B_0^F, D_0, R_0)$, transfers and income $\{T_t, \Pi_t^F, \Pi_t^{CB}\}_{t=0}^1$, and bond prices (Q_0^S, Q_0^B) such that households maximize (1) subject to (2)–(3); aggregate domestic expenditure equals its monetary settings; firms solve (9); foreign

positions and intermediary choices satisfy (12)–(14); and public budgets and markets satisfy (15)–(26). Consumption is positive, household and central-bank bond holdings are nonnegative, and policy respects (28). Returns and aggregate foreign positions follow their definitions above.

4 Equilibrium characterization and policy

4.1 Implementable allocations

The central bank operates through monetary conditions and reserve trades. These choices induce household spending, production and financial positions through private optimization. An allocation is implementable if there is an admissible policy under which households, firms and intermediaries choose it and all budgets clear. This characterization lets the planner choose allocations subject to their equilibrium restrictions, rather than repeatedly attaching a separate policy calculation to each allocation.

Two wedges organize the policy problem. A wedge is a difference between the household's marginal valuation and the marginal cost of obtaining a good or financing it. With the domestic price fixed at one, the *domestic wedge* is $1 - mc_t$. An extra unit of domestic consumption is worth ν_t in utility, while the labor and oil needed to produce it cost $\nu_t mc_t$. A positive wedge makes additional domestic consumption valuable before accounting for the foreign resources needed to support it.

The *financial wedge* concerns expenditure across periods. Define $\lambda_t = S_t \nu_t = \alpha / z_t$ as the marginal utility of foreign expenditure. Combining household saving, the exchange-rate conversion of bond returns and $\beta r = 1$ gives

$$1 + \psi_0 = \frac{z_1}{z_0} \tag{27}$$

Equivalently, $\lambda_0 - \beta r \lambda_1 = \lambda_1 \psi_0$. With a positive premium, an additional unit of foreign expenditure in the first period is worth more than its safe-rate repayment costs in discounted second-period utility. Households cannot obtain that financing directly because they cannot buy or borrow through the foreign safe asset. Intermediaries supply it subject to their marginal fee and position limit. These two wedges identify the margins policy can improve; repayment and inherited-debt valuation determine the cost of doing so.

For any positive candidate $(C_{H,0}, C_{H,1}, z_0, z_1, D_0)$, household demands recover the exchange rates and wages, production recovers labor and oil inputs, and saving recovers I_0. The first external budget then determines the reserve sale that would be required. The second external budget is an additional restriction: financing today must be paid for

tomorrow. The candidate must also satisfy intermediary optimality and the operational bounds

$$I_0 \geq 1, \qquad |\log(I_0/r)| \leq \overline{\Delta i}, \qquad |Z_0| \leq \bar{Z}, \qquad \underline{R} \leq R_{-1} - Z_0 \leq R_{-1},$$
$$|D_0| \leq D^{\max}, \qquad H_0 \geq 0, \qquad B_0^{CB} \geq 0 \tag{28}$$

H_0 and B_0^{CB} are household and central-bank bond faces. The constants $\bar{Z}$, $\underline{R}$ and $\overline{\Delta i}$ are the intervention-flow ceiling, reserve floor and maximum log rate change. The opening rate is r. These bounds apply to both policy menus.

Proposition 1 (Implementability conditions)**.** *Under the monetary demand-control assumption, consider positive allocations with positive household bond holdings. They are competitive-equilibrium allocations if and only if they satisfy household demands and labor optimality, cost minimization and goods clearing, (27), intermediary optimality, both external budgets, and the portfolio and policy bounds. Monetary policy selects their domestic expenditure levels, with*

$$I_0 = \frac{C_{H,1}}{\beta C_{H,0}}, \qquad Z_0 = R_{-1} + \bar{G} - F_0 - D_0 - A_0$$

and transfers determined by the public budgets.

Appendix B proves both directions and constructs the nominal accounts. Positive household bond holdings allow the short and long domestic returns to be equated. All reported quantitative allocations also satisfy that portfolio condition.

The characterization retains inherited-debt valuation. For inherited foreign-held face B_{-1}^{ext},

$$R_0^B V_{-1} = \frac{(1 + \delta_B Q_0^B) B_{-1}^{ext}}{S_0} \tag{29}$$

The coupon and face are contractual; their current foreign value responds to policy through the bond price and exchange rate. Taking these payments into the implementable set follows the portfolio approach in Fanelli and Straub (2021); Fanelli (2026). It is particularly important for an importer: a smaller foreign payment on inherited debt can finance part of the higher oil bill.

4.2 Planning problem

Let $\mathcal{E}(P_0^O, P_1^O, F_0)$ be the implementable set in Proposition 1, conditional on inherited portfolios. The central bank chooses the allocation with the highest household welfare in

that set:

$$\begin{aligned} \max_{\{C_{H,t},z_t,N_t,X_{E,t}\}_{t=0}^{1},D_0,Z_0} \quad & \sum_{t=0}^{1}\beta^t\left[(1-\alpha)\log C_{H,t}+\alpha\log z_t-\alpha\omega\log P_t^O-\chi N_t\right] \\ \text{subject to} \quad & \{C_{H,t},z_t,N_t,X_{E,t},D_0,Z_0\}\in\mathcal{E}(P_0^O,P_1^O,F_0) \end{aligned} \tag{30}$$

Terms constant across policies have been omitted from utility. In particular, membership in $\mathcal{E}$ requires

$$\begin{aligned} Y_t &= C_{H,t}+\bar{X}, & W_t &= mc_t\frac{\partial Y_t}{\partial N_t}, \\ S_tP_t^O &= mc_t\frac{\partial Y_t}{\partial X_{E,t}}, & z_1 &= (1+\psi_0)z_0, \\ A_0 &= R_{-1}-Z_0+\bar{G}-F_0-D_0, & A_0 &= rA_{-1}+NX_0-(R_0^B-r)V_{-1}, \\ 0 &= rA_0+NX_1-r\psi_0V_0 \end{aligned}$$

together with production (8), household conditions (4)–(6), bond returns (11), intermediary conditions (14), and the bounds (28). Household and public budgets and bond clearing remain (2)–(3) and (15)–(22). These restrictions preserve household and firm optimization when the planner chooses an allocation: the expenditure settings must be consistent with private choices, financing and repayment.

Monetary policy alone adds $Z_0 = 0$. *Joint policy* chooses Z_0 under the stated bounds. Both optimize monetary policy in both periods, face the same shock and inherit the same contracts. No intermediary charge is subtracted separately from (30). Payments to foreign intermediaries enter the external budgets, and the policy objective values the consumption and hours that remain feasible after those obligations are met.

The joint menu contains the monetary-only menu. To establish a strict benefit from FXI, however, one must find a reserve trade that improves household welfare after private behavior, repayment and inherited valuations adjust. The next section supplies such a test.

5 Discussion

5.1 Oil and the intermediary premium

Consider a rise in the first-period oil price with $P_1^O = \bar{P}^O$ and no change in the foreign-investor mandate. Hold the monetary expenditure settings and intervention fixed to isolate how the oil bill passes through the financial market. Domestic spending $C_{H,0}, C_{H,1}$

and the rate I_0 then remain fixed; import spending, production inputs, exchange rates and payments on inherited bonds adjust in equilibrium. This comparison describes transmission under a specified monetary response. It does not require the optimizing central bank to retain that response.

The two periods impose different requirements. Differentiating their budgets along this oil experiment gives

$$dD_0 = -dNX_0 + V_{-1}\, dR_0^B, \tag{31}$$

$$dNX_1 = r(1+\psi_0)\, dD_0 + rV_0\, d\psi_0 \tag{32}$$

The first equation says how much financing remains after trade and inherited payments adjust. The second says how much net export revenue is needed to repay it. Household saving connects the two periods through

$$dz_1 = (1+\psi_0)\, dz_0 + z_0\, d\psi_0 \tag{33}$$

An increase in the premium therefore changes the relative amounts households can spend abroad across the two periods.

Proposition 2 (Oil and the premium)**.** *Suppose $0 < \nu_E \leq 1$, foreign-owned domestic claims are nonnegative in both periods, and gross returns are positive. At a regular equilibrium, a small first-period oil-price increase raises the intermediary premium when the monetary path and intervention are fixed. Within the position limits,*

$$\frac{dD_0}{dP_0^O} > 0, \qquad \frac{d\psi_0}{dP_0^O} > 0$$

At a strictly binding upper limit the position remains fixed and the premium rises. A simultaneous decrease in F_0 reinforces the local premium response under the same monetary conditions. Starting from a zero premium, an oil shock alone can therefore generate a positive premium without a foreign-investor withdrawal.

The production condition matters for the sign. With limited substitution between labor and oil, higher oil prices increase the production oil bill at unchanged foreign household spending. Households adjust by reducing imports, and the resulting exchange-rate change lowers the foreign payment on inherited domestic-currency debt. Repayment in the second period limits how far these adjustments can absorb the bill. Solving (31)–(33) together gives a larger intermediary position and a higher premium inside capacity; at the upper limit, the position cannot rise and the scarcity premium increases instead. Appendix C derives the closed-form derivative and each sign.

For the oil-only comparison, import spending falls in the first period and weakly in the second. The second-period fall is strict inside capacity; at a binding upper limit it is strict when $V_0 > 0$. Domestic-good spending is fixed by the maintained monetary path, so the result concerns the composition of consumption, production inputs and external financing. It is not a claim that households must sell their long bonds, or that every monetary response to an oil shock produces the same premium. National borrowing and an individual household's bond saving are different objects.

A withdrawal puts additional pressure on intermediary financing, while also reducing the direct foreign claim to be repaid. Appendix C retains both effects and shows that the premium response remains positive. The combined shock's import-spending responses depend on their balance.

The mandate also does not prohibit foreign-investor transactions. Keeping F_0 unchanged when the foreign value of inherited bonds falls requires investors to replace part of that lost value with purchases. Those transactions are already included in the external budgets. Proposition 2 establishes that, even after that response, the remaining financing need can raise the intermediary premium.

5.2 What FXI adds to monetary policy

Monetary policy influences the premium by changing domestic demand, input use, the exchange rate and bond valuation. Moving all these objects together creates a trade-off: a monetary adjustment that makes foreign financing easier may also move domestic consumption and employment away from the allocation the household prefers. FXI provides a different way to change the financing position. A reserve sale supplies foreign currency and transfers domestic bonds to the central bank, without requiring the same initial movement in domestic spending.

The two wedges make this trade-off precise. Recall that the marginal utility of foreign expenditure is

$$\lambda_t = S_t \nu_t = \frac{\alpha}{z_t} \tag{34}$$

At fixed oil prices and investor mandates, cost minimization and household optimality give the following welfare change along any feasible policy adjustment:

$$\begin{aligned} d\mathcal{W} = \sum_{t=0}^{1} \beta^t \nu_t (1 - mc_t)\, dC_{H,t} + \lambda_1 \psi_0\, dZ_0 \\ - \lambda_1 V_0\, d\psi_0 - \lambda_0 V_{-1}\, dR_0^B \end{aligned}$$

The first term values changes in domestic consumption at the domestic wedge. The second values changes in the timing of foreign expenditure at the financial wedge. The last two terms account for changes in future foreign payments and the value of inherited debt. Monetary policy moves domestic spending and financing together. FXI provides another feasible adjustment, whose value depends on the sum of these effects. Appendix D derives the identity from production and both external budgets.

At a monetary-only optimum, hold its two monetary settings fixed and consider a small feasible increase in Z_0. Domestic consumption then remains fixed in both periods, so the first term vanishes. Use a derivative subscript Z to denote the response to that reserve sale. Its marginal welfare effect is

$$\mathcal{W}_Z = \underbrace{\lambda_1 \psi_0}_{\text{timing of resources}} - \underbrace{\lambda_1 V_0 \psi_{0,Z}}_{\text{future foreign payments}} - \underbrace{\lambda_0 V_{-1} R^B_{0,Z}}_{\text{inherited payments}} \tag{35}$$

The first term values the change in when foreign resources are available, given the financial wedge. The second records how intervention changes the return paid on claims held abroad. The third includes the revaluation of debt inherited before the shock. Under this fixed-monetary-path test, $R^B_{0,Z} = (R^B_0/z_0)z_{0,Z}$. An appreciation raises the foreign value of that inherited obligation and offsets part of an intervention's benefit.

The household and production conditions imply $\partial NX_t/\partial z_t < 0$: increasing import spending worsens net exports. This derivative includes the associated response of oil used in production. The following sufficient condition combines these trade responses and foreign payments, without treating a lower premium as an objective in itself.

Proposition 3 (Value of intervention)**.** *Consider a regular monetary-only optimum with room for a small reserve sale, $\psi_0 \geq 0$, $V_0 \geq 0$ and $V_{-1} \geq 0$. Suppose intermediary holdings are interior or strictly at the upper limit. Joint policy strictly improves on monetary policy alone if*

$$(1+\psi_0)V_0\left(-r\frac{\partial NX_0}{\partial z_0} - \frac{\partial NX_1}{\partial z_1}\right) + \psi_0 z_0 \frac{\partial NX_0}{\partial z_0}\frac{\partial NX_1}{\partial z_1} > -\frac{\partial NX_1}{\partial z_1} V_{-1} R^B_0 \tag{36}$$

The derivatives hold the monetary settings and oil prices fixed. The condition applies to an oil-only shock and to a combined oil and investor-mandate shock.

The first two terms in (36) capture the financing and future-payment benefits of changing the intermediary position and return. The right-hand side captures the inherited foreign claim that is revalued. Under the condition, the net derivative in (35) is positive. A reserve sale then raises welfare while keeping the optimized monetary path unchanged; allowing the central bank to adjust that path as well cannot reduce the best attainable welfare. Appendix D derives the exact derivatives both inside capacity and at the upper limit.

The investor shock changes this comparison through two channels. It reduces the direct foreign position F_0, and the additional financing required can push intermediaries against their limit. With a binding limit, intervention lowers the scarcity premium even though intermediaries cannot reduce their position immediately. A smaller F_0 also changes the foreign claim receiving the next return. These effects need not be proportional to the size of the mandate reduction, which is why the combined experiment must solve the same economy rather than add separate oil and portfolio responses.

Both instruments affect the two wedges: intervention changes import spending and inherited valuations, while monetary policy changes the financing requirement as well as domestic demand. The planner weighs their combined effect on consumption and hours under the policy and portfolio restrictions. Neither $mc_t = 1$ nor $\psi_0 = 0$ is imposed as an additional target, and the optimal premium can have either sign. The clean separation of monetary and financial stabilization in Itskhoki and Mukhin (2023) provides a benchmark for these remaining trade-offs.

6 Extended Model and Quantitative Results

The infinite-horizon economy preserves imported oil, flexible wages, the investor mandate, foreign-owned intermediaries and their fees and position limits, and fixed export contracts. It replaces terminal settlement with a long coupon bond, permits staggered price adjustment, and uses convex labor disutility. Household consumption is written as a CES aggregate; its calibrated unit elasticities reproduce the log expenditure shares of the two-period model. Production retains the same CES elasticity. The reference balance sheet is now calibrated to India rather than liquidated after two periods.

The analytical economy establishes a financing mechanism and a sufficient condition for a useful second instrument. In the infinite-horizon economy, today's policy also changes future price dispersion and the assets carried into later quarters. Those effects enter both the equilibrium and welfare below. Monetary policy now chooses the interest-rate path under the infinite-horizon equilibrium and policy rule. The welfare decomposition carries over, although the finite model's direct expenditure controls and the quantitative rate controls define different policy sets. All wages remain flexible.

6.1 Preferences, goods, and household saving

The household chooses $\{C_{H,t}, C_{M,t}, C_{E,t}, N_t, B_t^S, H_t\}_{t\geq 0}$ to maximize

$$\sum_{t\geq 0} \beta^t \left[\frac{C_t^{1-\sigma} - 1}{1-\sigma} - \chi_N \frac{N_t^{1+\varphi}}{1+\varphi} \right], \qquad \sigma > 0, \quad \varphi \geq 0 \tag{37}$$

Write $u(C_t)$ for the first term, with its continuous limit $\log C_t$ when $\sigma = 1$. The coefficient σ is inverse intertemporal substitution elasticity, φ is inverse Frisch labor-supply elasticity, and $\chi_N > 0$ sets the labor scale. For a given reference labor supply, set $\chi_N = \bar{\nu}\bar{W}/\bar{N}^{\varphi}$ to preserve its labor condition as curvature changes. Let $C_{F,t}$ denote the imported-consumption basket. Consumption uses the nested CES aggregates

$$\begin{aligned} C_t &= \left[(1-\alpha)^{1/\eta} C_{H,t}^{(\eta-1)/\eta} + \alpha^{1/\eta} C_{F,t}^{(\eta-1)/\eta} \right]^{\eta/(\eta-1)}, \\ C_{F,t} &= \left[(1-\omega)^{1/\vartheta} C_{M,t}^{(\vartheta-1)/\vartheta} + \omega^{1/\vartheta} C_{E,t}^{(\vartheta-1)/\vartheta} \right]^{\vartheta/(\vartheta-1)} \end{aligned} \tag{38}$$

The elasticities $\eta > 0$ and $\vartheta > 0$ govern substitution between domestic and imported consumption and between imported manufactures and energy, respectively. Use the continuous Cobb–Douglas limits at unit elasticity, including their normalization constants. The domestic-currency prices of imported manufactures and oil are $P_{M,t} = S_t$ and $P_{E,t} = S_t P_t^O$, and $P_{F,t}$ is the price index of the imported basket. With the same domestic bonds, the household budget is

$$\begin{aligned} P_t C_t + Q_t^S B_t^S + Q_t^B H_t = W_t N_t + B_{t-1}^S + (1 + \delta_B Q_t^B) H_{t-1} + \Pi_t^F + T_t \\ + S_t (r-1) \bar{G} \end{aligned} \tag{39}$$

The last term is predetermined foreign income. The fixed position $\bar{G}$ is rolled over and is not chosen by the household. Profits Π_t^F include export-contract income and are net of the lump-sum financing of the price-setting subsidy below. The household faces nonnegative long-bond holdings and the usual no-Ponzi and transversality conditions. Appendix E derives its conditions from this budget.

Let ν_t be the utility value of a domestic-currency unit and ζ_t^H the multiplier on the nonnegative long-bond holding. The price indices, demands and saving conditions are

$$P_{F,t} = S_t[(1-\omega) + \omega(P_t^O)^{1-\vartheta}]^{1/(1-\vartheta)},$$
$$P_t = [(1-\alpha)P_{H,t}^{1-\eta} + \alpha P_{F,t}^{1-\eta}]^{1/(1-\eta)}, \tag{40}$$
$$C_{H,t} = (1-\alpha)(P_{H,t}/P_t)^{-\eta} C_t, \qquad C_{F,t} = \alpha(P_{F,t}/P_t)^{-\eta} C_t, \tag{41}$$
$$\nu_t = C_t^{-\sigma}/P_t, \qquad \chi_N N_t^{\varphi} = \nu_t W_t,$$
$$\nu_t Q_t^S = \beta \nu_{t+1}, \qquad \nu_t Q_t^B = \beta \nu_{t+1}(1 + \delta_B Q_{t+1}^B) + \zeta_t^H,$$
$$\zeta_t^H \geq 0, \qquad H_t \geq 0, \qquad \zeta_t^H H_t = 0 \tag{42}$$

Within-import demands follow the same formula with shares $1-\omega, \omega$ and elasticity ϑ; Appendix E derives each demand. The same marginal utility of income governs spending and saving. On an interior portfolio the one-quarter domestic returns on the short claim and the long bond coincide, so the long-bond pricing formula in (46) continues to apply. The inequality in (42) covers a zero long holding.

6.2 Production and price adjustment

A domestic variety $j \in [0,1]$, sold at price $P_{H,t}(j)$, uses the same technology:

$$Y_t(j) = A\left[(1-\mu)N_t(j)^{(\nu_E-1)/\nu_E} + \mu X_{E,t}(j)^{(\nu_E-1)/\nu_E}\right]^{\nu_E/(\nu_E-1)} \tag{43}$$

As before, mc_t is marginal cost in domestic-good units; nominal unit cost is $P_{H,t}mc_t$. Common factor prices imply the same input ratio at every firm. Cost minimization gives

$$\frac{X_{E,t}}{N_t} = \left[\frac{\mu}{1-\mu}\frac{W_t}{P_{E,t}}\right]^{\nu_E},$$
$$P_{H,t}mc_t = \frac{1}{A}\left[(1-\mu)^{\nu_E} W_t^{1-\nu_E} + \mu^{\nu_E} P_{E,t}^{1-\nu_E}\right]^{1/(1-\nu_E)} \tag{44}$$

Domestic varieties have substitution elasticity $\epsilon_p > 1$. Under Calvo (1983) price contracts, a fraction $1-\theta_p$ can reset its price each period; the others retain their nominal price. There is no price indexation. The fixed revenue subsidy satisfies $1 + \bar{\varsigma}^p = \epsilon_p/(\epsilon_p - 1)$, so it corrects the steady monopoly markup and stays fixed under every policy.

Write $\Pi_{H,t} = P_{H,t}/P_{H,t-1}$ for gross domestic-good inflation and $P_{H,t}^{\#}$ for the newly chosen price. Then $p_t^{\#} = P_{H,t}^{\#}/P_{H,t}$ is the reset price relative to the domestic price index.

The aggregate price index and price dispersion satisfy

$$1 = \theta_p \Pi_{H,t}^{\epsilon_p - 1} + (1 - \theta_p)(p_t^{\#})^{1-\epsilon_p}, \qquad \Delta_t^p = \int_0^1 [P_{H,t}(j)/P_{H,t}]^{-\epsilon_p}\, dj$$

A resetting firm maximizes the discounted profits earned while its price remains in place. Appendix E derives its optimal reset price and the full recursions (93). Initial prices are symmetric, $\Delta_{-1}^p = 1$. Aggregation and goods clearing require

$$\Delta_t^p Y_t = A\left[(1-\mu) N_t^{(\nu_E - 1)/\nu_E} + \mu X_{E,t}^{(\nu_E - 1)/\nu_E}\right]^{\nu_E/(\nu_E - 1)}, \qquad Y_t = C_{H,t} + \bar{X} \tag{45}$$

The fixed export contract delivers $\bar{X}$ domestic goods for $\bar{X}^*$ foreign units. Its profit is $S_t \bar{X}^* - P_{H,t}\bar{X}$. Production oil and household oil remain separate quantities. Appendix K replaces these contracts with export demand that responds to the relative price of domestic goods. Flexible wages imply neither a wage Phillips curve nor a wage-dispersion state.

6.3 Portfolios and the policy problem

At the end of quarter t, each long bond pays one unit of domestic currency next quarter and leaves δ_B surviving units. Positive household holdings imply

$$I_t Q_t^B = 1 + \delta_B Q_{t+1}^B, \qquad Q_t^B = \sum_{j=1}^{\infty} \frac{\delta_B^{j-1}}{I_t I_{t+1} \cdots I_{t+j-1}}, \tag{46}$$

where the second expression uses the no-bubble condition. The return and premium are

$$R_t^B = \frac{1 + \delta_B Q_t^B}{Q_{t-1}^B} \frac{S_{t-1}}{S_t}, \qquad \psi_t = \frac{R_{t+1}^B}{r} - 1 \tag{47}$$

The same foreign intermediary problem applies in every quarter, with current position D_t, normal position $\bar{D}$, and unchanged limit $D^{\max}$. The direct foreign-investor target and the oil price follow the specified MIT paths in Section 7.

The consolidated external accounts are

$$A_t = R_t + \bar{G} - F_t - D_t, \qquad V_t = F_t + D_t, \tag{48}$$

$$A_t = r A_{t-1} + NX_t - (R_t^B - r) V_{t-1}, \qquad R_t = R_{t-1} - Z_t, \tag{49}$$

$$NX_t = \bar{X}^* - C_{M,t} - P_t^O (C_{E,t} + X_{E,t})$$

The predetermined foreign position $\bar{G}$ pays its interest income and is rolled over; it is not a freely chosen household asset. Both direct investors and intermediaries hold foreign claims on the domestic economy. The fiscal authority maintains a prescribed real gross

face $B_t^G/P_t = \bar{b}^G$. Central-bank holdings and market clearing obey

$$\frac{B_t^{CB}}{P_t} = \frac{B_{t-1}^{CB}}{P_{t-1}} + \frac{S_t Z_t}{P_t Q_t^B}, \qquad B_t^G = H_t + B_t^{CB} + \frac{S_t}{Q_t^B}(F_t + D_t) \tag{50}$$

The central bank's and fiscal authority's cash budgets are

$$\Pi_t^{CB} + Q_t^B B_t^{CB} + S_t R_t = (1 + \delta_B Q_t^B) B_{t-1}^{CB} + S_t r R_{t-1}, \tag{51}$$

$$T_t + (1 + \delta_B Q_t^B) B_{t-1}^G = Q_t^B B_t^G + \Pi_t^{CB} \tag{52}$$

As in the two-period economy, Π_t^{CB} is the central-bank remittance and T_t the net transfer to households. Adding the two budgets eliminates the remittance:

$$T_t = Q_t^B (B_t^G - B_t^{CB}) - (1 + \delta_B Q_t^B)(B_{t-1}^G - B_{t-1}^{CB}) - S_t (R_t - r R_{t-1}) \tag{53}$$

The predetermined income from $\bar{G}$ enters the household budget directly in this infinite-horizon economy. Assigning it to the fiscal transfer instead gives the same consolidated allocation. These accounting conventions are common to every policy.

Goods clearing is (45), domestic bond clearing is (50), and the short domestic claim has zero net supply, $B_t^S = 0$. Labor and production-oil markets satisfy

$$N_t = \int_0^1 N_t(j)\, dj, \qquad X_{E,t} = \int_0^1 X_{E,t}(j)\, dj$$

Households supply the common N_t. Imports are $C_{M,t}$ manufactures and $C_{E,t} + X_{E,t}$ oil. Varieties clear at $Y_t(j) = [P_{H,t}(j)/P_{H,t}]^{-\epsilon_p} Y_t$, foreign investors hold $B_t^F = S_t F_t / Q_t^B$, and intermediary bond face is $B_t^D = S_t D_t / Q_t^B$. Together with foreign funding at r, the external budget clears the foreign-exchange market.

The financial wedge also survives the extension. With $\lambda_t = S_t \nu_t = S_t C_t^{-\sigma}/P_t$, household saving gives

$$\lambda_t = \beta r (1 + \psi_t) \lambda_{t+1} \tag{54}$$

Under the calibrated $\sigma = 1$, household saving gives $I_t = P_{t+1} C_{t+1} / (\beta P_t C_t)$. The central bank chooses the admissible rate path, and spending follows from the full equilibrium and its continuation. This Euler relation constrains expenditure growth; it does not give policy an independently chosen expenditure level in every quarter. The analytical demand-control assumption is therefore replaced by the rate implementation in the infinite-horizon economy.

Let x_t collect equilibrium prices, quantities and portfolios. After the shock, the central bank commits to rates and reserve trades for $W = 24$ quarters. It solves

$$\begin{aligned}
\max_{\{I_t, Z_t\}_{t=0}^{W-1}, \{x_t\}_{t\geq 0}} \quad & \sum_{t\geq 0} \beta^t \left[u(C_t) - \chi_N \frac{N_t^{1+\varphi}}{1+\varphi} \right] \\
\text{subject to} \quad & (39)\text{–}(45), (46)\text{–}(53), \text{ and } (93), \\
& \psi_t = \gamma(D_t - \bar{D}) + \lambda_t^+ - \lambda_t^-, \quad |D_t| \leq D^{\max}, \\
& \lambda_t^{\pm} \geq 0, \quad \lambda_t^+ (D^{\max} - D_t) = \lambda_t^- (D^{\max} + D_t) = 0, \\
& H_t \geq 0, \quad B_t^{CB} \geq 0, \\
0 \leq t < W: \quad & I_t \geq 1, \quad |\log I_t - \log I_{t-1}| \leq \overline{\Delta i}, \\
& |Z_t| \leq \bar{Z}, \quad \underline{R} \leq R_t \leq R_{-1}, \\
t \geq W: \quad & Z_t = 0, \quad I_t = I_t^{\text{Taylor}}
\end{aligned} \tag{55}$$

The household solvency and transversality conditions continue to apply. The Taylor continuation is specified in (57), with the portfolios and prices produced by the policy plan, including all previous reserve sales. Monetary policy alone adds $Z_t = 0$ in every quarter. Joint policy can use both instruments; delayed joint policy additionally imposes $Z_0 = 0$ while still allowing the interest rate to respond immediately.

I solve the nonlinear equilibrium and evaluate household utility along its paths. The position limit can bind in some quarters and not others, so the return paid on additional financing changes across the adjustment. A single linear solution around the zero-premium reference would omit that distinction. The computational approximation is confined to the distant continuation, with the actual accumulated portfolios carried into it; Appendix G reports the solution and horizon checks.

The two wedges also carry over. Let $u_t = u(C_t) - \chi_N N_t^{1+\varphi}/(1+\varphi)$ denote period welfare. At fixed shocks, household optimality and cost minimization imply

$$du_t = \nu_t P_{H,t} \left[(1 - mc_t \Delta_t^p) dC_{H,t} - mc_t Y_t \, d\Delta_t^p \right] - \lambda_t \, dNX_t \tag{56}$$

The domestic wedge is now $1 - mc_t \Delta_t^p$: delivering an extra unit of consumption uses more inputs when prices differ across firms. The next term values the resource cost of changing that price dispersion. Combining the trade term with the external budgets recovers the financial wedge $\lambda_t - \beta r \lambda_{t+1} = \beta r \lambda_{t+1} \psi_t$, future foreign payments and inherited valuation. Unlike the finite economy's terminal settlement, the infinite-horizon economy carries bonds and reserves forward under the specified policy rule; their future consequences remain in welfare. Appendix F derives the complete decomposition, following the implementability-and-wedges approach of Farhi and Werning (2016).

A feasible intervention is useful when its combined marginal effect is positive. Holding the optimized monetary-only rates fixed, a small first-quarter reserve sale raises welfare for both oil-only and combined shocks. In the infinite-horizon economy with Calvo pricing, holding rates fixed still permits domestic spending and price dispersion to adjust, so those terms remain in the test. This derivative explains the additional policy margin; the reported welfare gains compare the fully optimized plans.

7 Calibration

7.1 Energy exposure and opening portfolios

Table 1 gives the Indian moments used to set import exposure, opening portfolios, shock persistence and the scale of intervention. Expenditure targets measure the import bill relative to gross domestic product (GDP), since that bill is central to the financing experiment. Financial quantities are in foreign-good units and reported relative to reference quarterly GDP, $Y^v = \bar{Y} - \bar{P}^O \bar{X}_E = 0.96001$, with reference gross output $\bar{Y} = 1$. Gross output includes imported production oil; domestic value added excludes it.

I combine the 2021–22 supply-and-use accounts with the input–output transformations of Jain (2025), averaging their B and D constructions (Ministry of Statistics and Programme Implementation, 2025). Petroleum Planning and Analysis Cell data report crude imports of INR901,262 crore and petroleum-product imports of INR176,835 crore (Petroleum Planning and Analysis Cell, 2023). Applying the domestic-use proportions in Chaudhuri et al. (2024) allocates INR983,055 crore to production, INR44,143 crore to households and INR50,899 crore to inventories. The allocation assumes proportional import use within each product and no direct re-exports; inventories are excluded from current consumption and production. Oil comprises crude and petroleum products, excluding coal and natural gas.

The common input–output GDP denominator is INR23,597,349 crore. Matching production oil relative to GDP gives an oil cost share of 0.03999345 in gross output. Household imports are INR702,714 crore, or 2.97794% of GDP; petroleum is 6.28176% of those imports. I set $\alpha = 0.02975714$ and $\omega = 0.06281758$, so $\alpha\bar{C}/Y^v$ and $\alpha\omega\bar{C}/Y^v$ match the household import ratios. This aggregate mapping targets external exposure rather than the private-consumption share in Indian national accounts; the non-oil import composite represents the remaining direct imports. With $\nu_E = 0.40$, the production coefficients are $\mu = 0.00033327$ and $A = 1.02774$. Appendix H derives the mapping. The input-substitution elasticity is close to the benchmark in Bodenstein et al. (2011).

Table 1: Indian calibration targets and model counterparts

Target (unit)	Data	Model
Expenditure and production, 2021–22		
Direct household imports / GDP (%)	2.978	2.978
Direct household petroleum imports / GDP (%)	0.187	0.187
Imported production oil / GDP (%)	4.166	4.166
Government and external portfolios		
Dated government securities / annual GDP (%)	34.10	34.10
Foreign-held dated debt / quarterly GDP (%)	3.137	3.137
Banks and brokers / foreign government bonds (%)	8.487	8.487
Official reserves / quarterly GDP (%)	73.31	73.31
Debt-type net foreign assets / quarterly GDP (%)	20.10	20.10
Foreign-held bond modified duration (years)	5.344	5.344
Quarterly persistence and policy scale		
Real oil price, autoregressive coefficient	0.854	0.85
Portfolio-debt liability ratio, autoregressive coefficient	0.838	0.84
95th percentile, absolute spot operations / opening reserves (%)	6.51	6.51

Foreign-held debt is $(\bar{F} + \bar{D})/Y^v$. The total debt stock is measured in March 2024, institutional composition and foreign portfolio duration in March 2025, and external stocks in 2025Q4. The composition and duration targets use government securities under the Fully Accessible Route. Duration matches bond-price sensitivity to an annual yield change. Liability-stock persistence proxies for mandate persistence. Sources and constructions follow.

Dated government securities equal 34.1% of annual GDP, and foreign portfolio investors hold 2.3% of that stock (Department of Economic Affairs, 2025). Thus $(\bar{F} + \bar{D})/Y^v = 4(0.341)(0.023) = 0.031372$. To divide it between intermediaries and direct investors, I use the institutional composition of government bonds in Central Depository Services (India) Limited (CDSL) data. In the Fully Accessible Route, banks and brokers hold INR17,120 crore and INR6,951 crore out of INR283,628 crore in March 2025 (Central Depository Services (India) Limited, 2025). Their combined share is 8.48682%, giving $\bar{D}/Y^v = 0.00266249$ and $\bar{F}/Y^v = 0.02870951$. Institutional type proxies for trading role, and this composition is assumed to represent foreign government bonds outside that route. The use of investor categories follows the sovereign-investor-base approach of Arslanalp and Tsuda (2014).

The bond parameter matches the interest-rate sensitivity of the bonds foreigners actually hold. I match all 41 securities in the March 2025 foreign-holdings table of Department of Economic Affairs (2026) to prices and modified durations from the Clearing Corporation

of India Limited (CCIL), then weight each duration by the bond's market value in that foreign portfolio (Clearing Corporation of India Limited, 2025). The resulting modified duration is 5.34403 years. I use this portfolio to represent the government bond held by direct investors and intermediaries. With annual yields quoted using semiannual compounding, the model bond's modified duration is $1/[4r(r-\delta_B)]$. Matching the target gives $\delta_B = 0.957106$ and $\bar{Q}^B = 1/(r-\delta_B) = 21.4555$. Appendix I gives the weighting and yield conversion. Reference holdings are calibrated in market value, with face quantities determined by this price.

The central bank initially holds 12.3% of government securities. Reserves and debt-type net foreign assets come from the Reserve Bank of India's (RBI) international investment position, excluding portfolio and direct-investment equity but retaining direct-investment debt (Reserve Bank of India, 2026b). For these external stocks, quarterly GDP is annual GDP inferred from the Department of Economic Affairs' debt-to-GDP ratio, divided by four. The reported government stock proxies for its reference market value, and official reserve components are treated as fungible foreign assets.

7.2 Intermediation costs and capacity

The fee slope governs compensation when an intermediary has room to trade; the position limit governs how much it can absorb. I discipline them separately. Lindé et al. (2024) estimate India's market depth within the Integrated Policy Framework, obtaining normal-market and shallow-market coefficients of 0.001 and 0.059. Matching the local zero-premium return response to positions relative to quarterly GDP gives $\gamma Y^v = 0.001$ in the benchmark. The coefficient 0.059 is a sensitivity. This transfers the local slope; the source model's regime-switching process is not imposed on the model's capacity constraint.

For capacity, I use a representative investment risk budget, following the balance-sheet proxy approach of Arora et al. (2019) and business-line allocation of intermediation capacity in Baranova et al. (2017). Société Générale's Indian branches report a March 2025 investment present-value sensitivity limit of INR24,500 thousand per basis point, usage of INR17,501.34 thousand per basis point, and government securities of INR56,525,399 thousand (Société Générale, 2025). The unused investment sensitivity is therefore INR6,998.66 thousand per basis point. Holding existing exposures and hedges fixed, each additional rupee of unhedged bonds uses 5.344032×10^{-4} rupees of sensitivity per basis point. Dividing the remaining risk budget by this marginal sensitivity and the reference government-bond book gives

$$\frac{D^{\max} - \bar{D}}{\bar{D}} = \frac{24{,}500 - 17{,}501.34}{5.344032 \times 10^{-4} \times 56{,}525{,}399} = 0.2316873$$

I assume this investment headroom represents the intermediary segment. Applying it to $\bar{D}/Y^v = 0.00266249$ gives $D^{\max}/Y^v = (1 + 0.2316873)\bar{D}/Y^v = 0.00327935$, with spare positive capacity of 0.06169% of quarterly GDP. The Indian disclosure supplies an allocated investment risk budget; the foreign-holdings data separately determine the model's opening intermediary position. Resident-branch securities are not counted as nonresident holdings. Other exposures and marginal hedging remain fixed, and the conversion at reference prices sets the model's constant foreign-unit ceiling and symmetric short-position limit. Appendix I compares proportional-risk headroom and removal of the limit under both slope calibrations.

7.3 The shocks and policy instruments

I report an oil-only MIT shock and a combined oil and investor-mandate shock. The oil price initially rises ten percent. In the combined experiment, direct investors' foreign-currency bond target also falls by one percent of reference quarterly output. The two paths are

$$\log(P_t^O/\bar{P}^O) = 0.85^t \log(1.10), \qquad F_t - \bar{F} = -0.01Y^v(0.84)^t, \qquad t = 0, 1, \ldots$$

In the oil-only experiment $F_t = \bar{F}$. Both innovations occur in the first quarter, and subsequent innovations are zero. The realized paths are known when policy responds. Quarterly oil persistence comes from log real Brent (US consumer prices as deflator), 2013Q2–2025Q4 (U.S. Energy Information Administration, 2026; U.S. Bureau of Labor Statistics, 2026). The autoregressive coefficient of portfolio-debt liabilities relative to quarterly GDP over 2018Q3–2025Q4 supplies the mandate-persistence proxy (Reserve Bank of India, 2026b). The ten-percent oil increase and one-percent-of-GDP mandate reduction are the experimental shock sizes. Across policies I hold these paths fixed and calculate net foreign bond sales at current transaction prices.

In the Indian episodes, sales extended to both bonds and equities (Figure 2). The Indian basket rose from about $85 per barrel in January 2022 to $113 in March, when foreign investors were net sellers in both markets; they also sold both assets during the March 2026 oil-price increase. The model isolates the financing of bond sales.

Table 2 separates standard preference and price-setting choices from financial inputs. The marginal-fee slope is $\gamma = 0.001/Y^v = 0.00104166$ in foreign-good units; exposure per unit of capital fixes the units of the capacity representation. The quarterly flow ceiling equals 6.51% of opening reserves, the 95th percentile of absolute quarterly net spot operations over 2013Q2–2025Q4 (Reserve Bank of India, 2026a). I impose a reserve

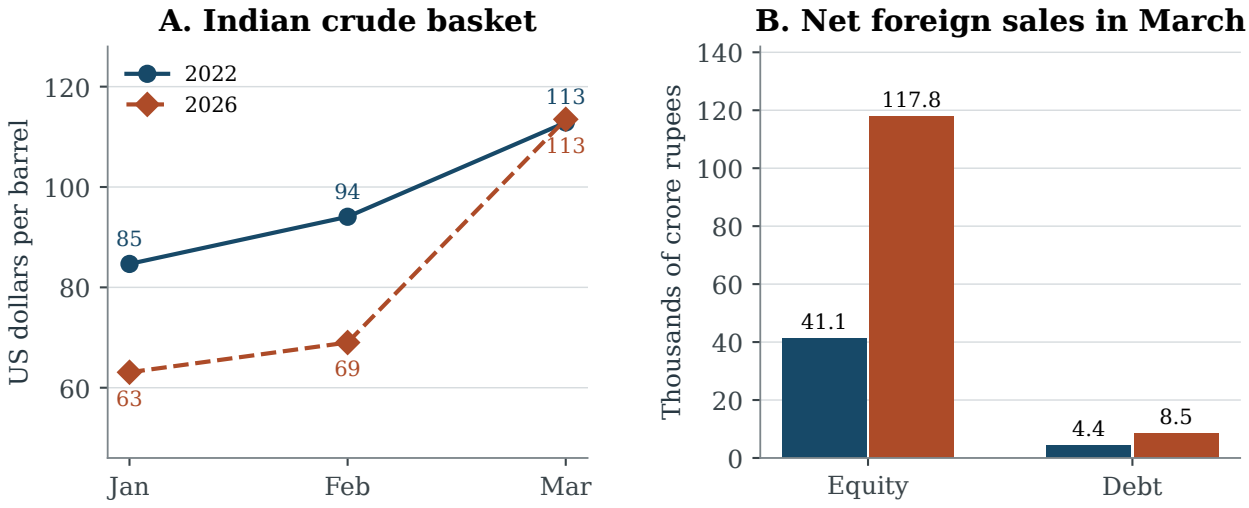

Figure 2: Simultaneous oil price increases and foreign sales of Indian securities

Panel A: monthly published Indian basket. Its composition changed in March 2026; the reported levels span that change. Panel B: March net foreign portfolio sales; one thousand crore equals ten billion rupees. Debt includes the voluntary retention route. Sources: Petroleum Planning and Analysis Cell (2026), Securities and Exchange Board of India (2022) and Securities and Exchange Board of India (2026).

Table 2: Preference, price-setting and financial parameters

Object	Value	Role
Discount factor; curvature of utility	0.9963; 1	Quarterly patience; log consumption
Inverse Frisch elasticity	1	Marginal cost of hours
Domestic–import; within-import elasticities	1; 1	Household substitution
Labor–energy substitution	0.40	Production input response
Price nonreset probability; variety elasticity	0.75; 6	Four-quarter mean price spell; price markup
Marginal-fee slope; exposure per unit of capital	0.001042; 5	Interior pricing; units of capacity
Available capacity above the normal position	23.17%	Investment-risk headroom
Maximum quarterly log rate change	0.005	Operating limit
Policy horizon	24 quarters	Rate and reserve decisions

floor corresponding to 4.5 of the initial 7.72 months of import cover, using import cover as a reserve-adequacy measure (International Monetary Fund, 2025). These are operating assumptions, not legal limits. As ratios to reference GDP, opening reserves are $R_{-1}/Y^v = 0.73310$, the floor is $\underline{R}/Y^v = 0.42749$, and the flow limit is $\bar{Z}/Y^v = 0.04775$. The rate-change bound and 24-quarter policy window are common across experiments. Wages remain flexible; preference and Calvo-price benchmarks follow the commodity-policy literature (Drechsel et al., 2026).

7.4 Policy comparisons and realized net sales

The policy comparisons use the same shocks, inherited portfolios and operational bounds:

- **Taylor rule:** the policy rate follows the rule below and $Z_t = 0$ throughout.
- **Monetary policy alone:** choose the admissible rate path to maximize welfare, with $Z_t = 0$ throughout.
- **Joint policy:** choose both the rate path and reserve trades to maximize welfare.
- **Delayed joint policy:** impose $Z_0 = 0$ on joint policy; rates can still respond in the first quarter.

The Taylor rule is

$$\log(I_t/r) = 0.75\log(I_{t-1}/r) + 0.25[1.5\log(P_t/P_{t-1}) + 0.0625\log(Y_t/\bar{Y})] \tag{57}$$

The first three policies establish what optimized monetary policy and the addition of FXI achieve. The delayed joint plan isolates the value of access to reserves in the shock quarter: all later instruments remain available, and the first-quarter rate is still optimized. Households anticipate the announced plan in each comparison.

At current transaction prices, nonresidents' net sale of bonds is

$$\text{Sale}_t = \frac{Q_t^B}{S_t Y^v}[\delta_B B_{t-1}^{ext} - B_t^{ext}], \qquad B_t^{ext} = B_t^F + B_t^D \tag{58}$$

The measure excludes coupons and cancels trades between two nonresidents. The target F_t fixes direct investors' holdings at the end of the period, valued in foreign currency. I report welfare in permanent consumption-equivalent basis points (CE bp): $10^4\{\exp[(1-\beta)\Delta\mathcal{W}] - 1\}$, where $\Delta\mathcal{W}$ is the gain in discounted welfare. With log aggregate consumption this is the proportional consumption increase in every quarter that makes the lower-welfare allocation equally desirable, holding its hours fixed. It is distinct from either an impact consumption percentage or a flow measured relative to GDP.

8 Results

8.1 Oil alone creates financial pressure

Under the Taylor rule, the oil-only shock lowers first-quarter consumption by 0.360% and depreciates the currency by 3.083%. Direct foreign investors retain their target, while spending and inherited debt values adjust. In the first quarter, the smaller foreign-currency payment on inherited bonds more than covers the deterioration in net exports, so intermediary holdings fall slightly (Table 3). Financial pressure develops over the subsequent adjustment: the position limit binds from the third quarter and the premium peaks at 36.01 quarterly basis points. Oil alone therefore creates a financing distortion without an investor-mandate shock, although its timing depends on monetary policy and the adjustment of inherited debt. Proposition 2 holds the two monetary settings fixed; the quantitative policy paths permit those settings to respond.

For unchanged opening portfolios, the first-quarter stock-flow identity is

$$D_0 - \bar{D} = -(F_0 - \bar{F}) - (NX_0 - \overline{NX}) + (R_0^B - r)\bar{V} - Z_0, \tag{59}$$

where $\bar{V} = \bar{F} + \bar{D}$. The four terms are the change in direct investors' target, the trade shortfall, the change in inherited foreign payments, and reserve sales. Their sum determines the change in intermediary financing. This identity accounts for all foreign bond transactions, including purchases needed to maintain an unchanged mandate after valuation losses.

Table 3: Oil only: financing the first-quarter trade shortfall

	Taylor	Monetary alone	Joint
Cut in investor target	0.0000	0.0000	0.0000
Deterioration in net exports	0.0939	0.0913	0.2351
Change in inherited foreign payment	-0.1107	-0.1076	-0.0156
Less: reserve sales	0.0000	0.0000	0.2284
Change in intermediary position	-0.0168	-0.0162	-0.0089

Percent of reference quarterly GDP; all intermediaries are foreign-owned. The first three rows minus reserve sales equal the change in intermediary holdings, before rounding. A negative inherited-payment entry is a smaller payment to existing foreign claim holders.

Optimizing monetary policy alone changes spending and prices but still leads to binding capacity from the third quarter. The central bank can ease financing pressure by inducing a larger external adjustment, yet that adjustment also changes household consumption and employment. At the monetary-only optimum, further changes in rates must be judged against those effects throughout the path.

Joint policy sells reserves worth 0.228% of quarterly GDP in the first quarter. Consumption falls by 0.263%, compared with 0.456% under optimized monetary policy alone. Households maintain more of their purchases, and the smaller depreciation also reduces the saving on inherited foreign payments. Reserves accommodate this larger financing need while keeping the intermediary position within its limit throughout the adjustment. The premium is initially slightly negative and remains close to zero, so intervention is not chosen to hit a zero-premium constraint. The initial exchange rate is close to its reference level, with an appreciation of 0.081% (Table 4).

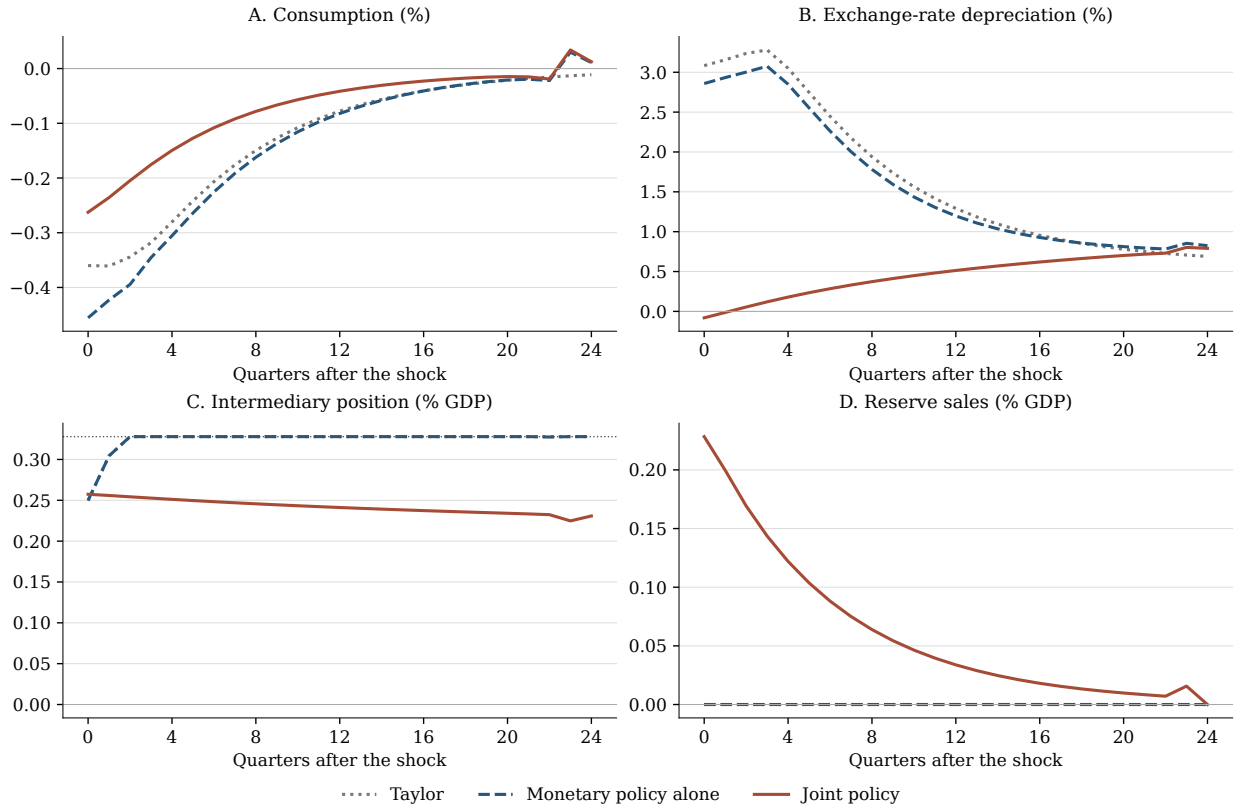

Figure 3: Oil only: consumption and the financing response

A ten percent initial oil-price rise with persistence 0.85 and no investor-mandate innovation. Consumption and exchange rates are changes from the stationary reference. Positive depreciation means a weaker domestic currency. The dotted horizontal line in panel C is the intermediary position limit. The central bank's optimized controls end after quarter 23; the Taylor continuation begins in quarter 24.

Why does a higher import bill coexist with higher welfare? Oil itself remains costly under either policy. Monetary policy alone must weigh the domestic wedge against the financial wedge as it changes spending and prices. Reserves allow an additional financing adjustment, so a smaller initial consumption cut can be worthwhile even when it leaves a larger import bill. The welfare test includes domestic production, price dispersion, foreign

Table 4: Oil only: first-quarter allocations and transactions

Policy	Consumption	Depreciation	Premium	Reserves	Net sales
Taylor	-0.360	3.083	-0.0017	0.000	-0.224
Monetary policy alone	-0.456	2.858	-0.0016	0.000	-0.222
Joint policy	-0.263	-0.081	-0.0009	0.228	-0.141

Consumption and depreciation are percent changes. The premium is in quarterly return basis points; reserve sales and net nonresident bond sales are percent of reference quarterly GDP. Negative net sales are purchases. No portfolio-demand innovation occurs in this experiment.

payments and the reserve position carried forward, as in (56) and Appendix F. A small reserve sale at the optimized monetary-only plan has a positive net derivative. The full reoptimized joint plan improves lifetime welfare by 0.007403 CE bp.

The first-quarter consumption fall is not a sufficient welfare statistic. Taylor policy has a smaller initial consumption contraction than optimized monetary policy alone, although the latter gives higher lifetime welfare. The planner also values later consumption and the hours required to produce domestic goods. Table 6 reports those full-path comparisons rather than ranking policies from a single response. The oil-only welfare gain also survives with responsive exports (Appendix K).

8.2 The policy mix under the combined shock

When the oil increase coincides with the reduction in foreign investors' target, intermediaries reach their position limit in the first quarter. Under optimized monetary policy alone, the improvement in net exports provides 0.4690% of quarterly GDP, the smaller payment on inherited foreign bonds provides 0.4693%, and intermediaries absorb another 0.0617%. These adjustments together accommodate the one-percent cut in the mandate, before rounding. The country pays for the shift in foreign demand partly through a larger contraction and depreciation.

Joint policy supplies reserves worth 0.447% of quarterly GDP on impact. Consumption falls by 0.664% rather than 1.077%, and depreciation falls from 16.504% to 9.718%. The weaker contraction permits a smaller improvement in net exports, while the smaller depreciation gives up part of the saving on inherited foreign debt. Both effects are included in the planner's choice. The intervention finances a different real adjustment; it does not remove the income loss from more expensive oil.

The policy mix also moderates inflation. Initial annualized consumer price inflation is 1.42 percentage points above the reference under joint policy, compared with 2.12 under monetary policy alone. The optimized interest-rate increase is smaller, and households

Table 5: Combined shock: first-quarter policy and allocations

Policy	Consumption	Depreciation	Premium	Reserves	Net sales
Taylor	-0.821	17.156	1048.7193	0.000	0.349
Monetary policy alone	-1.077	16.504	1055.6040	0.000	0.355
Joint policy	-0.664	9.718	935.9602	0.447	0.519
Delayed joint	-1.078	16.499	1455.2833	0.000	0.355

Same units as Table 4. The shock is a ten percent oil-price rise and a one-percent-of-GDP cut in the investor mandate. Delayed joint policy cannot sell reserves in the first quarter but can choose the interest rate immediately.

face a lower initial rise in the domestic price of imports (Figure 4). Intermediaries still earn a substantial scarcity premium at the limit. Additional intervention would alter reserve income, future financing and the value of inherited bonds, so the optimal joint policy need not eliminate that premium.

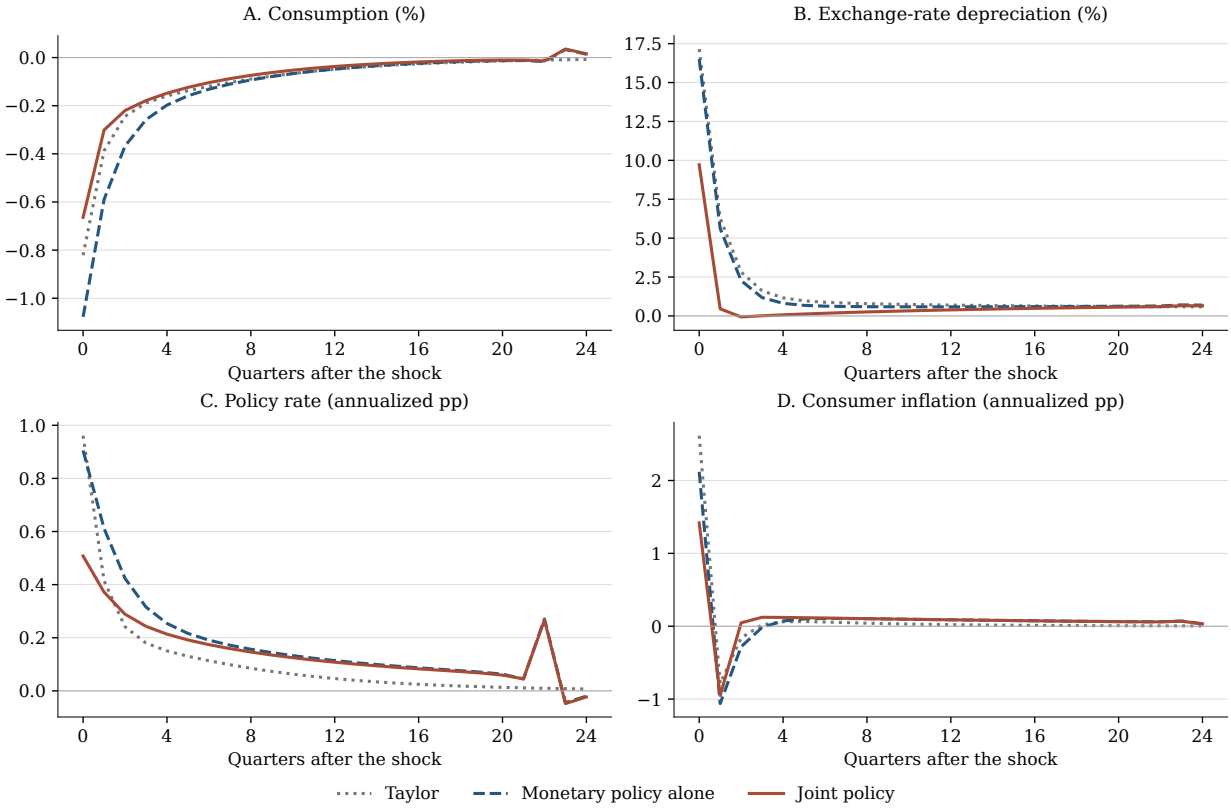

Figure 4: Combined shock: consumption, the exchange rate and monetary policy
Identical oil and investor-mandate paths under all three policies. Rate and inflation changes are annualized percentage points. Changes in slopes can reflect switches between binding and slack intermediary capacity; the policy window and continuation rule are common across the optimized plans.

Realized nonresident sales differ across policies even though the mandate shock is identical. They are 0.355% of GDP under monetary policy alone and 0.519% under joint policy. A given foreign-currency target corresponds to different face holdings when bond prices and the exchange rate change. Foreign-owned intermediaries can also buy bonds sold by direct investors. The transaction measure in (58) includes both groups and excludes revaluation and coupons; the reported difference is an equilibrium response to the same shock, not a different imposed outflow.

Table 6: Welfare relative to Taylor policy for the same shock

Shock	Taylor	Monetary alone	Joint	Delayed joint
Oil only	0.000000	0.001047	0.008450	0.007107
Combined	0.000000	0.003671	0.015150	0.008519

Permanent consumption-equivalent basis points. Every entry compares policies with the same shock and inherited portfolios. Delayed joint policy retains immediate monetary adjustment and permits reserve trades from the following quarter.

The joint gain over optimized monetary policy is 0.011479 CE bp in the combined experiment. These permanent consumption equivalents average a temporary policy improvement over the household's lifetime. The impact responses in Table 5 describe where the improvement occurs, while the welfare measure includes the future cost of financing it.

8.3 When waiting is costly

The timing comparison keeps the shock and the entire monetary-policy menu unchanged. The central bank can announce a plan immediately, but delayed joint policy must wait until the second quarter to trade reserves. Thus households anticipate future intervention; they cannot use next quarter's reserves to settle this quarter's trade.

In the oil-only experiment, immediate joint policy avoids binding capacity, but delayed joint policy reaches the limit in the first quarter. Anticipated future intervention changes current spending and asset prices even before reserves are sold. Under delay, the initial trade shortfall is 0.1388% of GDP, while inherited-payment savings supply 0.0771%; the remaining 0.0617% uses all available intermediary headroom. Thus first-quarter slack under a plan with no FXI does not imply slack under a plan promising FXI next quarter. Waiting raises the initial consumption fall from 0.263% to 0.413% and costs 0.001344 CE bp.

The loss is larger in the combined shock, because the foreign target falls sharply in the same quarter as the first oil bill arrives. Intermediaries reach their upper limit immediately under both immediate and delayed joint policy. Without a current reserve sale, the initial

private adjustment must clear the market at that fixed position. The first-quarter premium rises from about 936 quarterly basis points under immediate joint policy to 1,455 with delay. This return compensates investors for holding bonds across the first quarter. Future FXI is already anticipated under delayed joint policy, but clearing the initial trade without a reserve sale still requires the higher return.

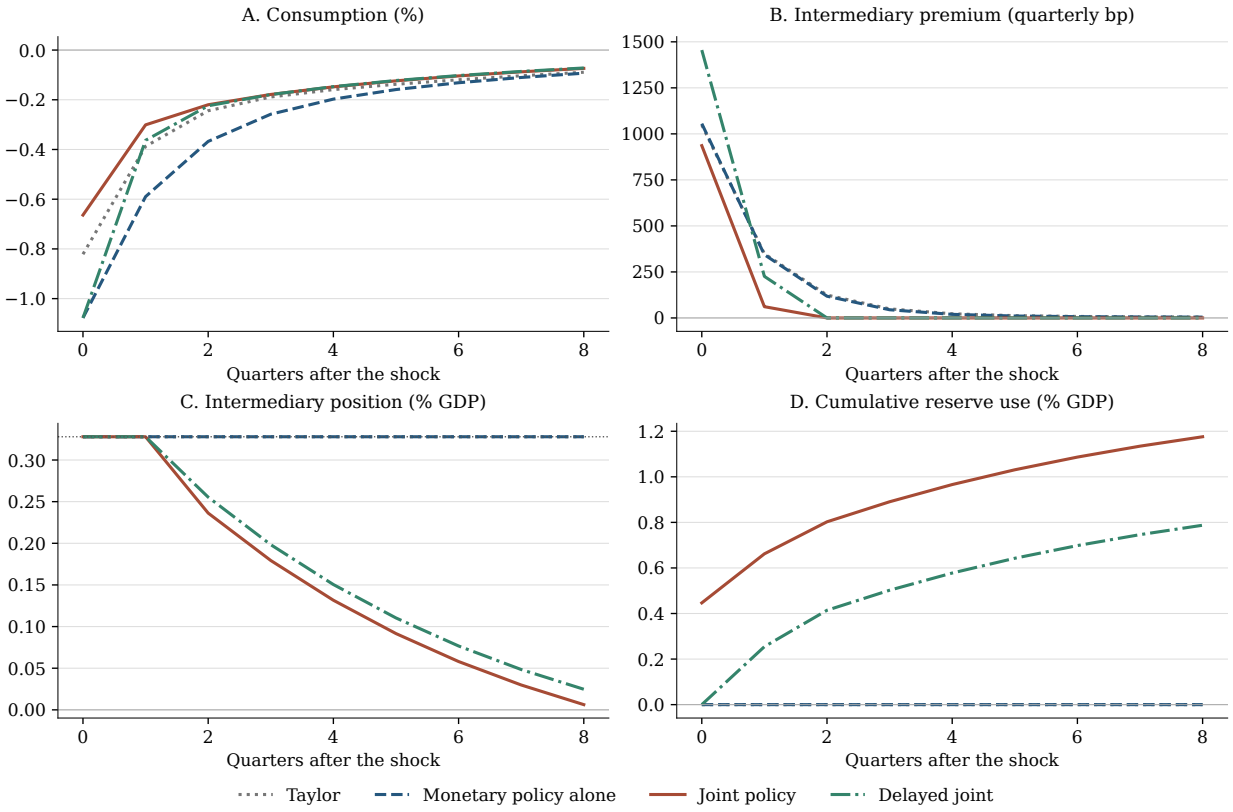

Figure 5: Combined shock: the initial trade and the cost of waiting

Delayed joint policy allows the same immediate interest-rate choice as joint policy and imposes only $Z_0 = 0$. The dotted horizontal line in panel C is the common position limit. Cumulative reserve use is the opening stock less the current stock, divided by reference quarterly GDP.

Waiting costs 0.006631 CE bp, or 57.8% of the gain from adding FXI to optimized monetary policy. Consumption initially falls by 1.078% rather than 0.664%, and the higher premium increases payments on the position carried into the following quarter. This loss combines the different initial real adjustment, payments promised on the initial position and the later paths needed to restore equilibrium. It is not simply the current premium multiplied by a fixed amount of borrowing.

Appendix J allows domestic ownership of intermediaries. Retaining more intermediary income at home lowers the cost of delay in those comparisons, while the financing constraint remains.

9 Conclusion

This paper shows how an oil shock can generate the financial pressure that makes FXI valuable alongside monetary policy. The higher oil bill must be met while households and firms adjust their purchases and existing domestic-currency claims change in value. When these adjustments leave a financing need, intermediaries provide it, but they ask for a higher return compared to the foreign safe return. Payments on that higher return are a cost to the economy that is already facing financing pressure, and if, in addition to all this, capital outflows also happen at the same time, the economy faces a huge financing problem.

Monetary policy alone can affect this adjustment through spending, production, exchange rates, and bond prices. A contraction reduces imports and firms' oil needs at the cost of lower consumption, while supporting demand leaves a larger bill to finance. Optimized monetary policy can therefore leave financial pressure that would be costly to reduce further. Reserves provide another way to accommodate that pressure.

The two-period model establishes when this additional instrument improves welfare. A small reserve sale at the monetary-only optimum can improve the timing of import spending and reduce future payments to foreign bondholders. The sufficient condition weighs these benefits against the increase in the foreign-currency value of inherited debt, with repayment and forgone reserve income already included in the external budgets. It applies to oil-only and combined shocks.

The infinite-horizon model, calibrated to India, quantifies these trade-offs with Calvo pricing while retaining the analytical model's central financing mechanism. When oil and portfolio shocks coincide, joint policy reduces the initial consumption decline from 1.08% to 0.66% and depreciation from 16.50% to 9.72%, relative to optimized monetary policy alone. FXI also cushions consumption and raises lifetime welfare in the oil-only experiment, including when exports respond to the exchange rate, and intermediaries are not all global.

The value of reserves also depends on their availability when the shock occurs. A one-quarter delay is costly when intermediary capacity binds under the delayed plan, requiring a sharper consumption adjustment and higher promised bond returns. Anticipated future intervention cannot supply the foreign currency needed for the initial trade. In the combined experiment, waiting sacrifices 57.8% of the gain from adding FXI, because later reserve sales cannot undo those initial costs.

Future work will introduce foreign equity holdings and study the Indian episodes, connecting oil exposure and expected firm profits to the composition of capital flows. Another important extension would be to study recurring shocks, which would introduce uncertainty about future reserve needs and how a central bank can prepare for that scenario. Lastly, comparisons across monetary regimes would clarify how exchange-rate commitments change the optimal policy mix and whether there are regimes and policies that can reach the joint optimum.

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A Two-period household, firm and financial accounts

A.1 Household optimization and public accounts

Preferences are exactly (1). The monetary representation selects aggregate domestic expenditure subject to private optimality; it adds no term to utility and no restriction to an individual household's consumption choices.

Bond clearing and the reserve trade are (21)–(22) and (15). The surviving bond pays L in the second period. The short domestic claim has price $Q_0^S = 1/I_0$, payoff one, and zero net supply.

Write T_t for the net public transfer to households. The consolidated public budgets in the finite economy are

$$T_0 + Q_0^B(B_0^{CB} - \delta_B B_{-1}^{CB}) + S_0(R_0 + \bar{G}) + B_{-1}^G = B_{-1}^{CB} + S_0 r(R_{-1} + \bar{G}), \tag{60}$$

$$T_1 + \delta_B L B_{-1}^G = L B_0^{CB} + S_1 r(R_0 + \bar{G}) \tag{61}$$

Here the predetermined nonreserve position is included in the consolidated public account and is settled with all remaining assets. It carries no household portfolio choice. Placing its predetermined income in a household transfer account gives the same allocation and external budget.

Intermediaries are foreign-owned, so their income does not enter the household budget. The gross return on their domestic bond position is included among payments abroad. Their private fee is paid within the foreign financial sector and creates no additional domestic resource charge.

The household chooses $(C_{H,t}, C_{M,t}, C_{E,t}, N_t)_{t=0,1}$ and (B_0^S, H_0) subject to (2)–(3). Let $\mathcal{H}_t$ denote income minus expenditure in those budgets. The Lagrangian is

$$\mathfrak{L}^H = \sum_{t=0}^{1} \beta^t \big[(1-\alpha)\log C_{H,t} + \alpha(1-\omega)\log C_{M,t} + \alpha\omega \log C_{E,t} - \chi N_t + \nu_t \mathcal{H}_t\big] + \zeta^H H_0,$$

where $\zeta^H \geq 0$ enforces $H_0 \geq 0$. Its goods and labor conditions are

$$\frac{1-\alpha}{C_{H,t}} = \nu_t, \qquad \frac{\alpha(1-\omega)}{C_{M,t}} = \nu_t S_t, \qquad \frac{\alpha\omega}{C_{E,t}} = \nu_t S_t P_t^O,$$
$$\chi = \nu_t W_t \tag{62}$$

The two asset conditions are

$$\nu_0 Q_0^S = \beta \nu_1, \qquad \nu_0 Q_0^B = \beta L \nu_1 + \zeta^H, \qquad \zeta^H H_0 = 0 \tag{63}$$

At positive long-bond holdings these equations give $I_0 Q_0^B = L$. Dividing the goods conditions gives (4) and (5); dividing the nominal multipliers across periods gives $C_{H,1} = \beta I_0 C_{H,0}$.

Concavity of utility and linear budgets make these private conditions sufficient at positive consumption. Linear disutility of work can make labor supply set-valued at the market wage; the stated employment is supported by labor-market clearing. The result does not require strictly convex labor disutility in the finite economy.

A.2 Input demands and the trade derivatives

Cost minimization has Lagrangian

$$\begin{aligned}\mathfrak{L}^F = {} & W_t N_t + S_t P_t^O X_{E,t} \\ & + mc_t \left[C_{H,t} + \bar{X} - A \left[(1-\mu) {N_t}^{(\nu_E - 1)/\nu_E} + \mu {X_{E,t}}^{(\nu_E - 1)/\nu_E} \right]^{\nu_E/(\nu_E - 1)} \right]\end{aligned}$$

Positive factor prices and output make the production constraint bind. The two factor conditions and constant returns give

$$\begin{aligned} W_t &= mc_t \frac{\partial Y_t}{\partial N_t}, & S_t P_t^O &= mc_t \frac{\partial Y_t}{\partial X_{E,t}}, \\ mc_t &= \frac{1}{A} \left[(1-\mu)^{\nu_E} W_t^{1-\nu_E} + \mu^{\nu_E} (S_t P_t^O)^{1-\nu_E} \right]^{1/(1-\nu_E)}, & & (64) \\ N_t &= Y_t A^{\nu_E - 1} (1-\mu)^{\nu_E} \left(\frac{mc_t}{W_t} \right)^{\nu_E}, & X_{E,t} &= Y_t A^{\nu_E - 1} \mu^{\nu_E} \left(\frac{mc_t}{S_t P_t^O} \right)^{\nu_E} \end{aligned} \quad (65)$$

Household optimality gives $W_t / S_t = \chi z_t / \alpha$. Substitution gives the production-oil bill

$$P_t^O X_{E,t} = \frac{C_{H,t} + \bar{X}}{A} \mu^{\nu_E} (P_t^O)^{1-\nu_E} \left[(1-\mu)^{\nu_E} (\chi z_t / \alpha)^{1-\nu_E} + \mu^{\nu_E} (P_t^O)^{1-\nu_E} \right]^{\nu_E/(1-\nu_E)} \quad (66)$$

This is production oil; household oil remains $\omega z_t / P_t^O$. Continuous limits apply when $\nu_E = 1$.

For the proofs below, a subscript z or P denotes a partial derivative holding domestic spending fixed; P refers to the current oil price. Let the oil share of unit cost, used only to state these derivatives, be

$$\theta_{E,t} = \frac{\mu^{\nu_E} (P_t^O)^{1-\nu_E}}{(1-\mu)^{\nu_E} (\chi z_t / \alpha)^{1-\nu_E} + \mu^{\nu_E} (P_t^O)^{1-\nu_E}}$$

Differentiating (66) gives

$$-NX_{t,z} = 1 + \nu_E(1-\theta_{E,t})P_t^O X_{E,t}/z_t > 0, \tag{67}$$
$$-NX_{t,P} = X_{E,t}[1-\nu_E(1-\theta_{E,t})] > 0 \quad \text{if } 0 < \nu_E \leq 1 \tag{68}$$

The oil-price derivative holds total household foreign spending z_t fixed, so the household's more expensive oil purchase is offset by its intratemporal allocation. The direct increase in the trade bill in (68) comes from production oil. Household oil still enters utility, import prices and the monetary-policy response.

A.3 Aggregation of the financial accounts

Substitute profits, public transfers and bond clearing into the household budgets. The first-period aggregate resource equation becomes

$$\bar{X}^* - z_0 - P_0^O X_{E,0} = \left[A_0 - rA_{-1} + (R_0^B - r)V_{-1}\right]$$

The second-period equation is

$$\bar{X}^* - z_1 - P_1^O X_{E,1} = [-rA_0 + r\psi_0 V_0]$$

These are (25)–(26). In the second period, the terminal return L is paid on every surviving private and central-bank bond, and the public foreign position is settled. No outstanding asset is discarded.

B Implementability and the conditional equilibrium

B.1 Proof of Proposition 1

Necessity follows by combining the household first-order conditions, firms' cost minimization, intermediary optimality and the preceding budget aggregation. In particular,

$$I_0 \frac{S_0}{S_1} = \frac{C_{H,1}}{\beta C_{H,0}} \frac{C_{H,0}/z_0}{C_{H,1}/z_1} = \frac{z_1}{\beta z_0} = r(1+\psi_0),$$

which proves (27). This calculation uses domestic asset pricing only.

For sufficiency, take an allocation satisfying the proposition's restrictions. Construct

$$S_t = \frac{\alpha C_{H,t}}{(1-\alpha)z_t}, \qquad W_t = \frac{\chi C_{H,t}}{1-\alpha}$$

Select the candidate's domestic expenditure levels as the monetary settings. Recover $I_0 = C_{H,1}/(\beta C_{H,0})$ and $Q_0^B = L/I_0$. Foreign investor and intermediary face holdings are

S_0F_0/Q_0^B and S_0D_0/Q_0^B. Recover central-bank holdings from (15) and household holdings from (22); they are admissible by hypothesis. Set short-claim holdings to zero. Choose the public transfers from (60)–(61).

The two external budgets imply the household budgets after these substitutions. Goods demands, labor supply and saving satisfy the household conditions. Concavity supports household optimality. CES cost minimization supplies firms' optimal factor demands at their preset output price. Strict concavity of (13), together with its multiplier conditions, supplies intermediary optimality. Foreign mandates and all markets clear by construction. These steps establish implementation within the stated demand-control policy set.

The proposition conditions on positive household long-bond holdings. At a zero holding, (63) must retain its inequality multiplier; one cannot impose long-short return equality without that condition. The maintained analytical branch and every reported quantitative policy path have positive holdings.

B.2 Private equilibrium for a specified policy

With $(C_{H,0}, C_{H,1}, Z_0)$ fixed, domestic spending, I_0 and Q_0^B are fixed. For any proposed D_0, the first budget has derivative

$$NX_{0,z} - V_{-1}R_0^B/z_0 < 0$$

with respect to z_0. Hence it has at most one positive root, and

$$\frac{dz_0}{dD_0} = \frac{1}{-NX_{0,z} + V_{-1}R_0^B/z_0} > 0$$

Inside intermediary capacity, $z_1 = z_0[1 + \gamma(D_0 - \bar{D})]$. Differentiating the second-budget residual with respect to D_0 gives

$$-r[1 + \psi_0] - r\gamma V_0 + NX_{1,z}\left[\frac{1 + \psi_0}{-NX_{0,z} + V_{-1}R_0^B/z_0} + \gamma z_0\right] < 0$$

At a position limit, D_0 is fixed and the residual's derivative with respect to ψ_0 is $NX_{1,z}z_0 - rV_0 < 0$. These signs require nonnegative foreign claims and positive gross returns. The branches meet at zero scarcity multipliers. When a root is bracketed on the admissible interval, these monotonicity properties select the private equilibrium; they do not assert existence for every proposed monetary setting.

C Oil and withdrawal transmission

C.1 Proof of Proposition 2

Hold monetary settings, the investor mandate and Z_0 fixed. The oil-price rise occurs only in the first period. Write a derivative subscript P for the total equilibrium response to P_0^O. The first budget and the stock identity give

$$D_{0,P} = (-NX_{0,z} + V_{-1}R_0^B/z_0)z_{0,P} - NX_{0,P} \tag{69}$$

Inside capacity, $\psi_{0,P} = \gamma D_{0,P}$. Differentiating the repayment budget and the household financial wedge gives

$$(-NX_{1,z})z_{1,P} + r[1 + \psi_0 + \gamma V_0]D_{0,P} = 0, \tag{70}$$

$$z_{1,P} = (1 + \psi_0)z_{0,P} + \gamma z_0 D_{0,P} \tag{71}$$

Both $-NX_{t,z}$ and $-NX_{0,P}$ are positive by (67)–(68), and positive gross returns imply $1 + \psi_0 > 0$. Eliminating $z_{1,P}$ and then $z_{0,P}$ yields

$$D_{0,P} = \frac{(-NX_{0,P})(-NX_{1,z})(1 + \psi_0)}{(-NX_{1,z})(1 + \psi_0) + (-NX_{0,z} + V_{-1}R_0^B/z_0)\{\gamma(-NX_{1,z})z_0 + r\gamma V_0 + r[1 + \psi_0]\}} > 0 \tag{72}$$

Every factor in the denominator is positive. Substituting this solution back into (69)–(71) gives $z_{0,P} < 0$ and $z_{1,P} < 0$, while $\psi_{0,P} = \gamma D_{0,P} > 0$. At a strictly binding upper position, $D_{0,P} = 0$. The first budget gives

$$z_{0,P} = \frac{NX_{0,P}}{-NX_{0,z} + V_{-1}R_0^B/z_0} < 0$$

Use $z_{1,P} = (1 + \psi_0)z_{0,P} + z_0\psi_{0,P}$ in the second budget to obtain

$$\psi_{0,P} = \frac{(-NX_{1,z})(1 + \psi_0)(-NX_{0,P})}{(-NX_{0,z} + V_{-1}R_0^B/z_0)[(-NX_{1,z})z_0 + rV_0]} > 0 \tag{73}$$

The repayment equation also gives $z_{1,P} = -rV_0\psi_{0,P}/(-NX_{1,z}) \leq 0$. This inequality is strict when $V_0 > 0$; with no foreign-owned claim in the second period, $z_{1,P} = 0$ at the binding limit. At a switching point use the feasible one-sided derivative. The sign establishes an increase in the premium; a positive level additionally requires a nonnegative starting premium. The zero-premium reference in Proposition 2 supplies that condition.

C.2 A simultaneous investor withdrawal

Allow the foreign-investor mandate to change by $dF_0 \leq 0$ at the same time as the oil price changes by $dP_0^O \geq 0$. Inherited positions, the second-period oil price and the monetary and reserve settings remain fixed. Differentiating the stock identity and both external budgets now gives

$$dD_0 = -dF_0 + \left(-NX_{0,z} + \frac{V_{-1}R_0^B}{z_0}\right) dz_0 - NX_{0,P}\, dP_0^O \tag{74}$$

$$(-NX_{1,z})dz_1 + rV_0 d\psi_0 + r[1+\psi_0]dD_0 = -r(1+\psi_0)dF_0 \tag{75}$$

The last term matters: a lower mandate also reduces the direct foreign position receiving the next bond return. Use (33) and, inside capacity, $d\psi_0 = \gamma\, dD_0$. Let $\mathcal{D}$ denote the positive denominator of (72). Elimination yields

$$d\psi_0 = \frac{\gamma(1+\psi_0)}{\mathcal{D}} \left\{ \begin{array}{l} (-NX_{1,z})(-NX_{0,P})\, dP_0^O \\ + \left[-NX_{1,z} + r\left(-NX_{0,z} + \dfrac{V_{-1}R_0^B}{z_0}\right)\right](-dF_0) \end{array} \right\} \tag{76}$$

Both shock coefficients are positive. Thus $d\psi_0 > 0$ and $dD_0 = d\psi_0/\gamma > 0$ if at least one shock is strict. At a strictly binding upper limit, set $dD_0 = 0$ in (74)–(75). The result is

$$d\psi_0 = \frac{(1+\psi_0) \left\{ \begin{array}{l} (-NX_{1,z})(-NX_{0,P})\, dP_0^O \\ + \left[-NX_{1,z} + r\left(-NX_{0,z} + \dfrac{V_{-1}R_0^B}{z_0}\right)\right](-dF_0) \end{array} \right\}}{\left(-NX_{0,z} + \frac{V_{-1}R_0^B}{z_0}\right)\left[(-NX_{1,z})z_0 + rV_0\right]} > 0 \tag{77}$$

The statement is a local comparison at a common equilibrium. Finite responses need not add across shocks, and the import-spending signs proved for oil alone do not follow for a combined shock: withdrawal also lowers future direct foreign claims.

C.3 What makes this a two-period result

The first budget alone leaves the response of import spending undetermined. Choosing a spending response that exactly absorbs the oil bill would satisfy that single identity, but it need not satisfy repayment and household saving. Equations (70)–(71) impose those additional restrictions and determine the positive derivative in (72). Oil prices revert in the second period; the second-period allocation generally does not. There is no third-period return to a reference allocation in this finite economy.

D The welfare value of the second instrument

D.1 The two wedges and the welfare identity

Write u_t for period utility in (1). For a policy variation at fixed oil prices and export contracts, cost minimization and goods clearing imply

$$W_t\, dN_t + S_t P_t^O\, dX_{E,t} = mc_t\, dC_{H,t}$$

Using the household conditions and $dNX_t = -dz_t - P_t^O\, dX_{E,t}$ gives

$$\begin{aligned} du_t &= \nu_t\, dC_{H,t} + \lambda_t\, dz_t - \nu_t W_t\, dN_t \\ &= \nu_t(1 - mc_t)\, dC_{H,t} - \lambda_t\, dNX_t \end{aligned}$$

This separates the domestic wedge from the value of foreign resources. Holding monetary settings fixed sets $dC_{H,t} = 0$. The cost envelope then becomes

$$W_t N_{t,z} + S_t (P_t^O X_{E,t})_z = 0$$

Since $\chi = \nu_t W_t$ and $S_t \nu_t = \alpha / z_t = \lambda_t$, period utility satisfies

$$u_{t,z} = \frac{\alpha}{z_t} - \chi N_{t,z} = \lambda_t [1 + (P_t^O X_{E,t})_z] = \lambda_t (-NX_{t,z}) \tag{78}$$

Equivalently, $du_t = -\lambda_t\, dNX_t$ for this experiment. Differentiating the external budgets with respect to a reserve sale gives

$$\begin{aligned} dNX_0 &= -dZ_0 - dD_0 + V_{-1} dR_0^B, \\ dNX_1 &= r(dZ_0 + dD_0) + rV_0 d\psi_0 + r\psi_0 dD_0 \end{aligned} \tag{79}$$

Multiply by $-\lambda_0$ and $-\beta\lambda_1$, respectively, and add. Household saving implies $\lambda_0 = (1 + \psi_0)\lambda_1$ and $\beta r = 1$. For a general policy variation, restoring the domestic terms gives

$$\begin{aligned} d\mathcal{W} = \sum_{t=0}^{1} \beta^t \nu_t (1 - mc_t)\, dC_{H,t} + \lambda_1 \psi_0\, dZ_0 \\ - \lambda_1 V_0\, d\psi_0 - \lambda_0 V_{-1}\, dR_0^B \end{aligned}$$

At fixed monetary settings the domestic terms vanish, yielding (35). The financial term uses the same wedge $\lambda_0 - \beta r \lambda_1 = \lambda_1 \psi_0$ that appears in household saving; inherited payments and changes in future foreign returns remain in the expression.

D.2 Proof of Proposition 3

For this proof only, use $\mathcal{D}$ for the positive denominator displayed in (72); it is an algebraic coefficient, not a new economic state. The assumption $V_{-1} \geq 0$ ensures $-NX_{0,z} + V_{-1}R_0^B/z_0 > 0$, while $V_0 \geq 0$ and $1 + \psi_0 > 0$ ensure positivity of the remaining denominator terms. The external budgets and the financial wedge imply

$$\begin{aligned} D_{0,Z} &= -1 + (-NX_{0,z} + V_{-1}R_0^B/z_0)z_{0,Z}, \\ z_{1,Z} &= (1+\psi_0)z_{0,Z} + z_0\psi_{0,Z}, \\ (-NX_{1,z})z_{1,Z} + rV_0\psi_{0,Z} + r[1+\psi_0]D_{0,Z} + r &= 0 \end{aligned} \tag{80}$$

On the interior branch $\psi_{0,Z} = \gamma D_{0,Z}$. Solving gives

$$\begin{aligned} D_{0,Z} &= -\frac{(-NX_{1,z})(1+\psi_0) + r(-NX_{0,z} + V_{-1}R_0^B/z_0)}{\mathcal{D}} < 0, \\ z_{0,Z} &= \frac{\gamma(-NX_{1,z})z_0 + r\gamma V_0 + r\psi_0}{\mathcal{D}}, \\ z_{1,Z} &= (1+\psi_0)z_{0,Z} + \gamma z_0 D_{0,Z} \end{aligned} \tag{81}$$

Let $\mathcal{B}$ denote the left side minus the right side of (36), solely to collect the algebra in this proof. Substitution into (78) gives

$$\mathcal{W}_Z = \frac{\alpha}{z_0\mathcal{D}(1+\psi_0)}\{\gamma\mathcal{B} + \psi_0(1+\psi_0)[-rNX_{0,z} - NX_{1,z}]\} \tag{82}$$

Under the proposition's assumptions the denominator is positive and the second term in braces is nonnegative. Condition (36) makes the first term strictly positive.

At a strictly binding upper limit, $D_{0,Z} = 0$, and (80) instead gives

$$\begin{aligned} z_{0,Z} &= \frac{1}{-NX_{0,z} + V_{-1}R_0^B/z_0} > 0, \\ \psi_{0,Z} &= -\frac{r(-NX_{0,z} + V_{-1}R_0^B/z_0) + (-NX_{1,z})(1+\psi_0)}{(-NX_{0,z} + V_{-1}R_0^B/z_0)[(-NX_{1,z})z_0 + rV_0]} < 0 \end{aligned} \tag{83}$$

The resulting welfare derivative is

$$\mathcal{W}_Z = \frac{\alpha\mathcal{B}}{z_0(-NX_{0,z} + V_{-1}R_0^B/z_0)(1+\psi_0)[(-NX_{1,z})z_0 + rV_0]} > 0 \tag{84}$$

Regularity ensures a locally continuous private response; room under the policy and portfolio constraints makes a sufficiently small sale feasible. It raises welfare while keeping the monetary-only optimum's monetary settings fixed. The best feasible joint plan can do at least as well as that improved allocation. This establishes a strict improvement without requiring a globally concave joint-policy problem or a zero premium at its optimum.

The proof applies when the non-FXI inequalities permit the stated direction. In particular, domestic bond holdings must remain positive, the central bank must have room to acquire bonds, and an unchanged interest rate must satisfy the common bound. At a switching point the appropriate feasible one-sided derivative replaces the strict-branch calculation.

E Household and firm choices with staggered prices

E.1 Household derivatives

The household budget is (39), with $P_t C_t = P_{H,t} C_{H,t} + S_t (C_{M,t} + P_t^O C_{E,t})$ at the expenditure-minimizing demands. Profits Π_t^F include export-contract income and net out the lump-sum financing of the price-setting subsidy; that subsidy still affects each firm's price choice. The last term is income on the predetermined foreign position. Intermediaries are foreign-owned and make no distributions to the household. There is no household first-order condition for $\bar{G}$.

Adding the separate central-bank and fiscal budgets gives (53). Substitute that transfer and bond clearing into (39). The resulting aggregate equation is (49). The predetermined foreign position earns interest and is rolled over; it is not liquidated at the end of the numerical policy window. Let $\mathcal{R}_t^H$ be the right-hand side of (39) minus its left-hand side. For the choices

$$\{C_{H,t}, C_{M,t}, C_{E,t}, N_t, B_t^S, H_t\}_{t \geq 0},$$

the Lagrangian is

$$\mathfrak{L}^H = \sum_{t \geq 0} \beta^t \left[u(C_t) - \chi_N \frac{N_t^{1+\varphi}}{1+\varphi} + \nu_t \mathcal{R}_t^H + \zeta_t^H H_t \right], \qquad \zeta_t^H \geq 0 \tag{85}$$

Predetermined foreign income, public transfers and firm profits are taken as given by the household. Payments to foreign intermediaries are accounted for in the external budget, not deducted again from utility. For $j = H, M, E$, write $C_{C_j,t}$ for the derivative of the nested consumption aggregate with respect to that good. The first-order conditions are

$$\begin{aligned}
C_t^{-\sigma} C_{C_H,t} &= \nu_t P_{H,t}, & C_t^{-\sigma} C_{C_M,t} &= \nu_t S_t, & C_t^{-\sigma} C_{C_E,t} &= \nu_t S_t P_t^O, \\
\chi_N N_t^{\varphi} &= \nu_t W_t, & \nu_t Q_t^S &= \beta \nu_{t+1}, & \nu_t Q_t^B &= \beta \nu_{t+1} (1 + \delta_B Q_{t+1}^B) + \zeta_t^H, \\
\zeta_t^H &\geq 0, & H_t &\geq 0, & \zeta_t^H H_t &= 0
\end{aligned} \tag{86}$$

For example, $C_{C_H} = (1-\alpha)^{1/\eta} (C/C_H)^{1/\eta}$; imported goods use the chain rule through C_F. Dividing the two inner demands gives their relative expenditure. Substituting into the

binding CES aggregate then gives

$$C_{M,t} = (1-\omega)(S_t/P_{F,t})^{-\vartheta} C_{F,t}, \qquad C_{E,t} = \omega(S_t P_t^O/P_{F,t})^{-\vartheta} C_{F,t},$$
$$P_{F,t}^{1-\vartheta} = (1-\omega) S_t^{1-\vartheta} + \omega(S_t P_t^O)^{1-\vartheta} \tag{87}$$

The outer nest gives (40)–(41) by the same steps. Homogeneity ensures that $P_t C_t = P_{H,t} C_{H,t} + S_t C_{M,t} + S_t P_t^O C_{E,t}$ at these demands. Continuous limits apply at unit elasticities. Concavity, the linear budget, no-Ponzi condition and transversality make the household conditions sufficient.

At $H_t > 0$, the two bond Euler equations give $I_t Q_t^B = 1 + \delta_B Q_{t+1}^B$, hence $R_{t+1}^B = I_t S_t / S_{t+1}$. Multiplying $\nu_t = \beta I_t \nu_{t+1}$ by S_t yields (54). Iterating the long-bond equation gives (46) under the no-bubble condition. The household corner retains the inequality multiplier in (86).

E.2 Assembly, factor choice, and Calvo prices

A competitive assembler minimizes expenditure on varieties subject to delivering the CES aggregate. Its first-order condition is

$$P_{H,t}(j) = P_{H,t} Y_t^{1/\epsilon_p} Y_t(j)^{-1/\epsilon_p}$$

Thus $Y_t(j) = [P_{H,t}(j)/P_{H,t}]^{-\epsilon_p} Y_t$, and substitution gives $P_{H,t}^{1-\epsilon_p} = \int_0^1 P_{H,t}(j)^{1-\epsilon_p} dj$. Total expenditure equals $P_{H,t} Y_t$, so assembly profit is zero.

Given demand $Y_t(j)$, producer j chooses its inputs to solve

$$\min_{N_t(j), X_{E,t}(j) \geq 0} \{W_t N_t(j) + P_{E,t} X_{E,t}(j)\} \quad \text{subject to (43)} \tag{88}$$

The Lagrangian is input expenditure plus $P_{H,t} mc_t$ times demanded output minus the CES output in (43). Positive factor prices make the constraint bind. Its conditions are

$$W_t = P_{H,t} mc_t \frac{\partial Y_t(j)}{\partial N_t(j)}, \qquad P_{E,t} = P_{H,t} mc_t \frac{\partial Y_t(j)}{\partial X_{E,t}(j)} \tag{89}$$

Differentiating the production function gives

$$\frac{\partial Y_t(j)/\partial N_t(j)}{\partial Y_t(j)/\partial X_{E,t}(j)} = \frac{1-\mu}{\mu} \left[\frac{N_t(j)}{X_{E,t}(j)}\right]^{-1/\nu_E}$$

Dividing the factor conditions gives the input ratio in (44). The production function and that ratio yield

$$N_t(j) = Y_t(j)A^{\nu_E-1}(1-\mu)^{\nu_E}\left(\frac{P_{H,t}mc_t}{W_t}\right)^{\nu_E},$$
$$X_{E,t}(j) = Y_t(j)A^{\nu_E-1}\mu^{\nu_E}\left(\frac{P_{H,t}mc_t}{P_{E,t}}\right)^{\nu_E} \tag{90}$$

Their expenditure equals $P_{H,t}mc_tY_t(j)$, proving the unit-cost formula. Since every firm uses the same input ratio, constant returns imply that aggregate inputs produce $\int_0^1 Y_t(j)dj = \Delta_t^p Y_t$. Substituting those inputs into the same CES expression gives (45).

A resetting producer chooses one price $P_{H,t}^{\#} > 0$ to maximize

$$\sum_{k\geq 0}(\beta\theta_p)^k\nu_{t+k}[(1+\bar{\varsigma}^p)P_{H,t}^{\#} - P_{H,t+k}mc_{t+k}]\left(\frac{P_{H,t}^{\#}}{P_{H,t+k}}\right)^{-\epsilon_p}Y_{t+k} \tag{91}$$

Demand and cost minimization have already been substituted, so there are no remaining equality constraints in this single-price choice. For $P = P_{H,t}^{\#}$, a summand's derivative, apart from its positive weight, is

$$P^{-\epsilon_p-1}P_{H,t+k}^{\epsilon_p}Y_{t+k}[-(\epsilon_p-1)(1+\bar{\varsigma}^p)P + \epsilon_p P_{H,t+k}mc_{t+k}]$$

Summing and setting the derivative to zero gives

$$P_{H,t}^{\#} = \frac{\epsilon_p}{(\epsilon_p-1)(1+\bar{\varsigma}^p)}\frac{\sum_{k\geq 0}(\beta\theta_p)^k\nu_{t+k}mc_{t+k}P_{H,t+k}^{1+\epsilon_p}Y_{t+k}}{\sum_{k\geq 0}(\beta\theta_p)^k\nu_{t+k}P_{H,t+k}^{\epsilon_p}Y_{t+k}} \tag{92}$$

The derivative is positive below this price and negative above it; it is the unique positive maximizer. The subsidy makes the leading factor one. Divide the numerator sum by $P_{H,t}^{\epsilon_p}$ to define K_t^p and the denominator sum by $P_{H,t}^{\epsilon_p-1}$ to define L_t^p. Separating current from future profits and splitting the price index and dispersion integrals between resetting and nonresetting firms gives

$$\begin{aligned}
K_t^p &= \nu_t P_{H,t}mc_tY_t + \beta\theta_p\Pi_{H,t+1}^{\epsilon_p}K_{t+1}^p,\\
L_t^p &= \nu_t P_{H,t}Y_t + \beta\theta_p\Pi_{H,t+1}^{\epsilon_p-1}L_{t+1}^p,\\
p_t^{\#} &= K_t^p/L_t^p,\\
1 &= \theta_p\Pi_{H,t}^{\epsilon_p-1} + (1-\theta_p)(p_t^{\#})^{1-\epsilon_p},\\
\Delta_t^p &= \theta_p\Pi_{H,t}^{\epsilon_p}\Delta_{t-1}^p + (1-\theta_p)(p_t^{\#})^{-\epsilon_p}
\end{aligned} \tag{93}$$

The auxiliary sums K_t^p, L_t^p are present values of price-setting terms, not assets. Their discounted definitions select the nonexplosive recursions.

F Welfare decomposition across horizons

F.1 Production and the domestic wedge

Consider a policy variation at a given oil-price path and investor mandate. Fixed export quantities imply $dY_t = dC_{H,t}$. Constant returns and cost minimization give

$$\frac{W_t}{P_{H,t}}\, dN_t + \frac{S_t P_t^O}{P_{H,t}}\, dX_{E,t} = mc_t\big(\Delta_t^p\, dC_{H,t} + Y_t\, d\Delta_t^p\big) \tag{94}$$

Household goods conditions value domestic consumption at $\nu_t P_{H,t}$ and imported spending at $\lambda_t = S_t \nu_t$. Labor optimality values dN_t at $\nu_t W_t$, whether disutility is linear or convex. Thus

$$du_t = \nu_t P_{H,t}\, dC_{H,t} + \lambda_t\, d(C_{M,t} + P_t^O C_{E,t}) - \nu_t W_t\, dN_t$$

Use (94), and substitute

$$dNX_t = -d(C_{M,t} + P_t^O C_{E,t}) - P_t^O\, dX_{E,t}$$

This proves (56). The identity does not assume optimal policy, zero inflation, or a slack intermediary limit. It describes a policy variation at fixed shocks; differentiating the oil shock itself would add a direct oil-price term.

F.2 External payments and the financial wedge

For periods $0, \ldots, T$, summing the differentiated external budgets gives

$$\begin{aligned}\sum_{t=0}^{T} \beta^t \lambda_t\, dNX_t = &\sum_{t=0}^{T-1} \beta^t (\lambda_t - \beta r \lambda_{t+1})\, dA_t + \beta^T \lambda_T\, dA_T + \lambda_0 V_{-1}\, dR_0^B \\ &+ \sum_{t=0}^{T-1} \beta^{t+1} r \lambda_{t+1} [V_t\, d\psi_t + \psi_t\, dD_t]\end{aligned} \tag{95}$$

Initial portfolios are held fixed, so $dA_{-1} = dV_{-1} = 0$; their first-period return can change. In later periods $dR_{t+1}^B = r\, d\psi_t$ and $dV_t = dD_t$. With fixed mandates and $\bar{G}$, $dA_t = dR_t - dD_t$. Substitute these identities and (54) into (95), then use (56). The exact welfare

derivative is

$$
\begin{aligned}
d\mathcal{W}_{0:T} = & \sum_{t=0}^{T} \beta^t \nu_t P_{H,t}[(1 - mc_t \Delta_t^p) dC_{H,t} - mc_t Y_t \, d\Delta_t^p] \\
& + \sum_{t=0}^{T-1} \beta^{t+1} r \lambda_{t+1} [\psi_t (-dR_t) - V_t \, d\psi_t] \\
& - \lambda_0 V_{-1} \, dR_0^B - \beta^T \lambda_T \, dA_T
\end{aligned} \tag{96}
$$

The first line contains domestic production and price dispersion. The second contains financing and foreign payments. The last line contains inherited valuation and the boundary position. In the infinite horizon the boundary disappears under the corresponding marginal transversality condition. In a finite numerical prefix it must be retained and combined with continuation welfare.

For the two-period economy, set $T = 1$, $dA_1 = 0$, $P_{H,t} = 1$ and $\Delta_t^p = 1$. Since $-dR_0 = dZ_0$ and $\beta r = 1$, equation (96) first gives the general two-wedge decomposition in Appendix D. Fixing the two monetary settings then makes $dC_{H,0} = dC_{H,1} = 0$ and yields (35). In the infinite-horizon economy, $-dR_t = \sum_{j=0}^{t} dZ_j$: a reserve sale changes future reserve stocks, not only its current flow.

F.3 A feasible intervention test

At a constrained monetary-only optimum, the derivative along an admissible monetary variation cannot be positive. Adding FXI admits additional directions. If one of them has a positive complete derivative in (96), a sufficiently small feasible intervention raises welfare. The criterion uses all terms, including inherited valuation, price dispersion and portfolios carried forward; it does not identify the premium alone with a welfare loss.

I evaluate such a direction at the newly solved monetary-only plans by retaining their first 24 interest rates and subsequent Taylor rule, and introducing a small first-quarter reserve sale. The exact derivatives are positive for both shock configurations. Six successively smaller interventions in each case converge to the derivative in independently solved private equilibria. The welfare identity agrees with direct utility differentiation to 5×10^{-14}, and extrapolated finite-difference derivatives agree to 6×10^{-7} in derivative units. These checks isolate the mechanism; the main tables compare separately optimized policy plans.

Under these fixed-rate variations, inherited valuation contributes positively and price dispersion negatively to the total derivative. A fixed rate in the infinite-horizon economy with Calvo pricing does not hold both periods' domestic spending fixed, as the finite monetary-direction test does. The positive net derivative is therefore the relevant connection between the two models, not an assertion that every component has the same sign.

G Numerical implementation and policy comparisons

G.1 Solution, continuation and welfare

For each shock, I solve the nonlinear commitment problem over the 24-quarter control window, first with 144 and then with 288 explicit equilibrium quarters, extending to 576 when the horizon check requires it. Candidate plans allow different quarters of binding and slack intermediary capacity. Each candidate retains household and firm optimality, the external budget, and all policy and portfolio constraints. Cold starts, independently generated private equilibria and neighboring capacity patterns are compared before retaining the highest verified welfare among the candidates. The checks establish feasibility and local stationarity; they do not require global concavity.

The selected controls are imposed in an independent private-equilibrium solution. Rates follow the stated Taylor rule after quarter 23 and intervention stops, while the economy carries forward its actual assets and price distribution. The distant continuation uses the stable transition and its local curvature around the reference allocation. The nonlinear equilibrium is replayed over 840 and 1,680 quarters, extending to 3,360 when needed for welfare accuracy. No reserve stock, bond position or consumption allocation is reset at the policy-window boundary.

The benchmark checks cover eight paths: two shocks under Taylor, monetary-only, immediate joint and delayed joint policies. Separate household, public and external budgets, intermediary optimality, policy bounds, and positive household and central-bank bond holdings are checked at transaction prices. The admitted equilibrium and accounting errors are below 2×10^{-8}. At the final pair of horizons, the optimization comparison and independent replay agree within 2×10^{-7} CE bp; extending the private equilibrium changes welfare by less than 10^{-8} CE bp.

The monetary-coordinate identity is checked independently on each path. With log consumption, nominal expenditure satisfies

$$I_t = \frac{P_{t+1} C_{t+1}}{\beta P_t C_t}$$

Computing the right-hand side directly from consumption and consumer prices reproduces the policy rate to numerical precision on all eight paths. Expressing the same rate restrictions through this Euler equation leaves the quantitative policy set unchanged; it does not make expenditure levels additional policy instruments.

G.2 The value of intervening in the first quarter

Let $v(c)$ be the highest welfare attainable when the first reserve sale is restricted by $Z_0 \leq c$, while later decisions are optimized. Because opening reserves are at their ceiling, the first

operation cannot be a reserve purchase. Consequently

$$v(0) = \mathcal{W}_{\text{delayed}}, \qquad v(\bar{Z}) = \mathcal{W}_{\text{joint}}$$

The feasible sets are nested. On a regular optimizing branch the multiplier on $c - Z_0$ is $v'(c)$; if v is absolutely continuous, the utility cost of delay is

$$\mathcal{W}_{\text{joint}} - \mathcal{W}_{\text{delayed}} = \int_0^{\bar{Z}} v'(c)\, dc$$

This is a property of the quantitative policy menus, not a separate three-period economy. The positive cost of delay in the combined experiment means that excluding first-quarter reserve trades removes useful feasible allocations even though the central bank can promise later intervention.

G.3 Reported quantities and provenance

Consumption and exchange-rate responses are percentage changes from the common stationary reference, with the domestic price level accumulated from domestic inflation. Annualized rate and inflation changes are four times their quarterly log changes, in percentage points. The premium is the quarterly holding return relative to r, in basis points. Reserve sales, intermediary positions and transaction flows are divided by fixed reference value added Y^v; their denominator is not current GDP.

The main-text policy tables and quantitative response figures are generated from these eight newly solved paths and their discounted utility. The financing decomposition reconstructs net exports, current bond prices and exchange rates and verifies the signed stock-flow identity before rounding. Intermediary income is foreign in the baseline, with no separate private-fee deduction from household welfare. The additional policy solutions in Appendices I, J and K retain the same control window and pass the same independent budget, constraint and continuation checks.

H Production coefficients and reporting units

The production function in (8) is the conventional CES form. A benchmark-input representation is an equivalent parameterization, widely used when calibrating input shares; see Klump et al. (2011). To match reference factor prices and quantities, choose

$$\begin{aligned} \mu &= \frac{\bar{P}_E \bar{X}_E^{1/\nu_E}}{\bar{W}\bar{N}^{1/\nu_E} + \bar{P}_E \bar{X}_E^{1/\nu_E}}, \\ A &= \frac{\bar{Y}}{\left[(1-\mu)\bar{N}^{(\nu_E-1)/\nu_E} + \mu \bar{X}_E^{(\nu_E-1)/\nu_E}\right]^{\nu_E/(\nu_E-1)}} \end{aligned} \tag{97}$$

The first equality matches the marginal-product ratio to $\bar{W}/\bar{P}_E$; the second matches gross output. The resulting cost share is

$$\frac{\bar{P}_E \bar{X}_E}{\bar{W}\bar{N} + \bar{P}_E \bar{X}_E} = \frac{\mu^{\nu_E} \bar{P}_E^{1-\nu_E}}{(1-\mu)^{\nu_E} \bar{W}^{1-\nu_E} + \mu^{\nu_E} \bar{P}_E^{1-\nu_E}}$$

With $\bar{Y} = \bar{P}_E = 1$, $\bar{X}_E = 0.03999345$, $\bar{N} = 0.99962689$, $\bar{W} = 0.96036488$ and $\nu_E = 0.4$, this gives $\mu = 0.0003332700$ and $A = 1.02773882$. These coefficients reproduce the same technology, input demands and marginal cost as the benchmark-input representation. Reference inputs are calibration observations, not additional states or constraints on production.

The model uses foreign-good units for $F_t, D_t, R_t, A_t, \bar{G}, Z_t$ and NX_t. Numerical storage and reported tables use these quantities divided by Y^v, the fixed reference value added defined in Section 7. Multiplying a stored position by Y^v recovers the model quantity. In particular, a slope of 0.001 with a GDP-normalized intermediary position corresponds to $\gamma = 0.001/Y^v$ in (13). All stock and intervention bounds are converted by the same factor; rates, premiums, choices and welfare do not change. This conversion keeps a change in current GDP from mechanically altering a reported financing flow.

I Financial calibration and sensitivity

I.1 Foreign-held bond duration

The duration target uses the 41 government securities in the March 2025 Fully Accessible Route holdings reported by Department of Economic Affairs (2026). I match each security by its International Securities Identification Number to the coupon, maturity, price and duration in Clearing Corporation of India Limited (2025). A security's portfolio weight is its foreign face holdings multiplied by its price including accrued interest, divided by the corresponding total across all securities. Weighting the published modified durations by these shares gives 5.344032 years. Reconstructing coupons and principal at the observed prices gives the same result to the precision of the published durations. This aggregation allows foreigners to hold bonds of different maturities and coupons while the model retains one representative bond.

CCIL values the bonds at March 28 prices with April 2 as the settlement date for duration. Modified duration measures the proportional price response to an annual yield change; Indian government-bond yields use semiannual compounding (Reserve Bank of India, nd). Let y denote that annual yield. At the model's quarterly gross reference return r,

$$\bar{Q}^B = \frac{1}{r - \delta_B}, \qquad y = 2(r^2 - 1), \qquad -\frac{\partial \log \bar{Q}^B}{\partial y} = \frac{1}{4r(r - \delta_B)} \tag{98}$$

Equating the last expression to 5.344032 gives $\delta_B = 0.9571056764$. The reference return is unchanged, and the same modified duration enters the marginal risk calculation in Section 7. Portfolio weights are used to measure duration; the total foreign stock and the institutional split retain their separate data constructions.

I.2 Interior compensation and position capacity

The interior premium slope and the position limit use different evidence. To map the estimated financial coefficient in Lindé et al. (2024), consider the deterministic return equation of its underlying model, Chen et al. (2023), suppressing its other financial wedges. In their notation let b^F denote a position relative to quarterly GDP and Γ the market-depth coefficient. Their return equation implies

$$\psi = \frac{\Gamma b^F}{1 - \Gamma b^F}, \qquad \left.\frac{\partial \psi}{\partial b^F}\right|_{b^F=0} = \Gamma$$

I transfer this local zero-premium slope to the model's normal position: $\gamma Y^v = \Gamma$. The benchmark uses the India deep-market estimate 0.001; 0.059 is the shallow-market sensitivity. This is a local-slope calibration rather than an equivalence of the two financial models.

The capacity construction in Section 7 holds other investments and hedges fixed and applies the unused investment risk budget to additional unhedged government bonds. The reported sensitivity has a negative sign for a rise in yields; the calculation uses its magnitude. The investment portfolio's existing risk per rupee need not equal that of the added bonds. As an alternative, suppose marginal bonds use the same risk per rupee as the existing portfolio. The resulting headroom is

$$\frac{D^{\max} - \bar{D}}{\bar{D}} = \frac{24{,}500}{17{,}501.34} - 1 = 0.3998928$$

Both mappings use the same investment-risk disclosure (Société Générale, 2025) and the same 8.48682% government-bond split (Central Depository Services (India) Limited, 2025). The proportional-risk alternative permits more absorption; removing the ceiling leaves the quadratic fee as the only intermediary trading friction. These comparisons keep the real calibration, shock paths and policy restrictions fixed and reoptimize every policy.

FXI improves on monetary policy alone in each specification. Capacity mainly changes the size and timing of that benefit. With the normal-market slope and no ceiling, the oil-only gain is 0.000733 CE bp and its delay cost is below 0.000001 CE bp. The corresponding combined-shock gain is 0.000752 CE bp. A steeper fee preserves an intermediation motive even without the hard limit, but the delay losses remain much smaller than with the benchmark capacity. The effect of the ceiling is therefore evaluated separately from the normal marginal compensation slope.

Table 7: Financial calibration and policy gains

		Oil only		Combined shock	
Headroom	Slope	Gain	Delay	Gain	Delay
23.17%	0.001	0.00740336	0.00134381	0.01147905	0.00663117
23.17%	0.059	0.00739718	0.00134165	0.01198998	0.00668619
39.99%	0.001	0.00724255	0.00104010	0.01119481	0.00640080
39.99%	0.059	0.00722456	0.00102856	0.01164365	0.00645209
No limit	0.001	0.00073256	0.00000019	0.00075222	0.00000196
No limit	0.059	0.00423245	0.00001137	0.00488535	0.00011348

Permanent consumption-equivalent basis points. Gain compares joint with optimized monetary policy; delay compares immediate with delayed joint policy. The slope is γY^v, for positions in quarterly-GDP units. Headroom is relative to the normal intermediary position. All intermediaries are foreign-owned.

J Domestic and foreign intermediaries

Let a share $s \in [0,1]$ of the unit mass of intermediaries be domestically owned, as in the ownership distinction in Cavallino (2019); Fanelli and Straub (2021); Basu et al. (2025). Both groups face the same funding rate, fee schedule and position limit. Their problem and optimality conditions, (13)–(14), are unchanged. Domestic fee receipts are rebated lump sum to households, so the fee affects private choices without entering household welfare as a resource loss.

Domestic households now receive intermediary earnings. In the infinite-horizon household budget, (39), replace the final income term by

$$S_t\big[(r-1)\bar{G} + s(R_t^B - r)D_{t-1}\big] \tag{99}$$

The same addition $sS_t(R_t^B - r)D_{t-1}$ enters each two-period household budget. Predetermined capital income remains consolidated with $\bar{G}$ under the existing accounting convention. The foreign-owned domestic bond position and external accounts become

$$V_t = F_t + (1-s)D_t, \qquad A_t = R_t + \bar{G} - F_t - D_t, \tag{100}$$

$$A_t = rA_{t-1} + NX_t - (R_t^B - r)\big[F_{t-1} + (1-s)D_{t-1}\big] \tag{101}$$

The full intermediary position still enters A_t: domestic intermediaries also borrow abroad. Only the foreign-owned share of their excess return leaves the economy. Domestic bond clearing continues to include $F_t + D_t$; measured foreign bond holdings in (58) instead use $B_t^{ext} = B_t^F + (1-s)B_t^D$.

Table 8 compares policies at three ownership shares. Total intermediary capacity, normal positions, direct investors' mandate, shocks and policy bounds are unchanged; each policy is optimized for its ownership share. Reference foreign-held domestic debt consequently falls with s, while reference total intermediary funding and net foreign assets remain fixed.

Table 8: Ownership and the welfare gain from FXI

Domestic ownership	Oil only	Combined shock
0%	0.007403	0.011479
50%	0.007057	0.010524
100%	0.006719	0.011643

Permanent consumption-equivalent basis points: joint policy relative to optimized monetary policy alone. Under Taylor policy, the oil-only premium rises above zero during the adjustment at each ownership share; it is slightly negative in the first quarter.

The oil-financing channel and the welfare gain from FXI survive at every tested share. Figure 6 shows that the combined-shock cost of waiting falls as domestic ownership increases. More of the higher return promised without immediate intervention goes to domestic households. Waiting still requires the initial trade to clear with scarce capacity, changing consumption, prices and subsequent financing even when all intermediary earnings stay at home. The decline shown is a result of the reoptimized policy comparisons, not an implication of ownership accounting alone.

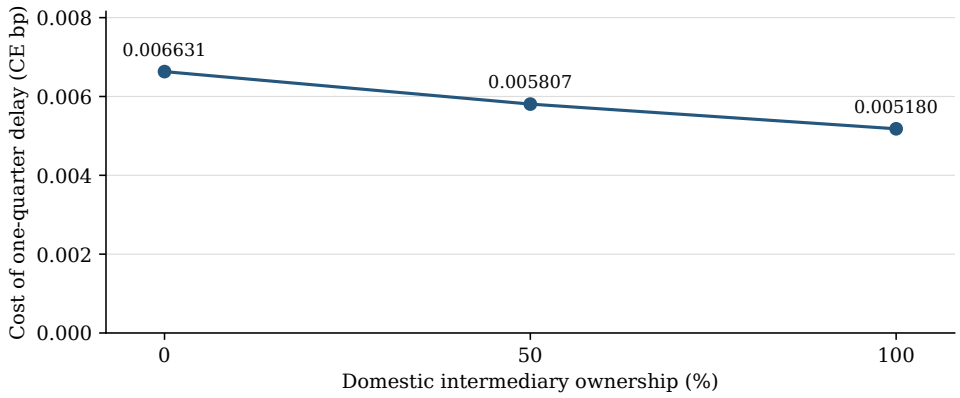

Figure 6: Domestic ownership lowers the cost of waiting

Combined shock. Welfare under immediate joint policy minus welfare under joint policy delayed by one quarter, in permanent consumption-equivalent basis points. Markers show the three solved ownership shares; lines connect them. Rates can respond immediately under both policies.

K Responsive exports

To allow trade to adjust, replace fixed export contracts in the infinite-horizon economy with constant-elasticity foreign demand for the domestic composite, following the export-demand specification in Yakhin (2025):

$$X_t = \bar{X}\left(\frac{S_t}{P_{H,t}}\right)^{\epsilon_X}, \qquad \text{foreign export receipts} = \frac{P_{H,t}}{S_t}X_t, \qquad \epsilon_X > 0 \tag{102}$$

The reference relative price is one. Exports use the same domestic varieties, labor and imported oil as domestic consumption, and goods clearing and net exports become

$$Y_t = C_{H,t} + X_t, \qquad NX_t = \frac{P_{H,t}}{S_t} X_t - C_{M,t} - P_t^O (C_{E,t} + X_{E,t}) \tag{103}$$

Export sales receive the domestic producer price, so combined producer and exporter revenue is $P_{H,t} Y_t$. The Calvo conditions retain their form with this total demand. The external budget, financial sector, policy restrictions and all other calibrated parameters are unchanged; intermediaries are fully foreign-owned.

I use $\epsilon_X = 13/3$, the foreign-demand elasticity in Yakhin (2025), as a sensitivity rather than an estimate for India. Depreciation raises export quantities and, at this elasticity, foreign receipts. Producing those exports also requires imported oil. Export pricing introduces a terms-of-trade policy motive, so I solve monetary-only and joint policy both with and without the oil shock.

Table 9: Policy gains with responsive exports

	Consumption fall (%)		Welfare gain
Export specification	Monetary alone	Joint	(CE bp)
Oil only			
Fixed contracts	0.456	0.263	0.007403
Responsive exports	0.858	0.675	0.003249
Combined shock			
Fixed contracts	1.077	0.664	0.011479
Responsive exports	1.416	1.140	0.004319

Consumption falls in the first quarter, in percent; welfare gains are permanent consumption-equivalent basis points for joint policy relative to optimized monetary policy alone. Intermediaries are fully foreign-owned. Within each experiment, export specifications use the same shocks and policy bounds.

FXI continues to cushion consumption and raise welfare relative to monetary policy alone in both experiments (Table 9). For the oil-only shock, the peak premium under Taylor policy falls from 36.01 to 10.69 quarterly basis points, but the capacity limit still binds during the adjustment. The no-shock joint-policy gain with responsive exports is 0.000153 CE bp. Subtracting that utility difference before converting to consumption equivalents leaves an additional oil-event gain of 0.003097 CE bp. Thus export adjustment reduces, but does not eliminate, the oil-only value of FXI in this comparison. The additional gain includes the interaction of financing and the terms of trade; it is not a separate measure of either mechanism. The combined-shock gain is 0.004319 CE bp. Fixed export contracts remain a distinct benchmark because they fix both quantities and foreign receipts.