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Bonds Wrap

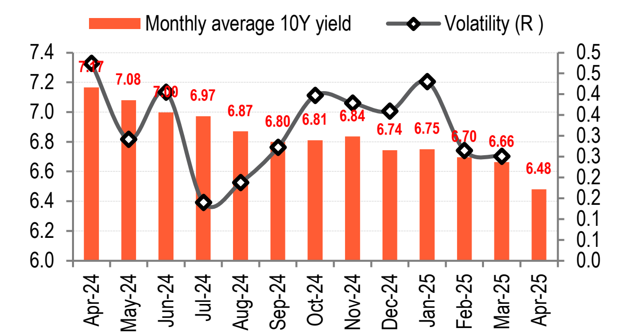
India's 10Y yield is again heading southward at a sharp pace. In this context, we chart out what has influenced its trajectory in FY25 and what are the factors that would contribute to the direction of yields going forward. We expect downward bias in yields to persist supported by risk off sentiments amidst heightened tariff turmoil. Apart from this, favourable interest rate spread with the US will attract capital flows especially in the debt segment. RBI's measures will ensure that liquidity will be supportive of an orderly evolution of the yield curve. We expect India's 10Y yield to trade between 6.25-6.55% in FY26.

How India's 10Y yield have moved in FY25:

The trajectory of India's 10Y yield in FY25 has been interesting. It almost saw a precipitous fall. The start of FY25 was marked by some bit of stickiness in yield as in Apr'25 US 10Y yield has risen by 48bps itself on account of stickier inflation data and tight labour market conditions. The same was reflective in India's 10Y yield, which remained elevated during the same period. However, post that supportive US 10Y yield with Fed stepping on to the rate cut cycle much earlier than RBI has favoured domestic yield. This coupled with India's inclusion to global bond indices (official date of inclusion: 28 Jun) and a prudent fiscal framework all kept yields rangebound. The liquidity conductions also remained conducive except for the latter part of the year. However, the impact of it on yields was largely capped supported by RBI's increased demand for securities through OMOs. A lot of factors impacted the movement of India's 10Y yield in FY25, which is illustrated below:

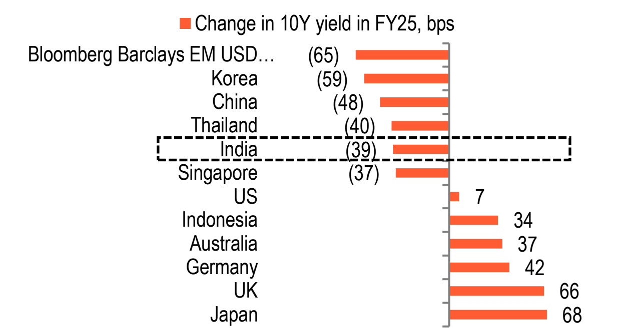
1. **Direction of global yields:** In line with major emerging markets (EMs), India's 10Y yield witnessed sharp fall. **Fig 2** reflects that risk-off sentiment (election year) amidst anticipation of the direction of Fed policy rate has led to higher demand for sovereign asset class. For India, higher flows through the FAR route also corroborated with fall in yield (explained in later section). However, for major advanced economies, rates broadly remained sticky. In UK, higher borrowing kept yields elevated. For Germany, much of the increase is attributable towards the latter part of the fiscal on account of parliament's approval for higher borrowing to fund defence spending. In Asia, Japan stood out as an anomaly supported by a recourse to rate hike, as part of policy normalization ending the regime of ultra-low rates. Thus, its yield in turn reflected the stickiness.

Figure 1: India's 10Y yield trajectory in FY25…



Source: Bloomberg, Bank of Baroda Research, Data till 4 Apr 2025

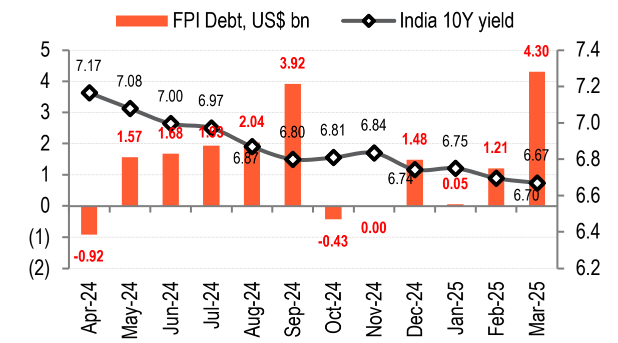
Figure 2: …Comparison with global yields



Source: Bloomberg, Bank of Baroda Research, FY: Mar'25 over Mar'24 (avg. basis)

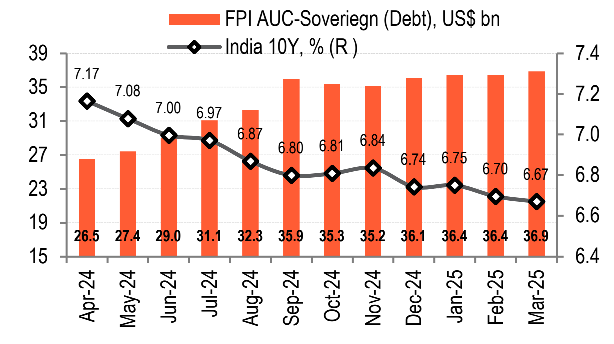
2. **Movement of India's 10Y yield and FPI-Debt flows:** FPI debt flows have gathered momentum since post announcement of India's inclusion to JP Morgan Global Bond Index. Further India's buoyant growth story leveraged sentiments of foreign investors at a time when still some degree of uncertainty prevailed over outlook of global economy. Volatility in DXY and US treasury yield also act as a catalyst for more flows into Indian debt market. Notably, AUCs of sovereign has picked up sharply to Rs US$ 36.9bn as of Mar'25 compared to US$ 26.5bn in Apr'24. (**Fig 3 and 4**).

Figure 3: FPI debt flows and India 10Y yield trajectory…



Source: Bloomberg, Bank of Baroda Research

Figure 4: …FPI AUC in Sovereign debt class



Source: Bloomberg, Bank of Baroda Research

JP Morgan has included 23 securities for inclusion to begin with. Tracking FPI investment in FAR securities gives a clue of the monthly flows ostensibly on account of their inclusion. This is apart from other exogenous flows. The FPI investment in these FAR securities has picked up considerably to Rs 2.2 lakh crore as of Mar'25 compared to Rs 1.3 lakh crore as of Apr'24. This has also remained favourable for India's 10Y yield in FY25. Going ahead, we expect the momentum to persist.

Table 1: FAR positions and yield

Figures in Rs lakh crore	FAR outstanding position	FPI investment	Change in FPI investment	India 10Y yield (%)
Apr-24	32.4	1.3	-0.02	7.2
May-24	32.7	1.3	0.04	7.1
Jun-24	33.2	1.4	0.13	7.0
Jul-24	33.5	1.6	0.16	7.0
Aug-24	33.7	1.7	0.16	6.9
Sep-24	34.0	1.9	0.13	6.8
Oct-24	33.9	1.9	-0.01	6.8
Nov-24	33.9	1.8	-0.03	6.8
Dec-24	33.9	1.8	0.01	6.7
Jan-25	33.9	1.9	0.06	6.8
Feb-25	33.9	2.0	0.10	6.7
Mar-25	33.9	2.2	0.18	6.7
Apr-25*	33.9	2.2	-	6.5

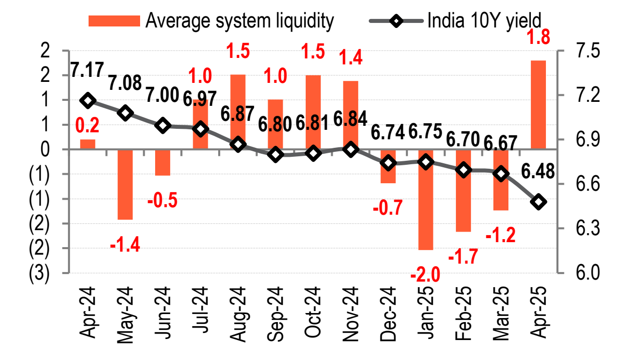
Source: NSDL, Bank of Baroda Research,* Data till 3 Apr 2025

3. **Movement of India's 10Y yield and domestic liquidity:** The evolution of domestic liquidity in FY25 has been interesting with RBI resorting to daily as well as durable liquidity management. Measures for pumping durable liquidity came into place towards the latter part of the year

when sticky dollar impinged on INR. However, India's 10Y yield was supported on account of robust demand conditions from banks, mutual funds (MFs) and pension funds (PFs). However, deteriorating system liquidity impacted overnight rates more (call rates showed for reference in **Fig 6**) compared to sovereign yield. **Fig 6** shows how the spread between Repo and call widened in times of turbulence on liquidity.

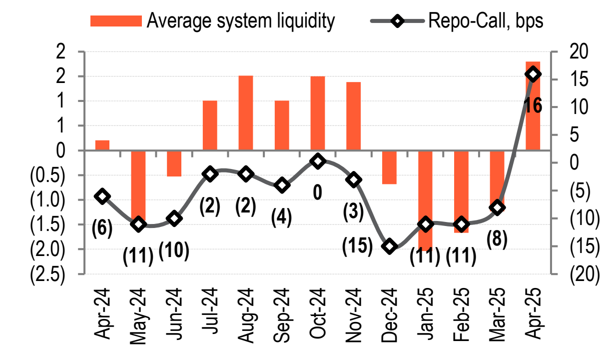
RBI's measures have effectively handled the deficit situation. In H1 we expect liquidity to be comfortably placed. Factors which will contribute towards the same are **1)** Government spending will be on course this time with no Election constraint. **2)** Dollar volatility to be largely capped. DXY has fallen by -4.3% in CYTD25 (Till 2 Apr). Thus, we feel it will be supportive of rupee liquidity in the near term. **3)** Seasonal correction in banking liquidity. Currently the gap between incremental deposits and borrowings net of incremental credit and investment is at (-) Rs 1.3 lakh crore as of 7 Mar 2025 which has seen slight improvement from the previous fortnight of (-) Rs 1.7 lakh crore. The challenge will be pickup in deposit growth in a softer policy space. However, range bound credit growth will help in maintaining the gap at a comfortable level. Taking all these factors into account, we expect liquidity to be in surplus of ~ 0.3-0.5% of NDTL in the near term.

Figure 5: System Liquidity and 10Y yield…



Source: Bloomberg, Bank of Baroda Research, Data till 4 Apr 2025

Figure 6: …System liquidity and call spread over repo



Source: Bloomberg, Bank of Baroda Research, Data till 4 Apr 2025

Table 2: Liquidity tools of RBI

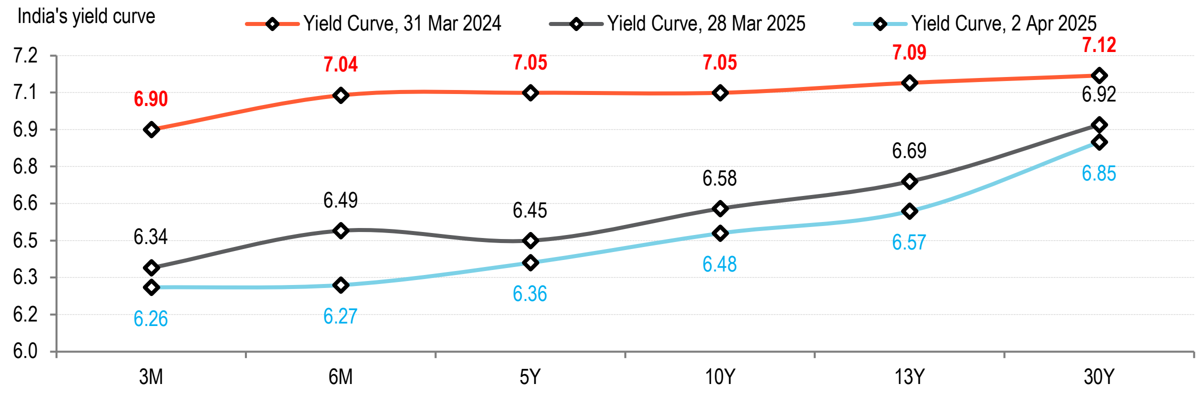
Liquidity injection since 15 Jan 2025 (Rs crore)	Notified amount
VRRs	**60,15,000**
Less than equal to 14 days	58,15,000
above 14 days	**2,00,000**
OMOs	
Auction	3,30,000
Secondary	2,38,845
INR USD swap	**2,16,458**

Source: Bloomberg, Bank of Baroda Research, data till 4 Apr 2025, 15 Jan has been chosen since that day onwards RBI started the daily conduct of VRRs

How India's yield curve has emerged in FY25:

Fig 7. Shows India's yield curve witnessed significant downward shift in FY25, and the pace is continuing this fiscal as well. In FY25, short-end part of the curve witnessed significant correction while long end yields remained range bound. This has increased the gap between long end and short end (30Y -3months paper) to 58bps as on 31 Mar 2025 which was just 22bps in the previous financial year. Despite tight liquidity, government moves such as redeeming short term debt have supported yields towards this segment. In FY26, we expect a similar steepness to continue as some stickiness in short end part might be witnessed due to higher supply of papers while long end yields will show downward bias.

Fig 7: Movement of India's yield curve

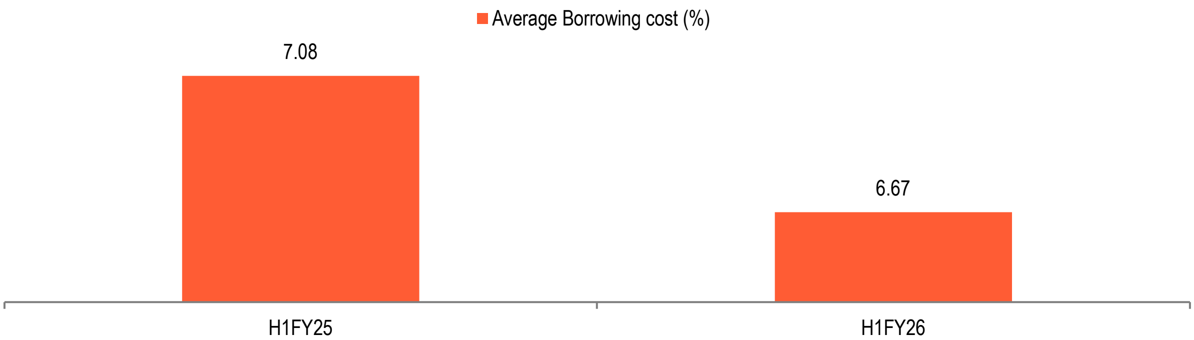


Source: Bloomberg, Bank of Baroda Research

Average borrowing cost:

As seen from the cut off yield of auction, average borrowing cost calculation as total interest expense to total amount of papers issued for the financial year, is expected to soften significantly in H1FY26 compared to same period of previous year.

Fig 8: Movement of Borrowing cost



Source: RBI, Bank of Baroda Research

Outlook on 10Y yield:

- India's 10Y yield headed southwards in a steady manner throughout FY25. The narrative started with sharp fall in US 10Y yield at the beginning of FY25, with frontloading of rate cut by Fed far ahead of the RBI cycle. The second important driver of domestic yield has been India's phased increase in weight in global bond index which has garnered significant FPI flows especially through the FAR route. Other factors such as buoyant demand conditions, especially from Banks, MFs and PFs, have also supported yields especially in an environment where system liquidity remained tight. Government's finely tuned borrowing program with more supply of securities towards the short end hints at keeping the long part of India's yield curve broadly stable. Further, the continuous adherence to the fiscal roadmap has also boosted investor confidence. In FY26 we remain bullish on yield. We expect India's 10Y yield to trade in the range of 6.25-6.55% in FY26, with downward bias. Favourable liquidity conditions, higher tilt towards risk-off biased sentiments and easier monetary conditions by RBI will allow it to trade with a downward bias.

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