



Nippon **india** Mutual Fund

Wealth sets you free

Fixed Income

Market Outlook

June 2026



Fixed Income Market Update and Outlook

Market Update

Delay in War Resolution and Changing Central Bankers' Reaction Function

The Iran war resolution continued to remain elusive, although both the parties agreed to come to compromise. Three months into war, the global central bankers (CBs) have raised concerns about upside risk to inflation, with some CBs either have already started hiking rates (Indonesia) or given forward guidance (ECB) in that direction. Crude Oil eased in May although the absolute lvl continued to remain elevated at US\$100 plus.

India

Monetary:

In early Jun'26 policy, the RBI preferred to remain cautious and hold policy rates and monetary stance unchanged (In line with Consensus). RBI projected FY27 growth to remain resilient at 6.6%/y (Apr'26 policy: 6.9%/y) and has upwardly revised inflation projection to 5.1%/y (Apr'26 policy: 4.6%/y) on war uncertainty and El Nino concerns. Addressing the foreign capital flow issue and pressure on INR, the RBI announced slews of measures to boost capital flows through FPIs in debt, NRI deposits and ECBs etc.

Fiscal:

FY26 Fiscal deficit came in line with revised estimate (RE) at 4.4% of GDP. This was despite shortfall in tax collection and downward revision in FY26 nominal GDP number. Improvement in the fiscal deficit was achieved through a). Lower Revenue expenditure (primarily through lower interest payment); b). Lower capex than RE. Note, capital expenditure growth was tepid at 1.6%/y (Lower than RE: 4.2%/y).

Latest trend indicates that the Apr 2026 Fiscal deficit stood at 21% of BE FY27 (~12% in previous yr). This was due to Robust expenditure (Revenue & capex), while non-debt receipts languish due to adverse base effect (non-tax receipts & non-debt capital receipts) and muted tax collections.

Inflation:

Apr'26 CPI inflation rose marginally to 3.48%y/y (March 2026 at 3.40%y/y; Consensus: ~3.80%y/y). The rise in monthly print was driven primarily by seasonal pick-up in sequential momentum (+ve 27 bps), while base effect continued to remain supportive. Market Core inflation (excludes food, fuel) rose marginally to 3.40% y/y (Avg Jan-March 2026 ~3.4% y/y). Core-core inflation (excludes petrol, diesel gold etc) stood at 2.2% y/y (Avg Jan-Mar 2026 ~2.1% y/y).

Foreign Trade:

In Apr'26, the trade deficit widens to US\$28 bn (After declining to ~US\$21 bn decline in Mar 2026). Both exports (oil & core) and imports (gold and core) grew double digit on the annual basis. During similar period, the net services exports grew at robust ~17%y/y despite adverse base effect.

Liquidity:

Monthly average system liquidity in May 2026 moderated to ~Rs. 1.7 trn from robust ~Rs. 3.9 trn in Apr 2026 on seasonality (higher cash demand, lower govt spending). Core Liquidity by May end likely to have improved to ~Rs. 5 trn from ~Rs. 3 trn at April end driven by record high RBI dividend (~Rs. 2.9 trn).

Foreign Flows:

Iran war continue to result in the net FPI outflows from the peak of ~US\$14 bn in March, US\$7.5 bn in April 2026 to relatively lower US\$3 bn outflows in May 2026. YTD FPI outflows in the calendar year 2026 stood at US\$23 bn (as against outflow of US\$12bn in CY25).

Currency:

After depreciating by 4%m/m & ~0.6%m/m by March end & Apr end 2026 respectively, INR depreciated marginally by 0.15%m/m by May end. INR stood on an average 95.6 against dollar (Apr 2026: 93.60). YTD Calendar year 2026 INR has depreciated by ~6% driven primarily by the geopolitical concerns.

Yield Levels & Spreads:

After remaining elevated in April, the G-sec yield continued to remain high in May on crude prices, INR pressure and FPI outflows. 10 yields moved in the narrow range of 6.92%-7.08% (March range: 6.87%-7.05%). It closed the month marginally lower at 6.98% (Feb 2026: 6.66%; Mar 2026: 7.00%; Apr 2026: 7.01%).

Taking cues from G-sec, SDL yields moved up and remained elevated on non-resolution of war and higher supply. 10-year SDLs moved in the range of 7.64%-7.83% (Prior month: 7.58%-7.77%). It closed the month high at 7.72% (Feb 2026: 7.37%, Mar 2026: 7.61%; Apr 2026: 7.68%). The average spread between 10 yr SDL over G-sec stood higher at 72 bps during the month (Feb 2026: 75 bps, Mar 2026: 72 bps; Apr 2026: 68 bps).

Similarly, 10-year AAA bond yields moved in the range of 7.60%-8.00% (Prior month: 7.57%-7.76%) and closed the month higher at 7.83% (April 2026: 7.71%).



Global

Financial Markets:

UST yield continued to rise and remain volatile in May 2026 on non-resolution of Iran war, fiscal and inflation concerns and expectation of rate hike. 10 yr UST close the month higher at 4.45% (Feb 2026: 3.97%; Mar 2026: 4.35%; Apr: 4.40%).

After depreciating ~2.4% m/m in Apr on geopolitical concerns, DXY appreciated by ~0.9% m/m in May 2026 on non-resolution of Iran war. Calendar year till date the DXY has appreciated by ~0.6%.

After surging by ~46% m/m in Mar 2026 & ~14% m/m in Apr 2026, the crude oil declined by ~9% m/m in May 2026 on expectations of early resolution on Iran war. The average crude oil stood at US\$107/ barrel (Avg. lvl in Mar 2026: US\$103/barrel; Apr 2026: US\$117/barrel).

Market View

- » Going forward, unless there is resolution on Strait of Hormuz status, the financial, currency and commodity markets may be likely to remain volatile, although general expectations of resolution in coming weeks. In this context, crude price and INR movement may be closely watched.
- » Development on the supply chain front is likely to impact inflation, growth, currency, foreign flows and accordingly influence the policymakers (fiscal and monetary) responses.
- » Apart from the crude prices and INR movement, the yields may likely to be influenced by development of monsoon front on back of El Nino concerns.
- » In early June monetary policy (5th Jun'26), the RBI preferred to remain "prudent to wait for greater clarity to emerge" while acknowledging deterioration in inflation, growth & capital account. Policy also removed the additional risk premium demanded by the market for likely knee-jerk reaction of central bank.
- » Foreign exchange measures undertaken in policy are primarily stop-gap arrangements to address currency concern. Over next 6-12 months, if macro-stability parameters do not improve, we may expect 50-100 bps rate hike.

Common Source:

RBI, CSO, FAO, CEIC, NSO, US Federal Reserve, US Treasury department, Commerce Ministry of India, Finance Ministry of India, Mospi, NIMF Internal Research.

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