



Nippon **india** Mutual Fund

Wealth sets you free

Fixed Income

Market Outlook

July 2026



Fixed Income Market Update and Outlook

Market Update

War Resolution, Sharp Decline in Oil Prices and Improvement in INR Outlook

The Iran war resolution was finally reached in Jun'26 with both the parties signing MoU to end conflict and agreeing to resolve the issues within two months' timeframe. This has resulted in sharp decline in geopolitical uncertainty. The opening of Strait Hormuz has resulted in resumption of sea route for trade. As a result, the oil prices have declined sharply easing concerns regarding stagflation globally. RBI preferred to remain on pause, while upwardly revising inflation projections and revising downward growth projections. RBI also launched slew of FX measures along with govt to boost FX flows, FPI flows in G-sec market, thereby resulting in improvement in currency outlook.

India

Monetary:

In early Jun'26 policy, the RBI hold policy rates and monetary stance unchanged. RBI projected FY27 growth to remain resilient at 6.6%/y (Apr policy: 6.9%/y) and has upwardly revised inflation projection to 5.1%/y (Apr 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.

Balance of Payment:

4Q FY26 (Jan-Mar 2025) current account improved to positive 0.7% of GDP (seasonality) from deficit of 1.5% in 3Q FY26 (4Q FY25: +ve 1.4%). Robust net services exports and NRI remittances helped in reducing current account deficit (CAD).

FY26 CAD stood muted at 0.6% of GDP despite sharp rise in US trade tariff and Iran war. Capital account flows were marginal (FY25: US\$17 bn), due to net outflow of foreign investment and other items in capital account. As a result, BoP was negative by US\$24 bn (FY25: -ve US\$5 bn). This is the second consecutive year of negative flows, raising concerns about medium term macro-economic stability.

Foreign Trade:

In May, the trade deficit remained elevated at US\$28 bn. During Apr-May 2026, both exports (oil & core) and imports (gold and core) grew double digit on the annual basis. During April-May 2026 period, the net services exports was modest at ~9%y/y.

Fiscal:

Apr-May 2026 Fiscal deficit stood at ~10% of BE FY27 (Apr-May 2025: ~1%). This was primarily due to robust expenditure (revenue & capital expenditure), while revenue receipts remained muted. On sources of funding fiscal deficit, YTD small savings and Others' collections are robust. The govt was holding robust cash balances (RBI dividend) indicating comfort in raising the funds.

Inflation:

May CPI inflation increased to 3.9%y/y (Apr 2026: 3.5%y/y; Consensus: 4%y/y). The rise in monthly print (0.75% m/m) was driven primarily by seasonal pick-up in food prices & impact of domestic fuel price hike. Core inflation (excludes food, fuel, petrol and diesel) rose to 3.90% y/y (Avg Jan-Apr 2026 ~3.7% y/y). Core-core inflation (excludes petrol, diesel gold etc) rose to 2.3% y/y (Avg Jan-Apr 2026 ~2.1% y/y).

Liquidity:

Monthly average system liquidity in Jun 2026 moderated to ~Rs. 0.8 trn (Apr 2026: ~Rs. 3.9 trn; May 2026: Rs. 1.64 trn) on seasonality (advance tax outflows). Core Liquidity by June end decline to ~Rs. 4.5 trn from ~Rs. 5 trn at May end driven by RBI's FX swap maturity.

Foreign Flows:

After three consecutive months of heavy outflows (cumulative Mar-May 2026 : -ve US\$24 bn), the FPI flows turned small positive in June (US\$0.5 bn) driven by resolution of Iran war and RBI's FX measures. YTD FPI outflows in the calendar year 2026 stood at US\$23 bn (as against outflow of US\$12bn in CY25).

Currency:

INR appreciated by 0.8%m/m in Jun 2026, after depreciating by 0.15%m/m in May 2026, INR stood on an average 94.97 against dollar (May 2026: 95.60). YTD Calendar year 2026 INR has depreciated by ~5% driven primarily by the sharp rise in geopolitical concerns.

Yield Levels & Spreads:

After remaining elevated in April & May, the G-sec yield rallied in June on war resolution, sharp decline in crude prices, improvement in INR outlook and robust FPI inflows in G-sec (fiscal policy measures related to taxation, RBI's FPI measures related to G-sec (FAR Securities)). 10 yields moved in the range of 6.75%-7.02% (May range: 6.92%-7.08%). It closed the month much lower at 6.75% (Feb 2026: 6.66%; Mar & Apr 2026: 7.00-7.01%; May 2026: 6.98%).

Taking cues from G-sec, SDL yields eased despite higher supply. 10-year SDLs moved in the range of 7.40%-7.74% (Prior month: 7.64%-7.83%). It closed the month lower at 7.40% (Feb 2026: 7.37%, Mar 2026: 7.61%; Apr 2026: 7.68%; May 2026: 7.72%). The average spread between 10 yr SDL over G-sec stood at 70 bps during the month (Apr 2026: 68 bps; May 2026: 72 bps).

Similarly, 10-year AAA bond yields moved in the range of 7.38%-7.83% (Prior month: 7.60%-8.00%) and closed the month lower at 7.38% (April 2026: 7.71%; May 2026: 7.83%).



Global

Financial Markets:

UST yield continued to remain volatile in June 2026 on resolution of Iran war and rate hike expectations. 10 yr UST close the month marginally lower at 4.44% (Feb 2026: 3.97%; Mar- Apr 2026: 4.35%-4.40%; May 2026: 4.45%).

After appreciating ~1% m/m in May, DXY appreciated further by ~2.3% m/m in Jun 2026 on hawkish pivot of US Federal reserve. Calendar year till date the DXY has appreciated by ~3%.

After surging in Mar 2026 (~46% m/m) & Apr 2026 ~14% m/m, the crude oil declined by ~9% m/m in May 2026 and further by ~20% m/m in June on resolution on Iran war and opening of Strait. The average crude oil declined to US\$85/ barrel (Apr 2026: US\$117/barrel; May 2026: US\$107/barrel).

Market View

- » War resolution (although fragile), opening up of strait off Hormuz and sharp decline in oil prices has helped in improving macro stability outlook (growth, inflation & Current Account Deficit (CAD)) for India.
- » Further, Govt and RBI's proactive measures to boost Foreign Exchange (FX) flows and FPI flows in G-sec market has already resulted in robust flows in G-sec markets and improvement in INR outlook.
- » RBI's FX hedging policy for NRI FCNR (B) (Foreign Currency Non-Resident (Bank)) deposits & European Central Banks (ECB) may be expected to boost capital flows in Sep quarter and potentially support INR in near term.
- » Going forward, the development of monsoon may be closely tracked on back of El Nino concerns.
- » Foreign Exchange (FX) 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 bps rate hike.
- » Aligning investment horizon with fund duration may help mitigate the impact of interest rate volatility. Short end of the curve, particularly debt funds with a duration upto 3 years look relatively better placed. Given the yield levels currently available, in the 20-30 year segment, investors with a long-term investment horizon may consider Long Duration products as part of their overall debt allocation strategy, subject to their investment objectives and risk appetite.

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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