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Evolution of India’s yield curve post government policy support

India’s yield curve has exhibited considerable volatility this year. Both global and domestic factors resulted in the same. Most importantly, the debt outflow arising from global policy uncertainty further worsened the situation. The gap between India and US 10Y yield is at multi year low level and far below long run average. This may have further aggravated the FPI-debt outflow. Government policy measure to attract durable capital flows came at a very opportune time. The policy response was felt across the entire yield curve. The inclusion of new issuances for 15Y, 30Y and 40Y paper in the FAR route has resulted in significant downward correction in yields across these tenors. If we see the net market activity report of Gsec category-wise, there is a clear shift in pattern where foreign banks are gaining momentum post policy support to FPIs.

The short end part of the yield curve has also declined sharply. This may be on account of system liquidity remaining comfortably above the 1% NDTL level. Going forward, we expect steepness in India’s yield curve as long end part of the curve might exhibit some upward bias anticipating rate action from RBI and tracking the war situation between US and Iran. Short end yields are expected to get some support from adequate system liquidity conditions post FCNR (B) deposit flows.

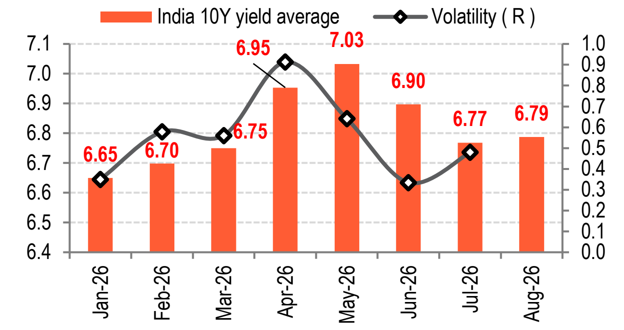
Background:

This year saw a lot of volatility in terms of India’s yield movement. A number of factors came into play. From global policy uncertainty to domestic factors such as weakening INR, pressure on domestic liquidity and impact of West Asia crisis, all have contributed towards the fluctuating movement of yield. On the other hand, coordinated monetary and fiscal policy response have supported yields broadly. The measures targeted towards retaining durable capital flows at a time when FPI flows were retreating, have been welcome.

Fig 1 shows that the volatility of India’s 10Y yield (expressed in terms of standard deviation (SD) of daily change in yield) has peaked in Apr’26; when war related uncertainty took the centre stage. However, with government’s efforts aimed at tax rationalisation measures in capital markets, volatility in India’s 10Y yield softened substantially. The measures especially expanding the scope of FAR by including new issuances in GSec in tenors of 15Y, 30Y and 40Y years as also Sovereign Green Bonds and exempting interest and capital gains on G-Secs from income tax w.e.f. 01.04.2026, have been very targeted measure.

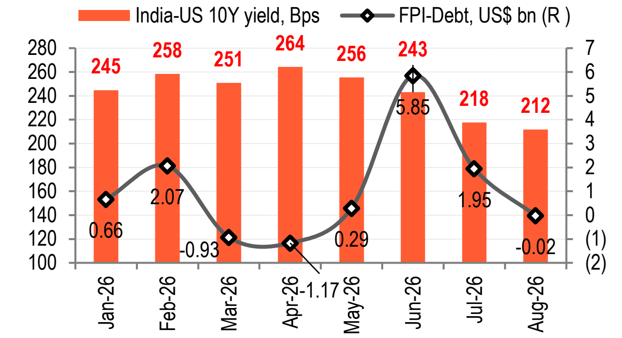
Fig 2. shows how FPI debt flows have been equally volatile. A lot of it can be attributable to the falling interest rate differential between India and US. It is to be noted that the current level at 212bps, (average of Aug’26 till date) is running at multi-year low. Hence the policy measure by the government comes at the opportune time when FPI-debt flows are subjected to pressure.

Figure 1: India's 10Y yield has exhibited volatility this year



Source: Bloomberg, Bank of Baroda Research

Figure 2: Volatile FPI flows have been in line with lower interest rate differential between India and US



Source: Bloomberg, Bank of Baroda Research

Impact of policy support seen across different tenor yields:

Table 1 shows the evolution of India's yield curve post policy support announced by the government to attract foreign capital. The red marked securities are the ones whose new issuances are included in the scope of FAR. The yield of 15Y, 30Y and 40Y have fallen significantly by 24bps, 12bps and 13bps respectively. Apart from this, 7Y and 10Y yield has softened. This may be based on the liquidity of the corresponding securities. The short end part of the curve especially 9M and 1Y have fallen considerably. This is in line with improvement in durable liquidity and system liquidity, more recently with the policy initiative of RBI to attract FCNR (B) deposits.

Regarding the nature of India's yield curve, one interesting thing is that the gap between 10Y and 9M paper has increased. This part of the yield curve does exhibit the possibility of some more steepening in the near term. The spread between 10Y and 9-month paper has increased from 108bps as on 05 Jun 2026 (date of policy announcement) to 129bps as on 20 Aug 2026. This may be on account of downward movement in short end part of the curve as system liquidity is far above the 1% NDTL level. Currently, average system liquidity in Aug'26 (till 20th) is hovering at 1.2% of NDTL (NDTL as of 31 Jul 2026).

Same trend is mirrored for the yield gap between 40Y and 9Month paper. Here also some steepness in yield curve is seen albeit rising demand for very long-dated securities (30 year and above). The gap between 40Y and 9-month paper has risen from 175bps as on 05 Jun 2026 to 194bps as on 20 Aug 2026. The 9-month paper has been taken for the yield gap calculation, as it exhibited maximum momentum amongst all other short end part of the curve.

We expect the steepness of India's yield curve to continue. The short end yield will continue to get support from abundant system liquidity. The long part does exhibit some upward bias from continued impasse in talks between US and Iran and higher international oil prices. Domestic inflationary risks pertain in Q2 and Q3 which might drive long end yield yields higher amidst growing expectation of rate hike by RBI. The recent minutes of RBI policy also had a hawkish bias with RBI Governor hinting at signs of "generalisation of inflation" and "de-anchoring of inflation expectations". This has led to single day- upward correction of yields across tenor especially the 10Y paper (which rose by 5bps in the last trading session).

Table 1: Movement of India's yield curve across different time points

Tenor	05-06-2026 (date of policy announcement)	30-06-2026	31-07-2026	14-08-2026*	20-08-2026	Change** in yield, in bps, since policy support (5th Jun)
3M	5.41	5.23	5.32	5.24	5.27	-14
6M	5.6	5.3	5.59	5.53	5.59	-1
9M	5.9	5.42	5.52	5.56	5.58	-32
1Y	5.94	5.5	5.72	5.68	5.73	-21
5Y	6.62	6.42	6.45	6.36	6.52	-10
7Y	6.95	6.65	6.68	6.6	6.69	-26
10Y	6.98	6.75	6.83	6.76	6.87	-11
15Y	7.28	6.98	7.02	6.94	7.04	-24
30Y	7.59	7.31	7.46	7.35	7.47	-12
40Y	7.65	7.44	7.59	7.43	7.52	-13
Spread, bps (10Y-9m)	108	133	131	120	129	-
Spread, bps (40Y-9m)	175	202	207	187	194	-

Source: Bloomberg, Bank of Baroda Research, Note: Red marked securities are the ones whose new issuances are included under the FAR route,* 14 Aug is taken as it was the date of announcement of premature closure of FCNR (B) swap facility by RBI, ** Change from 5 Jun 2026 to 20 Aug 2026

Foreign Banks saw major buying momentum post policy support:

Table 2 shows the net activity report category wise for GSec. The monthly data is arrived at by aggregating the daily activity report. It is seen that Foreign Banks who were major net sellers in the month of Apr'26 and May'26 have turned into net buyers in Jun'26, Jul'26 and the momentum is continuing in Aug'26 as well (first 20 days). In the month of Jun'26, the net activity peaked to Rs 40,204 crore for Foreign Banks. On the other hand, PSBs which were major net buyers in the secondary market in Apr'26 and May'26, turned into net sellers in Jun'26. In Jun'26, the amount was high at Rs 45,224 crore (negative is for selling). This may be on account of higher credit demand. Mutual Funds have been net sellers since May'26 onwards.

Among major categories, only Foreign Banks and "others" category which comprises of insurance firms, provident firms and RBI are showing consistent net buying activity in the secondary market. The quantum of net buying for Foreign Banks especially in Jun'26, is the highest against the backdrop of immediate policy response targeted at easing investment norms for FPIs.

Table 2: Foreign Banks have been the major net buyer since Jun'26

Net Purchase of G-secs in the secondary market, Rs crore	Apr-26	May-26	Jun-26	Jul-26	Aug-26*
Foreign Bank	-6,856	-8,282	40,204	10,521	27,009
PSB	15,703	13,841	-45,224	28,904	4,827
PVB	-13,519	9,745	7,590	-14,093	-15,105
Mutual Fund	10,357	-5,924	-4,419	-12,530	-17,336
Primary dealers	30,318	17,746	-9,766	-35,227	17,638
Others	-36,002	-27,126	11,615	22,425	-17,033

Source: Bloomberg, Bank of Baroda Research, Note: *Aug'26 data is till 20 Aug 2026, Monthly data is the sum of daily net activity report

To conclude:

- India's yield curve has exhibited significant volatility in the current year.
- Government policy support targeted towards attracting durable foreign capital is welcome.
- It has resulted in downward correction of yields across tenor.
- The major decline in yield was seen for the 9-month, 1 Year, 7 Year and 15 Year paper. It is to be noted that new issuances of 15 Year paper were included under the FAR route along with the inclusion of new issuances for 30Y and 40Y paper.
- Going by the yield gap between long and short end part of the curve, we expect India's yield curve to have a steepening bias. Short end part of the curve is likely to get support from abundant system liquidity.
- The long end part is subject to upward bias as war situation between US and Iran is escalating. Further, rate action on part of RBI is anticipated as signaled in recent communication.
- A closer look at the net buying pattern of GSec across categories shows that momentum of foreign banks picked up post policy announcement by the government. This may be on account of higher inflows in the debt segments by FPIs post liberalization in few of the capital norms.

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