

A dovish monetary policy adds cheer to bond markets

September, 2025



The new tariff rates including the additional penalty on Indian exports set-in motion in September. Even as the trade talks have been ongoing, presently, India continues to face higher tariffs than most of the 90-odd countries – even as the US maintains a pause on China as trade talks continue. In the last two-weeks of September, investor sentiments soured further as the US administration hiked work visa fees, popularly known as the H-1B visas. Data from the U.S. Citizenship and Immigration Services (USCIS) reveals that Indians accounted for 71% of this visa. While the immediate implications appear fairly contained as the fee hike would apply on fresh applications. However, it dampened investor sentiments. The recent remark of 100% tariffs on branded pharmaceuticals, a sector which was exempted until now, further dragged the already frail sentiments. Having said that, India's recent goods and services tax (GST) tax cuts which came into effect on 22-Sep has added to some cheer in the global backdrop uncertainties.



At first, the markets feared negative fiscal implications, however, the GST rate rationalization details earlier in the month was far more encouraging. The rationalization of rates from four-tier to two-tier rate structure along with a special rate of 40% on demerit goods is seen absorb ~50% of the revenue loss the govt. is estimating for. More so, for the current fiscal, given the existing accumulation under the compensation cess fund, we see limited fiscal implications. These have continued to support investor sentiments.

In terms of growth-inflation trends, post the GST rate cut the outlook is far more favorable for inflation trajectory with upside to growth; offsetting the negative impact from tariffs. With inflation undershooting MPC's estimates in 1H FY26, the 2H FY26 trajectory is also looking benign. In this weeks' Oct meet, the MPC lowered its FY26 estimates by 50bps to 2.6% YoY. Monsoon season appears to have ended the year with ~8% above long period average (data till 29-Sep) and summer crop sowing till 19-Sep is up 1.3% YoY led by 3% increase in foodgrain sowing. Overall, a favorable monsoon, reservoir levels and also with maximum number of the items seeing GST rate revisions into the lower bracket suggest the inflation trajectory will remain soft. In the current settings, the MPC revised lower its inflation forecasts for Q1 FY27 to 4.5% YoY from 4.9% seen at the Aug'25 policy.

Globally, the US Fed delivered a "risk-management" rate cut at the Sep policy meet. The Fed's 'dot plot' indicated that further easing remains in place, but the markets responded to the FOMC's tone that was less dovish than expected. The US inflation prints have been in-line with expectations, however, the key data to the Fed policy is the US jobs data. The next Fed policy decision is due Oct. 29, with traders torn on the likelihood of a reduction after unexpectedly strong consumer spending data. The final print on the US GDP growth for Q2 CY25 stands at 3.8% vs 3.3% estimated earlier. Even the US equity markets have touched record highs and investors seen brace for the earnings season this month which could possibly show first wave of tariff effects on companies' earnings. While the dollar index has held steady, gold prices have continued to march higher & touched fresh highs of US\$ 3800/oz. The concerns over slowing US job growth, geopolitical developments kept gold prices higher. Oil prices rose ~5% MoM following the renewed pressure from the US on Russian energy buyers; negating the gains from recent production increases by the Organization of the Petroleum Exporting Countries (OPEC).

Our Take:

Global trade and tariff policy uncertainty continues to linger. The GST reforms are likely to partially offset the negative impact of tariff-led moderation in exports. The festivities along with the GST cuts that kicked-in from 22-Sep-25 are expected to spur consumption in Sep-Dec months. Overall, domestic growth outlook is still positive and expected to clock 6.5-6.8% levels in FY26. Post the Diwali and festive season, as the consumption momentum fades and the tariffs effect start to kick-in, data would be key to track. Meanwhile, on the inflation front, the outlook has turned far more benign esp. following the GST cuts. The lowered rates and the rationalization, if passed through to consumers, is expected to have a positive impact on inflation trajectory; lower headline inflation levels by 50-100bps. The fiscal implications of the GST rate rationalization have been put to rest, for now, with the impact estimated to be fairly contained at ~0.1% of GDP for FY26. Having said that, the fiscal impact on Indian States is yet to be seen and is likely to draw focus in the ensuing quarters. Meanwhile, the govt. has stuck with its 2H FY26 borrowing plan of ~INR 6.8 lakh crore with some tweaks in the tenor wise issuance as it lowered the issuances on the extreme long end of the curve and increased it in the belly as well as shorter dated tenors of the curve. Following the RBI MPC's dovish policy pivot and a clear signal of rate cuts on the anvil have positively influenced market sentiments.

The MPC's growth-inflation outlook and the policy pivot reinforces our view that the easing cycle is not over yet and we expect that the MPC is likely to cut by 25bps at its Dec'25 policy. After the Dec'25 cut, the next policy move would be contingent upon incoming data and external developments. The two external members opinion to change the policy stance to accommodative from neutral suggests the members might be leaning towards a more accommodative policy. However, we continue to believe that the Dec'25 policy will see a 25bps cut with a neutral stance while leaving the room to cut rates in this easing cycle.

Fund positioning (post policy)

We reiterate that the easing cycle is not over yet and that the room to cut opens-up in the backdrop of the abovementioned scenarios playing out. Since, we believe there is scope for future rate cuts, it has increased our conviction on increasing duration bias across our portfolios. While the SDL calendar will be closely watched, and any higher-than-expected calendar amount might increase the pressure on yields on the extreme long end of the yield curve. We believe the 10–15 year point on the curve may offer good relative value with yields softening as rate cut expectations get built in.

Additionally, we continue to remain positive on 2-4 year corporate bonds as this segment may continue to offer favourable spreads. This we believe is the sweet spot on the corporate yield curve. Given liquidity is expected to remain in surplus for the near future, we believe corporate bond spread compression story may continue and provides for an opportunity for further compression in corporate bonds.

Abbreviations:

GDP: Gross Domestic Product
CPI: Consumer Price Index
MPC: Monetary Policy Committee
RBI: Reserve Bank of India
FII: Foreign Institutional Investors
AEs: Advanced Economies
EM: Emerging Markets

Source: Bloomberg & HSBC MF Research estimates as on September 30, 2025 or as latest available

Note: Views provided above are based on information in public domain and subject to change. Investors are requested to consult their financial advisor for any investment decisions.

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