

Debt Market Review



Rates Recalibration





September marked a broad-based repricing across global and Indian debt markets, with bond prices falling as the Middle East conflict prolonged the energy shock. Brent crude oil surged, averaging US\$ 102/bbl; reigniting concerns over global inflation. Inflation persistence led the US Federal Reserve to raise rates for the first time since CY23. The policy pivot in combination with the fiscal fears have led to a bond selloff, with the US 10Y benchmark yield breaching the 5% mark and the 30-year hitting about a 22-year high. US equities were mixed with tech stocks held their ground, but broader markets struggled. India was hit hardest among major markets, and sentiment was weak with FIIs pulling out US\$ 4.1 bn from equities and US\$ 1.7 bn from bonds, the Rupee weakened, and RBI continued to tackle the excess surplus system liquidity.

The oil price shock reignited concerns around higher inflation and thereby, a shift towards tighter policy expectations by key Central Banks. The US Fed FOMC unanimously voted to raise the federal funds rate by 25 bps to a target range of 3.75%-4.00%, the first hike since CY23. The dot plot turned decisively hawkish as well, with 16 of 18 officials projecting at least one more hike by end-2026, with the median rate forecast rising to 4.1% from 3.75% in June. Following the employment data and PCE inflation figures, market expectations for a Oct'26 rate hike have retreated considerably with ~75% probability of a status-quo policy on 28-Oct. Meanwhile, last month, the US treasury yields hardened, and the 30Y treasury paper touched multi-year highs; the rates recalibration has been a global phenomenon as a combination of factors of elevated oil prices, fiscal worries in some countries, and a shift towards tighter monetary policy globally.

For India too it was a similar story primarily driven by higher oil prices which continued to dampen sentiments. In the milieu of global rates hardening, almost across the globe, in Sep'26, Indian markets too reeled under pressure, with FII outflows amounting to US\$ 5.9bn in Sept'26, of which debt outflows amounted to US\$ 1.7bn, the highest monthly outflow in last 18-months.

While most AE central banks have already tightened policy, most banks have a hawkish tilt. India's RBI-MPC too has pivoted on its policy rates after having stayed pat on rates for three-straight policies (esp. since the US-Iran conflict broke out). The RBI MPC on 7-October in a unanimous vote decided to hike the policy rate by 25 basis points, taking the Repo Rate to 5.50% and changing the policy stance to 'calibrated tightening'. The MPC highlighted increasing inflation risks, including the broadening of price pressures, elevated global commodity prices, deficient monsoon conditions and El Niño.

The MPC revised its FY2026-27 real GDP growth forecast up by 40 bps to 7.1%, reflecting resilient domestic demand, strong investment and robust export activity despite global headwinds. In contrast, the CPI inflation forecast was raised to 5.2%, with inflation expected to peak at 6.0% in Q3 before moderating to 5.7% in Q4; Interestingly, core inflation is projected at 4.4%. The revisions point to a stronger growth outlook but a less benign and more persistent inflation environment.

In summary, the MPC has adopted a hawkish but measured policy approach, delivering its first 25 bps rate hike in 44 months and moving the stance from neutral to calibrated tightening. The decision signals that rate cuts are off the table in the near term but does not imply a predetermined or aggressive hiking cycle. In our view, the Repo rate could rise by a further 50 bps to 6.00% in this cycle, although additional tightening would require a renewed deterioration in the inflation outlook or a materially higher global-rate environment. In parallel, the RBI is likely to continue actively managing surplus liquidity while monitoring the impact of policy on growth and credit conditions.

Fund positioning

The MPC's 25 bps rate hike was broadly in line with market expectations. While the market was divided on a stance change, the MPC changed the policy stance to 'calibrated tightening', which resulted in a knee jerk reaction with yields moving up sharply. However, later on the Governor clarified that calibrated tightening was in context of policy guidance going forward and should be read as a milder form of tightening. This, along with the fact that two MPC members were not in favour of changing the stance, infers that policy rates could reach a terminal rate of 6%. Further policy action would be mainly dependent on global markets and crude prices.

Current market sentiment remains negative, with risks remaining pertaining to global markets, energy prices and possible further OMO sales. We have remained underweight on duration versus peers across our funds. However, with US Treasury yields reaching decadal highs and our rates also having moved significantly higher, valuations are becoming favourable. We will keep evaluating incoming data and look to opportunistically add duration across our funds on any signs of sustained moderation of US Treasury yields or crude prices.

Investors with short-term investment horizon can look at the less than 1 year bucket, i.e. Ultra Short Duration, Money Market Fund and Low Duration Fund as they offer pick-up over the Liquid category.

For investors with a medium-term investment horizon, Corporate Bond category can be a good investment opportunity as it provides reasonable accrual in a lower duration product.

For investors who can look at tactical allocations with a medium-term horizon, Short Duration and Banking and PSU categories can also be possible avenues.

Abbreviations:

RBI: Reserve Bank of India
MPC: Monetary Policy Committee
SDF: Standing Deposit Facility
MSF: Marginal Standing Facility
VRRRs: Variable Rate Reverse Repos
CRR: Cash Reserve Ratio

OMO: Open Market Operations
GDP: Gross Domestic Product
CPI: Consumer Price Index
SDL: State Development Loans
G-Sec/IGBs: Government Securities
EMs: Emerging Markets

FX: Foreign Exchange
AEs: Advanced Economies
EM: Emerging Markets
Reference: White House press release, 20-Feb

Past performance may or may not be sustained in future and is not a guarantee of any future returns.

Note: Views provided above are based on information in public domain and subject to change. Investors are requested to consult their financial, tax and other advisors before taking any investment decision(s).

Source: Bloomberg & HSBC MF Research estimates as on October 7, 2026 or as latest available.

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