

# Spillover effects

March, 2026



The Operation Epic Fury and Roaring Lion – a joint attack by the US and Israel on Iran on 28-Feb has not only altered the dynamics of the Middle East but also sent shockwaves across the world as the source and supply of energy came to a near standstill. The situation intensified as Iranian attacks targeted commercial hubs in neighboring countries that aid the U.S. military and also targeted oil infrastructure in the region - including vessels in the Strait of Hormuz (SoH), through which 20% of the world's oil passes. The disruption of oil flows out of the Persian Gulf quickly led to fuel shortages and rationing in parts of Asia, which rely heavily on oil supplied through the SoH, and sharp increase in price in the global oil market<sup>1</sup>.



Geopolitical uncertainty has crystallised into market volatility, and it persists amid uncertainty around de-escalation. Historically, oil prices are the usual channel for how geopolitical risk impacts the economy and eventually feeds into investment markets. March was no different, and both bonds and stocks saw a sell-off, this time around, engulfing gold & silver as well.

Given the frail sentiments, recent memories of oil price shock and higher inflation phase have further exasperated market worries; making the oil prices trajectory crucial. Street expectations and market analysts are continuing to work with scenario analysis drawing inference from the past playbook, however, this time the scale and order of the shock is different compared to the similar energy shocks which also means the policy choices and responses are likely to be different than the recent past.

In India, if oil prices hover near the US\$100/bbl, it would cause adverse impact on macros - as the trade imbalance worsens, capital flows weaken and transpires into currency pressures, the fiscal costs rise, inflation accelerates, and growth stumbles. With India at a good starting point, on all these aspects, it limits the negative spillovers; and also leaves policy scope and space to absorb the shock, so far.

On the fiscal front, the govt. has addressed the energy price costs via excise tax cuts on fuel and subsidy on fertilizer. Govt. has opted to pass on some price pressures onto consumers for cooking gas, rationing between household and commercial usage, while also stepping up its procurement efforts.

On the FX front, after a likely phase of aggressive FX intervention, post the war, the RBI is taking up other measures to stem the rupee fall; In the last couple of weeks, the RBI directed banks to cap daily open positions in the onshore currency market at US\$100 mn by April 10, and a day later further banned banks from offering the most popular instrument for trading the Rupee offshore. The intensity and the duration of the conflict to determine the policy choices.

As of today, in the wake of the current uncertainties and external headwinds, the RBI monetary policy committee (MPC) has unanimously voted for a 'neutral' pause on policy rates with a neutral stance – which provides the flexibility to respond judiciously to incoming information. The MPC Minutes may provide clarity on the policy stance as this policy lacked a member-wise view on the policy stance. In the current backdrop, the MPC's vigilance is reflected in upwardly revised inflation forecast, while its cautiousness is evident in the downwardly revised growth numbers, mainly for Q2FY27. For FY27, MPC inflation forecast stands at 4.6% YoY and the GDP growth forecast is at 6.9% YoY; with both facing risks from the ongoing West Asia conflict. For GDP growth, key downside risks include the West Asia conflict disrupting supply chains and shipping routes (freight/insurance costs), volatility in global financial markets, and potential damage to energy infrastructure. For inflation, the upside risks emanate from elevated global energy/commodity prices from the conflict; possible El Niño affecting the monsoon and food prices; and the risk of second-round effects from supply-chain dislocations. From this policy, Core CPI inflation makes its debut in the policy resolution; However, the Governor at the presser did clarify that the inflation targeting approach is the same and that Core CPI was always considered in the past policies as well. Based on feedback, it will now be giving Core CPI forecasts too. To begin with, the MPC has projected core CPI at 4.4% YoY for FY27.

In our view, the RBI MPC is on a neutral hold and has taken a 'wait & watch' approach given the global uncertainties. The RBI-MPC maintained a calm demeanor amid a chaotic environment. The policy statement reinforces that India is at a good starting point and thus, better equipped to navigate the current external headwinds/shock. Based on our analysis and assumptions, we believe that the RBI MPC is likely to maintain a long pause on policy rates while keeping the liquidity conditions in sufficient surplus.

<sup>1</sup>Reference: <https://www.britannica.com/event/2026-Iran-war>

The external environment would continue to shape and influence the policy dynamics. At this juncture, we believe that the Repo Rate stays at 5.25% throughout CY26 and the risks of rate hikes in CY27 would start building up if oil prices/energy shock persist, and if weather-related risks seep into prices. At this juncture, to us, it looks like a long pause on policy rates.

### Fund positioning

During the month, 10 yr IGB levels moved sharply from 6.66% to 7.04% due to increased geo-political tensions. 10 yr IGB levels hit a high of around 7.15% in early April. Post the temporary ceasefire announcements between US and Iran yesterday and the MPC meeting today, 10 yr IGB yields have softened significantly and are now trading in the 6.90%-6.95% band. While the ceasefire announcement has brought relief to markets, the complete revival of supply disruptions might take some time, which means impact of increased crude prices and supply side disruptions will still be felt. This means that IGB levels might not go back to pre-war levels and might remain range bound around the current levels.

SDL calendar for Q1 FY2027 came in lower than market estimates and with SDLs trading at 50-70 bps above the corresponding IGBs, we believe that SDLs offer good value over IGBs and there is possibility of spread compression. We have increased our allocation to SDLs across our funds in the 5-11 year segment.

Another important factor to note is that RBI mentioned in the policy that they will continue to maintain adequate liquidity in the system. Given the G-Sec maturities lined up this quarter along with RBI dividend to the Government expected in May, liquidity is expected to remain positive. With March 2027 CD levels currently around 7.15% (close to 200 bps over Repo), we believe there is value in this segment and levels can come off going forward. Also, corporate bonds in the 2-3 year segment are currently trading at above 100-125 bps spread over G-Sec. We believe there is room for these spreads to compress and hence we continue to remain positive on this segment across our bond funds.

Investors with short-term investment horizon can look at the liquid plus category i.e. **Ultra Short Duration, Money Market Fund and Low Duration Fund** as they offer pick-up over **Liquid Funds**.

For investors with a medium-term investment horizon, **Short Duration Fund, Banking & PSU Debt Fund and Corporate Bond Fund** can be a good investment opportunity as they provide accrual plus opportunities to create alpha through capital gains.

For investors with 2-year horizon, **Income Plus Arbitrage FOF** provides a tax efficient solution in a debt product.

#### Abbreviations:

|                                 |                                   |  |
|---------------------------------|-----------------------------------|--|
| RBI: Reserve Bank of India      | OMO: Open Market Operations       | EMs: Emerging Markets                        |
| MPC: Monetary Policy Committee  | GDP: Gross Domestic Product       | FX: Foreign Exchange                         |
| SDF: Standing Deposit Facility  | CPI: Consumer Price Index         | AEs: Advanced Economies                      |
| MSF: Marginal Standing Facility | SDL: State Development Loans      | EM: Emerging Markets                         |
| CRR: Cash Reserve Ratio         | G-Sec/IGBs: Government Securities | Reference: White House press release, 20-Feb |

**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.

**Source:** Bloomberg & HSBC MF Research estimates as on March 31, 2026 or as latest available.

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