FI Weekly: Fed cut overlooked as yields climb; India awaits policy cues

Union Bank of India
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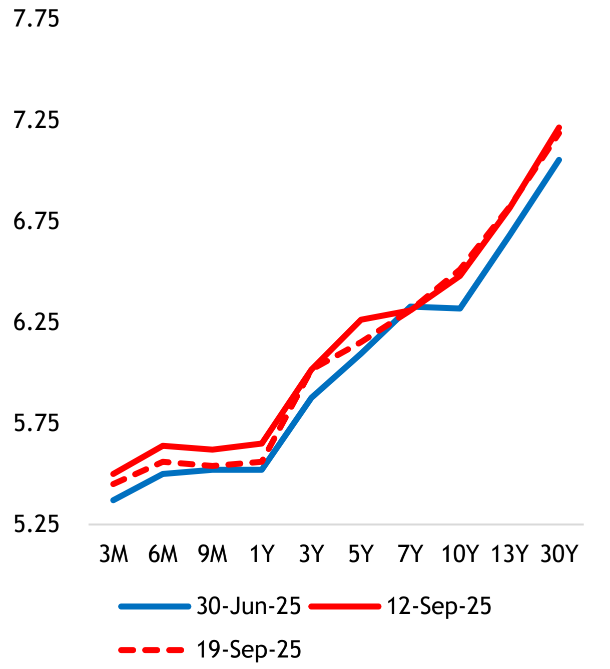
Fig.1: Yield curve softened on W-o-W basis; (%)



Source: Bloomberg, UBI Research

US 10-year Treasury yields rose to 4.15% last week, despite the Federal Reserve delivering a 25 bps rate cut. The market response was driven more by stronger-than-expected macro data—particularly robust retail sales, jobless claims, and manufacturing activity which led investors to scale back expectations of further easing. The upward move in yields reflects a shift in focus from monetary policy to economic resilience, reinforcing confidence in the US growth outlook. In contrast, Indian 10-year G-Sec yields remained range-bound (6.46-6.53%) amid tightening liquidity and cautious positioning ahead of key domestic triggers. The RBI's VRR operations partially eased pressure from tax outflows, while bond markets found support from a strong gilt auction and growing optimism over India's potential inclusion in Bloomberg's Global Aggregate Index. With the October-March borrowing calendar and the RBI's MPC meeting approaching, investors are looking for policy clarity. While no change in policy is expected, the focus will be on the tone of communication. A dovish pause, against the backdrop of base-effect-driven GDP growth, sub-3% inflation prints, and rising food price risks, may be a more effective strategy than a premature cut. We continue to expect a token 25-50 bps rate cut in H2 FY26, with October being a close call and December as a possible fallback.

US 10-Year Yield rises despite Fed cut as strong data shifts market outlook:

- During the previous week, US 10-year Treasury yield rose by approximately 10 basis points, from 4.05% to 4.15%. This increase came despite the Federal Reserve delivering a 25bps rate cut on September 17, lowering the federal funds target range to 4.00 to 4.25%. While such a move typically lowers yields, the bond market reacted more strongly to robust economic data that pointed to ongoing strength in the US economy.
- Key data releases during the week reinforced this narrative. August retail sales rose by 0.6% month-over-month, well above the 0.2% consensus, while industrial production increased by 0.1% compared to an expected decline of 0.1%. Initial jobless claims for the week ending September 13 fell sharply to 231,000 from the prior 264,000, the largest weekly drop in nearly four years. The Philadelphia Fed Manufacturing Index surged to 23.2 from the previous -0.3, reflecting a broad-based recovery in regional factory activity. Although housing data showed weakness, with August housing starts down 8.5% and existing home sales falling 5.5%, these figures had limited influence relative to the strength seen elsewhere.
- With markets already pricing in the rate cut, attention quickly shifted to the Fed's forward guidance and incoming economic indicators. Chair Powell emphasized a data-dependent approach and signaled that further easing would be gradual. The combination of hawkish tone and stronger-than-expected data led investors to dial back expectations for additional cuts, prompting a steady rise in yields.

India 10-year remained in consolidation, Borrowing calendar & MPC to give direction:

- The benchmark 10-year government security (G-Sec) yield remained range bound during the week oscillating between a low of 6.46% and a high of 6.53%. There was no breakout on either direction, reflecting a balanced market amid mixed signals.
- System liquidity fell to a three-month low of Rs.70,579 crore due to advance tax outflows, pushing overnight money market rates higher. RBI through variable rate repo (VRR) auctions and government spending to ease liquidity pressures by month-end.
- To manage liquidity:
  - On Sep 19, RBI conducted a 3-day VRR, injecting Rs.390 crore at 5.51%, maturing Sep 22.
  - On Sep 19, a 6-day VRR to inject Rs.0.59 lakh crore at the 5.51% cut-off and maturity date of Sep 25.
- Government cash balances increased to Rs.2.33 lakh crore as of Sept 12, from Rs.2.08 lakh crore on Sept 05, while the system liquidity decreased in the same period from Rs.2.88 lakh crore to Rs.2.64 lakh crore.
- Bond markets found some relief on Friday with a successful auction outcome and supportive global cues. The RBI's auction of the 6.33% 2035 gilt was well received, clearing at a cut-off yield of 6.5198%—slightly better than expected. Strong demand was driven by short covering and renewed buying across market participants, helping reverse initial losses. Elevated activity in the special repo segment reflected continued short interest. Shorter-tenor bonds outperformed, particularly the 5.91% 2028 gilt, which saw firm demand from banks' ALM desks and was likely picked up by a large state-run bank. Corporate buying in the secondary market and selective FPI interest in 5- and 7-year papers also supported the short end, with the 6.01% 2030 bond yield falling by nearly 5 bps.
- Investor sentiment was further lifted by Bloomberg Index Services' move to seek feedback on including India's Fully Accessible Route (FAR) bonds in its Global Aggregate Index—a development that could drive over $20 billion in inflows over time. While actual inclusion may take up to a year, traders noted potential front-running by FPIs, who were net buyers of Rs.6.32 billion worth of FAR bonds on Friday. At the longer end, bonds recovered amid expectations that the government may reduce the share of ultra-long bonds in the upcoming Oct-Mar borrowing calendar. The upcoming borrowing calendar is now seen as the next key trigger for market direction.

RBI's upcoming MPC, Market eyes status quo but dovish hints may emerge:

- The RBI's upcoming MPC meeting is expected to result in a pause on rates and stance, but market participants are increasingly watching for dovish signals. Q1 FY26 GDP printed at 7.8%, though largely due to favourable base effects, with limited evidence of strong underlying demand. Meanwhile, headline CPI is tracking at 2.0-2.5%, well below the MPC's projection of 3.1%, and far softer than the 4% estimate at the start of the year.
- While inflation risks persist, mainly from potential food price spikes due to flooding in northern India and rising global metal prices, the overall trajectory remains benign. This supports expectations of a token 25-50 bps rate cut in H2 FY26. October would be a close call for the first cut, though a delay to December is possible if GST cut impacts is to be seen clearly.
- In our view, a dovish pause would be more effective than a hawkish cut, as bond yields are unlikely to ease meaningfully unless accompanied by softer guidance. Markets are already contending with fiscal concerns and the central bank's cautious strategies. Yield curve distortions could be addressed through a combination of calibrated measures—such as rebalancing the borrowing calendar, more accommodative MPC communication, and effective signalling in the market.

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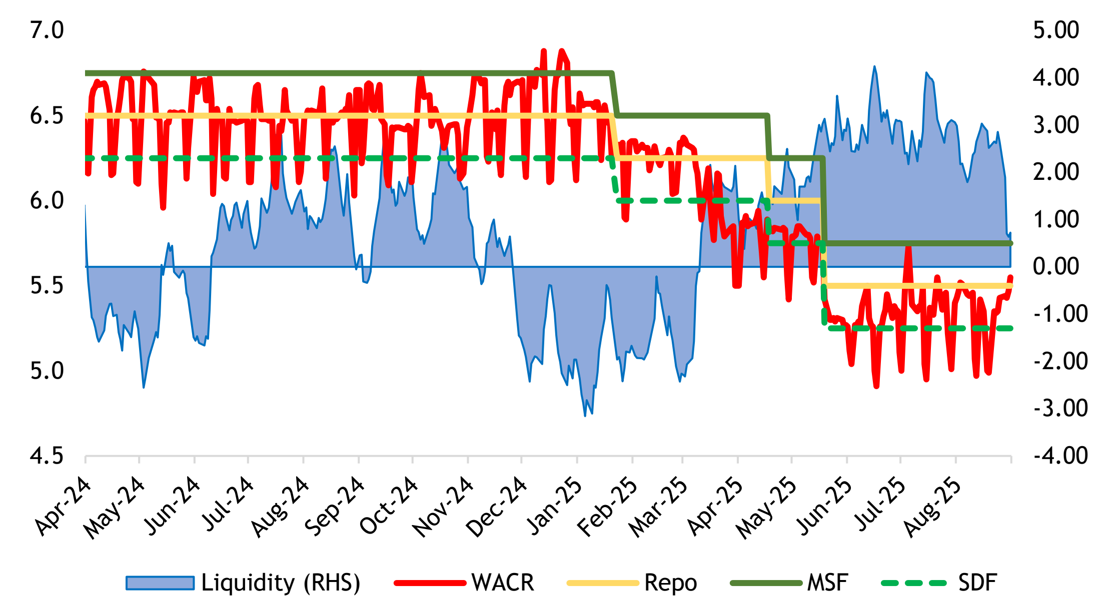
Table 1: Market Snapshot Instrument	Yield (Sep 19)	Weekly Change	Commentary
10 Year G-Sec (6.33% GS 2035)	6.51%	+3 bps	Fiscal worries benign post GST rationalization clarity
1 Year T-Bill	5.56%	-9 Bps	System liquidity in surplus, while it came down on weekend
US 10 year Yield	4.13%	+6 bps	Fed cuts rate, while data driven approach made market cautious
Credit Growth (%) (as of 05th Sep'25)	10.3%	+25 bps	Credit & Deposit growth increased on fortnight basis, while negative gap closes
Deposit Growth (%) (as of 05th Sep'25)	9.8%	-39 bps	
Credit Deposit Wedge (bps) (as of 05th Sep'25)	46	+63 bps	

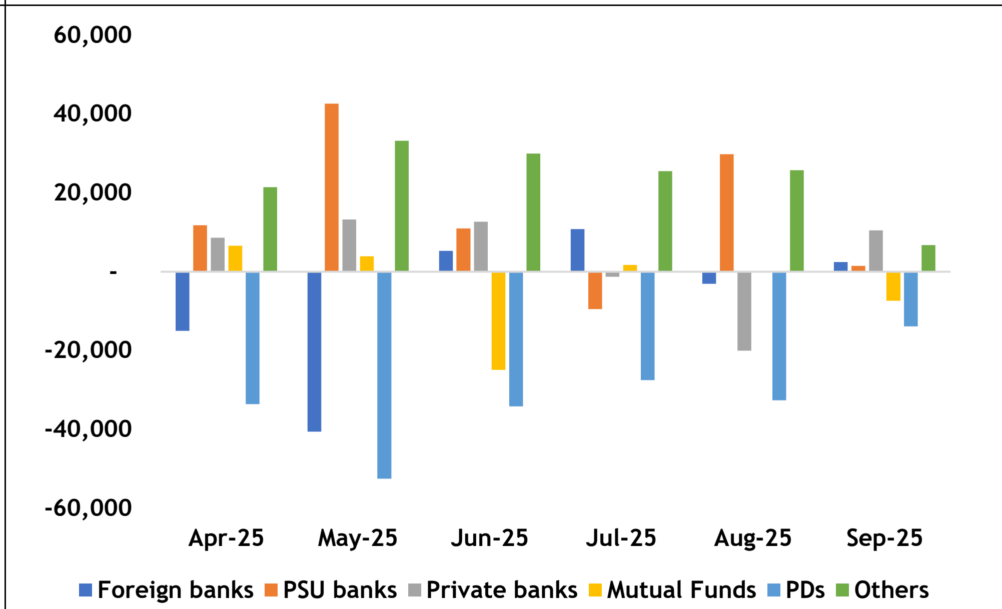
Source: RBI, CCIL, UBI Research

Fig.2: WACR managed to stay in the corridor more aligned to Repo Rate; (%)



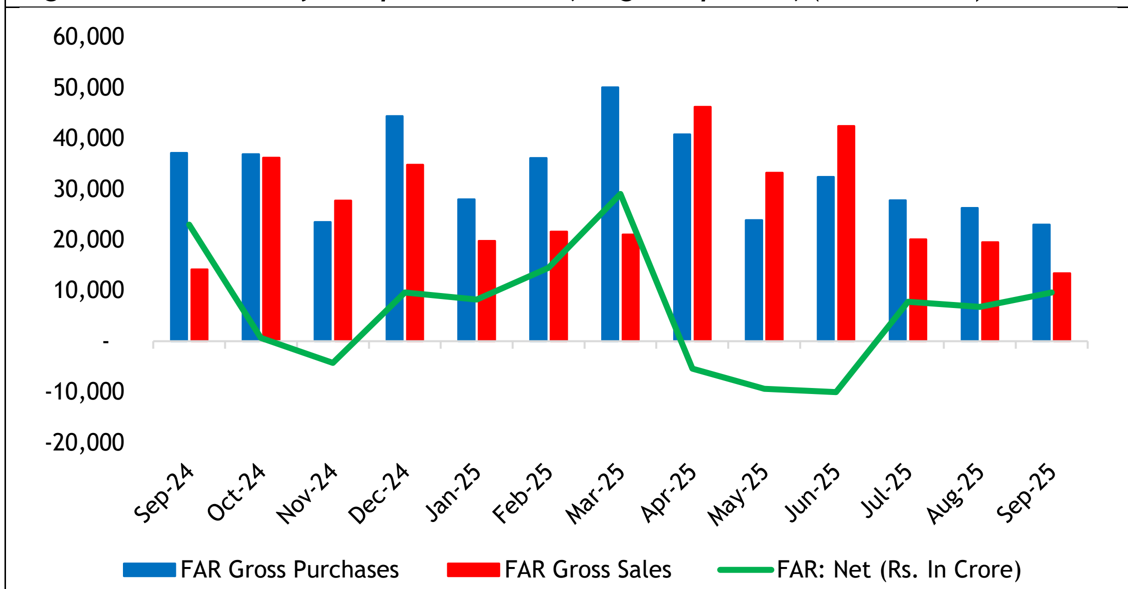
Source: Bloomberg, CEIC, UBI Research

Fig.3: Market activity benign in Sep'25; Rs. in Crore



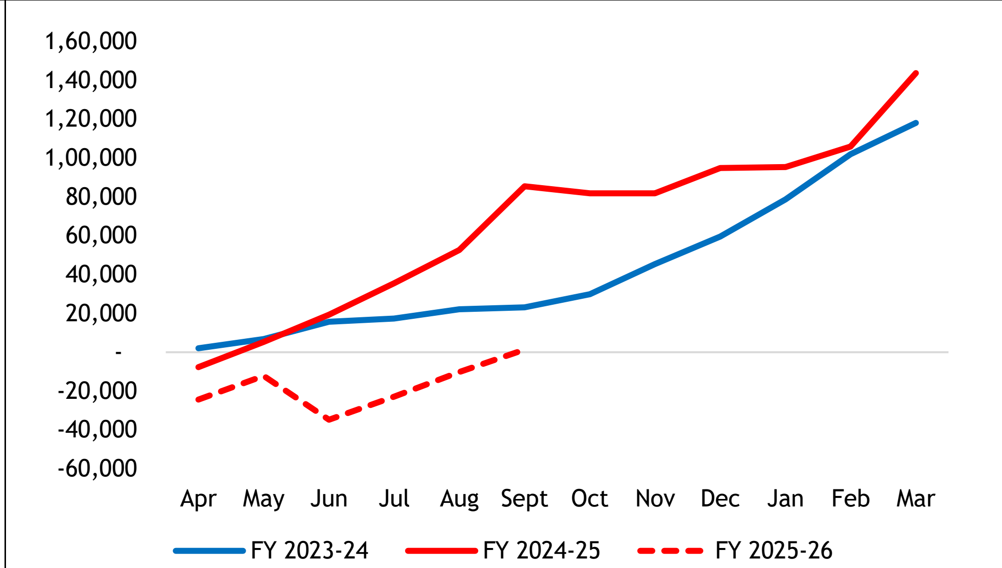
Source: Bloomberg, UBI Research

Fig.4: FAR securities flows positive in Jul, Aug & Sep 2025; (Rs. In Crore)



Source: CEIC, UBI Research

Fig.5: Cumulative FPI flows under Debt Segment; (Rs. In Crore)



Source: NSDL, UBI Research

Table 2: Fixed Income tracking Heatmap

Fixed Income Heatmap	Apr-24	May-24	Jun-24	Jul-24	Aug-24	Sep-24	Oct-24	Nov-24	Dec-24	Jan-25	Feb-25	Mar-25	Apr-25	May-25	Jun-25	Jul-25	Aug-25
	Growth																
PMI Manufacturing (YoY Gr%)	58.80	57.50	58.30	58.10	57.50	56.50	57.50	56.50	56.40	57.70	56.30	58.10	58.20	57.60	58.40	59.10	59.30
PMI Services (YoY Gr%)	60.80	60.20	60.50	60.30	60.90	57.70	58.50	58.40	59.30	56.50	59.00	58.50	58.70	58.80	60.40	60.50	62.90
GST Collection (YoY Gr%)	12.42	9.96	7.63	10.28	9.99	6.47	8.92	8.54	7.26	12.29	9.09	9.89	12.58	16.39	6.20	7.50	6.49
Govt Expenditure (YoY Gr%)	39.26	-37.87	-18.42	0.12	20.94	2.63	31.65	3.63	22.15	12.43	-17.66	9.65	9.95	40.26	37.39	3.35	
Vehicle registrations (% y/y)	26.93	3.49	1.62	14.21	3.40	-7.45	33.66	13.88	-11.44	7.75	-5.33	0.70	3.44	6.10	5.40	-3.53	2.88
Exports (% y/y)	1.98	13.27	2.44	0.63	-14.09	-0.30	16.57	-5.30	-1.53	-2.62	-11.08	0.66	8.59	-2.79	-0.05	7.30	6.72
Imports (% y/y)	11.07	7.30	4.64	11.20	10.00	7.77	1.89	16.10	2.32	10.31	-16.34	11.36	19.12	-1.74	-3.72	8.60	-10.13
	Inflation																
CPI (Y-o-Y Gr%)	4.83	4.80	5.08	3.60	3.65	5.49	6.21	5.48	5.22	4.26	3.61	3.34	3.16	2.82	2.10	1.61	2.07
Core CPI (Y-o-Y Gr%)	3.23	3.12	3.14	3.39	3.40	3.49	3.67	3.64	3.58	3.67	3.99	4.10	4.11	4.24	4.41	4.12	4.11
	Transmission																
Bank Credit (YoY Gr%)	19.21	20.72	17.40	13.71	13.59	12.34	11.80	11.16	11.16	12.54	12.26	11.03	10.09	8.96	9.48	10.04	10.04
Bank Deposits (YoY Gr%)	12.56	14.02	11.12	10.57	10.83	10.38	11.50	11.25	9.83	12.06	12.01	10.28	9.79	9.89	10.05	10.17	10.22
C-D Ratio (%)	79.90	79.90	79.70	79.70	79.80	79.60	79.80	79.90	80.80	80.70	80.80	81.10	80.10	79.30	79.30	79.60	79.70
WALR O/s Rupee Loans (%)	9.81	9.81	9.89	9.89	9.89	9.88	9.88	9.87	9.86	9.87	9.80	9.77	9.68	9.67	9.44	9.38	
WALR Fresh Rupee Loans (%)	9.55	9.39	9.32	9.40	9.41	9.37	9.54	9.40	9.25	9.33	9.40	9.35	9.26	9.20	8.62	8.80	
WADR O/s (%)	6.97	6.99	7.00	7.00	7.01	7.04	7.04	7.06	7.08	7.09	7.10	7.11	7.11	7.07	7.00	6.92	
WADR Fresh (%)	6.49	6.49	6.49	6.51	6.49	6.57	6.47	6.47	6.60	6.62	6.55	6.72	6.34	6.11	5.75	5.61	
MCLR 1 Year - Median	8.85	8.79	8.85	8.85	8.93	8.95	8.95	9.00	9.00	9.00	9.05	9.00	9.00	8.95	8.90	8.75	8.60

Source: CEIC, UBI Research

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