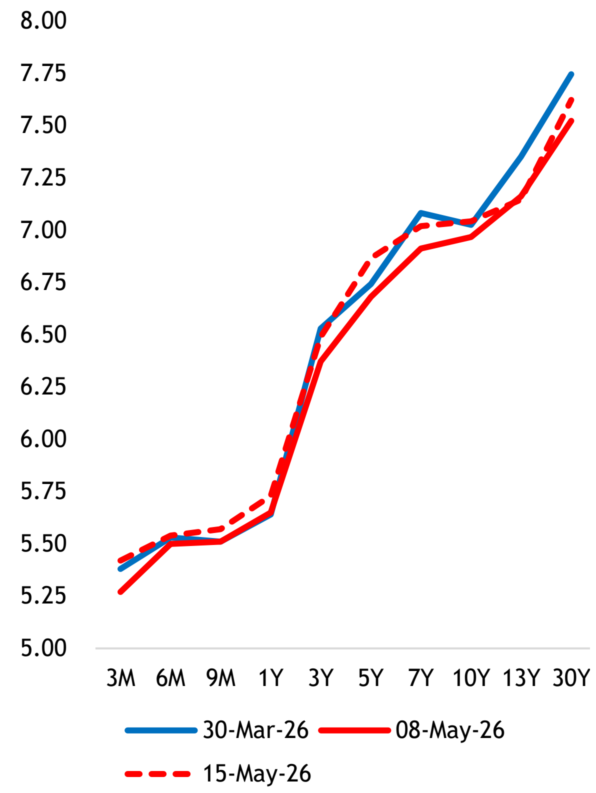
18th May 2026

Fig.1: Yield Curve turning flat as short term curve move up; (%)



Source: Bloomberg, UBI research

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Global fixed income markets witnessed a sharp repricing as US 10-year Treasury yields decisively breached the 4.60% mark, triggering a broad-based sell-off across sovereign debt markets and tightening global financial conditions. Market pricing remained heavily distorted by the continuing geopolitical deadlock between the US and Iran, which kept crude oil prices elevated and inflation risk premia firmly embedded across global yield curves. The spillover into India was visible through rising G-sec yields, with the benchmark 10-year yield drifting toward the 7.10% zone despite stable long-end demand. Domestically, macro signals turned increasingly nuanced. CPI inflation remained contained at 3.48%, while WPI surged sharply to 8.30%, highlighting mounting input-cost pressures without immediate retail pass-through. This widening divergence is complicating the inflation outlook and narrowing room for future policy flexibility, particularly as OIS markets have started pricing in the possibility of near-term rate hikes — significantly ahead of the broader market consensus which continues to expect tightening only in H2FY27. Liquidity conditions tightened materially through the week, with banking system surplus liquidity falling sharply amid persistent credit-deposit mismatch, higher currency leakage, and INR weakness near record lows. Rising Certificate of Deposit (CD) issuance to a seven-year high reinforced the underlying funding stress, with CD rates continuing to lead and overshoot policy rates — a classic signal of tightening liquidity and evolving rate expectations. Importantly, unlike FY26 where durable liquidity support was largely provided through OMOs, the RBI in FY27 has shifted toward a Variable Rate Repo (VRR)-led liquidity framework and has not fully sterilised FX-related liquidity outflows. This has allowed money market rates to remain firm and funding conditions to tighten more organically. The evolving backdrop reinforces the need for pre-emptive fund-raising by banks, as delays could expose balance sheets to materially higher incremental funding costs in the coming months.

US Treasury shock: 10 year yields breaks above 4.60%

- Global bond markets witnessed a sharp sell-off during the week, with the US 10-year Treasury yield decisively breaching the critical 4.60% threshold and touching nearly 4.65%, its highest level in almost a year. The move marked a major repricing of the global interest rate outlook.
- Sticky inflation data, resilient consumer spending, and elevated producer price pressures reinforced the Federal Reserve's "higher-for-longer" stance. Elevated crude oil prices and persistent geopolitical tensions further intensified inflation concerns, while rising fiscal deficits and heavy US Treasury issuance amplified pressure on long-duration bonds.
- The surge in US yields sent shockwaves through global debt markets. The UK 30-year Gilt touched a 28-year high, while Japan's 30-year sovereign yield hit an unprecedented 4.00% mark as domestic producer costs jumped at their fastest pace since 2014.

Domestic Bond Market under pressure

- Indian government bonds tracked the global fixed income sell-off, with the benchmark 10-year G-Sec yield decisively moved toward the 7.10% zone. Rising US Treasury yields, elevated crude prices, and INR weakness continued to weigh heavily on domestic sentiment.
- Friday's ₹32,000 crore gilt auction saw the RBI accept the entire notified amount, providing some stability to the primary market despite cautious investor positioning. Demand for the newly issued 40-year 2066 bond was led primarily by long-term investors such as EPFO and insurance companies, while participation from public sector banks remained relatively limited.
- The RBI fixed the coupon on the new 40-year paper at 7.71%, broadly in line with market expectations. However, appetite for shorter-duration securities remained weak, with the cut-off price for the 6.36% 2031 bond coming in below expectations amid growing speculation that the domestic rate cycle could gradually shift toward tightening later in the financial year. OIS markets have also started pricing in the possibility of near-term rate hikes, contrasting with broader market expectations of tightening only in H2FY27.

CPI vs WPI: Divergence deepens, but stagflation risks still evolving

- India's retail inflation (CPI) for April 2026 came in at 3.48% YoY, marginally higher than March's 3.40% but still comfortably within the RBI's tolerance band. Food inflation accelerated to 4.20%, driven by vegetables, cereals, and weather-related supply disruptions, while fuel pass-through to consumers remained relatively contained.
- In sharp contrast, Wholesale Price Inflation (WPI) surged to 8.30% YoY, rising sharply from 3.88% in March and marking the highest level in over three years. The spike was largely driven by a 24.71% jump in fuel and power prices, along with higher manufacturing and metal input costs amid elevated global crude oil prices and supply chain stress.
- The widening gap between CPI at 3.48% and WPI at 8.30% highlights severe input-cost pressures building within the economy. While the divergence has revived market discussions around stagflation risks, India is not yet facing a classic stagflationary environment. Credit growth remains healthy at around 12–14%, domestic demand conditions are still resilient, and economic activity remains stable. However, if elevated wholesale inflation persists alongside slowing growth and INR weakness, RBI's policy flexibility could narrow considerably in the coming quarters.

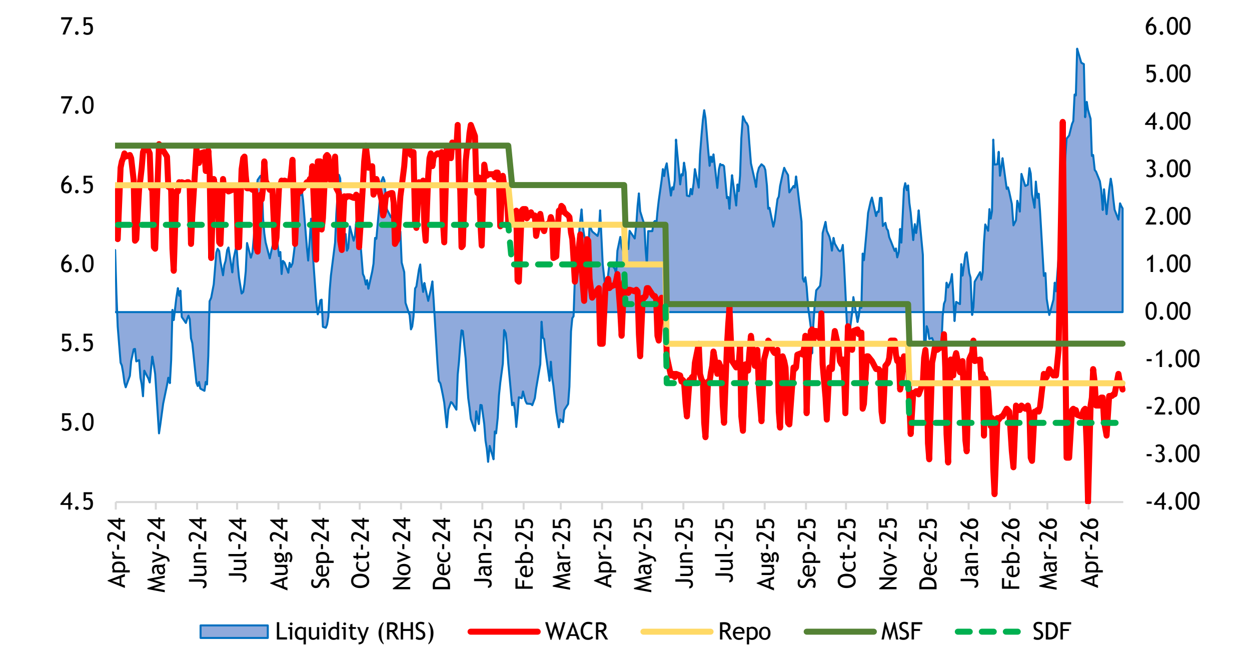
Liquidity tightens as INR pressure drains Banking system funds

- Systemic banking liquidity tightened sharply during the week, with surplus liquidity falling to ₹1.42 lakh crore on 17th May from ₹2.22 lakh crore on 10th May. The average liquidity surplus for May has also moderated significantly to around ₹2.19 lakh crore, compared with ₹3.84 lakh crore in April 2026, reflecting a rapid withdrawal of excess system liquidity.
- Added pressure came from FX-driven liquidity absorption as INR volatility intensified and the currency weakened toward record lows near 96.40. Unlike FY26, where liquidity pressures were largely offset through OMOs, the RBI has shifted toward a VRR-led liquidity framework in FY27 and has not fully sterilised FX-related liquidity outflows.
- This tightening is also clearly reflected in money market instruments. Certificate of Deposit (CD) issuance surged to a seven-year high of ₹457 billion in April, as banks increasingly relied on market borrowings to bridge asset-liability mismatches. The accompanying CD rate behaviour (as seen historically in the CD-Repo cycle) shows that CD yields tend to lead and overshoot Repo during tightening phases, reflecting both liquidity scarcity and forward rate expectations — a pattern consistent with the current cycle where CD rates remain elevated above policy signals.
- Ahead of the June 5 policy meeting, market focus remains on announcement of the RBI dividend expected in May 2026.

Table 1: Market Snapshot Instrument	Yield (May 15)	Weekly Change	Commentary
10 Year G-Sec (6.48% GS 2035)	7.04%	+ 8 bps	Crude moves up, uncertainty escalates
1 Year T-Bill	5.73%	+ 8 bps	Surplus Liquidity reduced
US 10 year Yield	4.59%	+ 24 bps	Inflation expectations increased amid oil shocks
Credit Growth (%) (as of 30th Apr'26)	16.0%	+100 bps	Credit & Deposit growth decreased on fortnight basis with gap widening
Deposit Growth (%) (as of 30th Apr'26)	12.3%	+ 9 bps	
Credit Deposit Wedge (bps) (as of 30th Apr'26)	372	+90 bps	

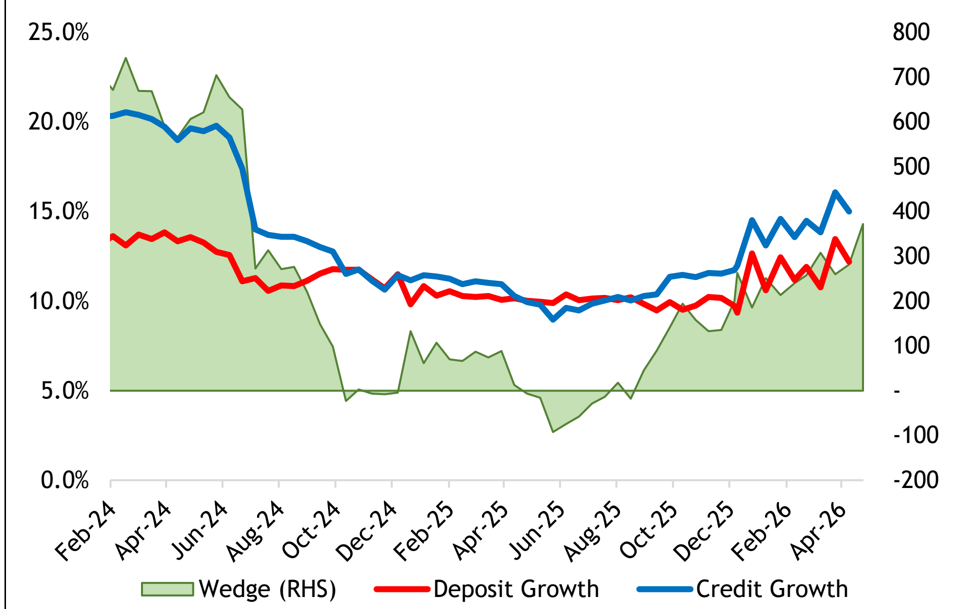
Source: RBI, CCIL, UBI Research

Fig.2: Alignment of WACR to Repo amid surplus liquidity



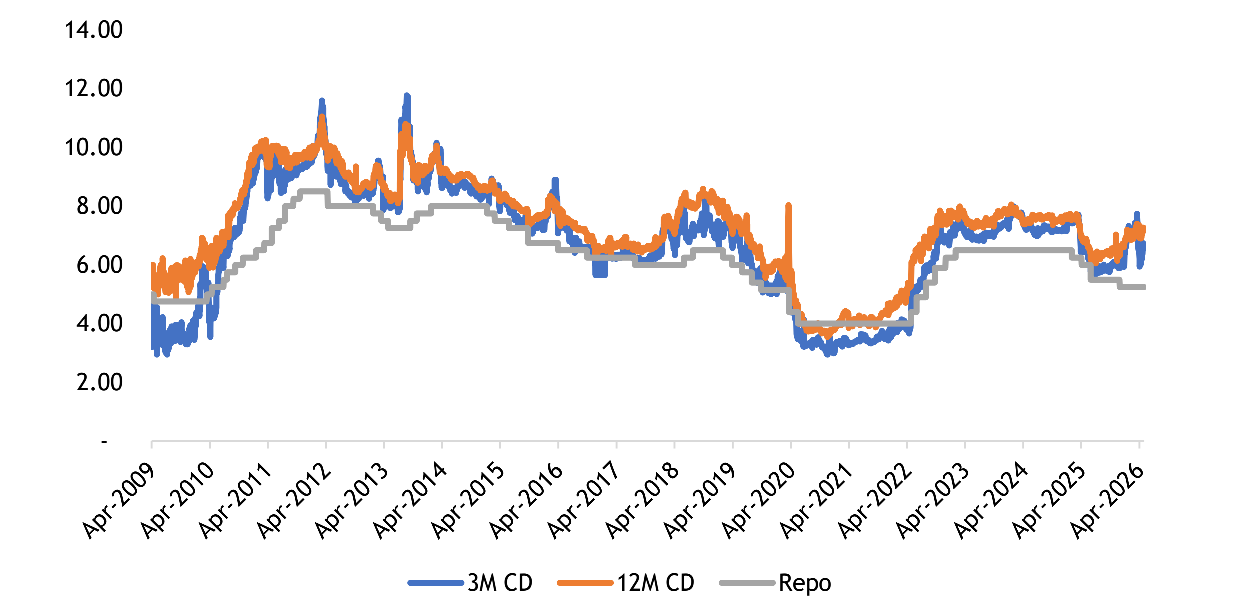
Source: RBI, CEIC, UBI Research

Fig.3: Credit Deposit Gap widened to ~372 bps in fortnight ending 30th Apr 2026



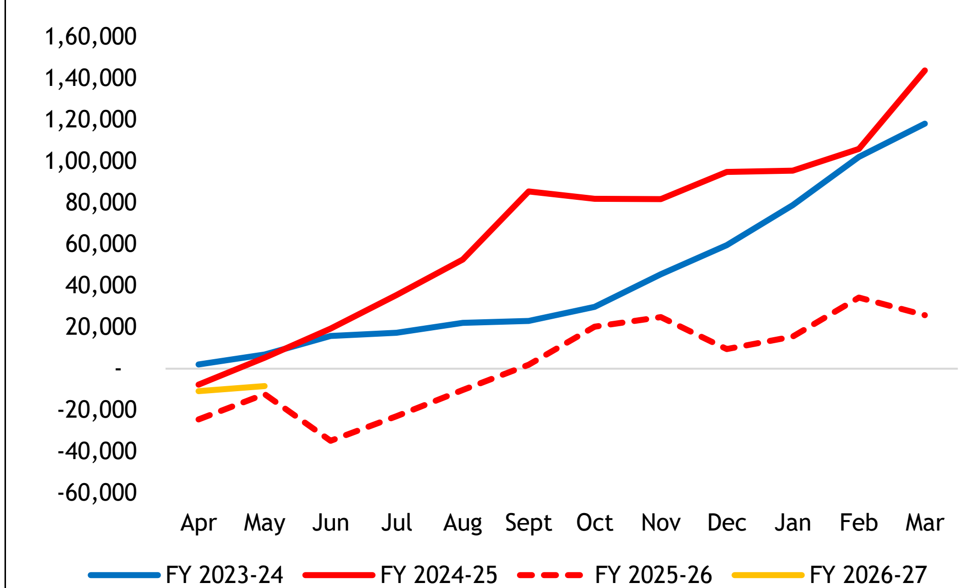
Source: CEIC, UBI Research

Fig.4: CD Rates vs Policy Rate dynamics; (%)



Source: Bloomberg, 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	Sep-25	Oct-25	Nov-25	Dec-25	Jan-26	Feb-26	Mar-26	Apr-26
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	57.70	59.20	56.60	55.00	55.40	56.90	53.90	54.70
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	60.90	58.90	59.80	58.00	58.50	58.10	57.50	58.80
GST Revenue (YoY Gr%)	12.42	9.96	7.63	10.28	9.99	6.47	8.92	8.54	7.26	12.29	9.09	9.87	12.58	16.39	6.20	7.50	6.49	9.11	4.59	-3.97	1.27	1.95	2.82	2.07	
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	-9.88	-7.99	-11.07	12.42	-7.33	-8.52	9.69		
Vehicle registrations (% y/y)	25.67	3.76	2.06	14.12	3.80	-6.41	33.64	13.85	-7.80	5.99	-5.52	0.21	2.85	5.87	5.32	-3.13	3.43	6.13	41.88	2.77	16.08	18.60	25.31	26.85	13.34
Exports (% y/y)	14.97	10.95	3.27	-5.25	-14.09	-0.96	16.60	-5.34	-1.53	-2.64	-10.86	0.86	-3.83	-1.23	-1.32	13.27	5.72	6.03	-12.50	18.59	1.15	0.37	-0.79	-7.44	13.79
Imports (% y/y)	11.08	7.35	5.25	11.91	10.44	8.29	3.22	16.75	2.75	10.66	-14.81	12.54	19.99	-1.33	-3.43	9.10	-9.54	17.67	17.92	-1.48	10.26	19.85	25.01	-6.51	10.03
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	1.44	0.25	0.71	1.33	2.73	3.21	3.40	3.48
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	4.27	4.41	4.34	4.63	3.38	3.41	3.36	3.40
Transmission																									
Bank Credit (YoY Gr%)	19.21	20.72	17.40	13.71	14.03	12.34	11.80	11.16	11.16	12.53	12.26	11.03	10.09	8.96	9.48	10.04	10.12	10.79	12.00	11.54	14.54	13.41	14.00	17.08	16.45
Bank Deposits (YoY Gr%)	12.56	14.02	11.12	10.57	12.72	10.38	11.50	11.25	9.83	12.12	12.01	10.28	9.79	9.89	10.06	10.17	9.31	9.36	10.84	10.18	12.67	10.64	11.31	16.16	13.24
C-D Ratio (%)	79.90	79.90	79.70	79.70	78.80	79.60	79.80	79.90	80.80	80.60	80.80	81.10	80.10	79.30	79.30	79.60	79.30	80.50	80.60	80.80	82.00	82.60	82.60	81.70	82.30
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	9.71	9.67	9.44	9.38	9.32	9.26	9.24	9.21	9.06	9.04	9.00	8.99	
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	8.81	8.72	8.39	8.61	8.71	8.28	8.49	8.44	8.40	
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	6.87	6.82	6.78	6.73	6.68	6.64	6.62	6.62	
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	5.56	5.61	5.57	5.59	5.67	5.66	5.65	6.07	
MCLR 1 Year - Median	8.85	8.79	8.85	8.85	8.90	8.95	8.95	9.00	9.00	9.00	9.05	9.00	9.00	8.95	8.90	8.75	8.60	8.60	8.55	8.50	8.45	8.40	8.45	8.40	8.55

Source: CEIC, UBI Research

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