

Fig.1: Fiscal and Borrowings impact on yields

Parameter	Optimistic	Base Case	Pessimistic
Fiscal Deficit FY27	4.0-4.2%	4.3%	≥ 4.5%
Gross Borrowings	< Rs. 16 Trillion	Rs. 16.1 - Rs. 16.9 Trillion	≥ Rs. 17 Trillion
Expected 10Y yield range	6.25% - 6.50%	6.50% - 6.70%	6.80% - 7.10%

Source: UBI Research

Global bond markets are at an inflection point, with US 10-year yields stabilizing around 4.20-4.25% and Japanese 10-year yields rising to 2.25-2.30%, narrowing historical differentials and increasing global duration volatility. Divergent monetary paths and USD-JPY dynamics are driving cross-border flows and carry-trade adjustments. In India, the 10-year benchmark (6.48% GS 2035) remains range-bound in the 6.62-6.67% zone during the previous week. Recent auctions on January 23 (₹32,000-33,000 crore) were smoothly absorbed, supported by long-term demand and expectations of RBI support. Liquidity conditions remain tight despite RBI action. The advancement of ₹1 lakh crore OMO purchases to January 29 and February 5, alongside VRR operations and a \$10 billion FX swap, signals policy support, though CD rates remain elevated due to seasonal tightness, strong credit growth, FX-related liquidity absorption, and structural funding gaps. The FY27 Budget (February 1) is the key catalyst. Markets expect a fiscal deficit of 4.3-4.5% of GDP and gross borrowings of ₹16.1-16.9 trillion, with outcomes hinging on how ₹5.5 lakh crore of redemptions are managed through fresh issuance versus cash balances, switches, buybacks, and other tools.

**Global Yields at an Inflection Point:**

- The US 10-year Treasury yield has eased modestly toward 4.20-4.25% after testing higher levels earlier in the month. While easing tariff-related concerns have provided temporary relief, markets remain cautious ahead of the FOMC, with policy rates expected to be held steady. The broader narrative continues to be “restrictive for longer,” anchoring yields at elevated levels.
- Japanese 10-year JGB yields have surged to around 2.25-2.30%, marking levels last seen in the late 1990s. This sharp move reflects a combination of BoJ policy normalization, reduced bond purchases, higher inflation compensation, and domestic political uncertainty following election-related developments. Volatility in JGBs has increasingly spilled over into global duration markets.
- Elevated US yields had earlier supported aggressive yen-funded carry trades; however, recent yen strength (USD/JPY near 153-154) suggests partial unwinding amid rising intervention risks. Market chatter around coordinated efforts to curb excessive USD strength underscores how currency stability is now critical to containing further upward pressure on Japanese yields.

**India G-Secs - Supply absorbed but caution prevails:**

- The 10-year benchmark (6.48% GS 2035) has traded largely between 6.62% and 6.67%, hovering near 10-month highs. Strong domestic macro prints, elevated SDL supply, and cautious positioning ahead of the Budget have limited any meaningful rally, even as outright levels remain attractive.
- At the January 23, 2026 auction, the government raised around ₹32,000-33,000 crore across key tenors. The auction cleared smoothly, with cut-offs broadly aligned with secondary market expectations and no significant tailing, indicating steady but price-sensitive demand. Long-term investors such as insurers and pension funds continue to provide a stable bid, particularly at the long end. This demand, combined with expectations of RBI support through OMOs, has helped prevent a sharp breakout in yields despite sustained supply pressures.

**RBI liquidity push - scale and signal:**

- The RBI has moved forward its OMO purchase auctions to January 29 and February 5, injecting ₹50,000 crore in each tranche (total ₹1 lakh crore) of government securities to support durable liquidity and ease pressure on bond yields. This rescheduling was prompted by rising yields and the need to reinforce liquidity ahead of Budget.
- These auctions are part of a broader set of measures that include 90-day VRR operations and a \$10 billion 3-year USD/INR buy-sell swap, aimed at smoothing funding conditions and stabilizing the money market as systemic liquidity comes under seasonal and structural stress.
- Why CD rates are “Flying”:
  - Seasonal Pressures: CD rates typically spike during the Jan-Mar quarter, often peaking in March. This year, rollover of deposit maturities, strong credit demand, and expectations of even tighter conditions later in the quarter have led banks to lock in funds at elevated levels. Notably, 3- and 6-month CD rates are trading at or above 1-year rates, reflecting mutual funds’ preference for shorter tenors and their bargaining power in a stretched funding environment.
  - Market Transmission Effects: A sharp rise in short-term forward rates has spilled into money markets, further pushing up CD pricing. There is growing market consensus that RBI may consider shifting swap operations toward shorter tenors (1 year or below) to address this distortion more effectively.
  - Systemic Liquidity Constraints: Multiple factors continue to weigh on liquidity this quarter—FX intervention, high government cash balances, currency leakage, and seasonal tax outflows. While RBI has largely offset FX-related drains, deposit creation remains constrained. Measures such as easing CRR maintenance, more frequent VRR operations, or temporary uncollateralized facilities could help tide over seasonal frictions.
  - Structural Drivers keeping rates elevated: Beyond seasonality, banks face a structural credit-deposit growth gap. Core deposits (CASA and retail term deposits) are insufficient, forcing reliance on CDs and other wholesale funding at higher costs. This is also putting pressure on regulatory metrics such as LCR, NSFR, and CD ratios, especially for large PSU banks issuing short-term CDs to meet quarter-end LCR requirements.

**Budget 2026-27 - The Fiscal test for Bonds:**

- With the Union Budget scheduled for February 1, 2026, markets are focused on fiscal consolidation and borrowing discipline rather than just the headline deficit. A credible glide path for debt-to-GDP is seen as key to yield stability.
- Borrowing & Deficit Scenarios:
  - *Optimistic:* Fiscal deficit 4.0-4.2% of GDP; gross borrowings < ₹16 trillion; 10-year yields 6.25%-6.50%.
  - *Base Case:* Fiscal deficit ~4.3%; gross borrowings ₹16.1-₹16.9 trillion; 10-year yields 6.50%-6.70%.
  - *Pessimistic:* Fiscal deficit ≥ 4.5% of GDP; gross borrowings ≥ ₹17 trillion; 10-year yields 6.80%-7.10%.
- A key market divide revolves around the treatment of ₹5.5 lakh crore of redemptions, as the extent of fresh issuance versus reliance on cash balances, switches, buybacks, and other liability-management operations will directly shape gross borrowing and term premia.

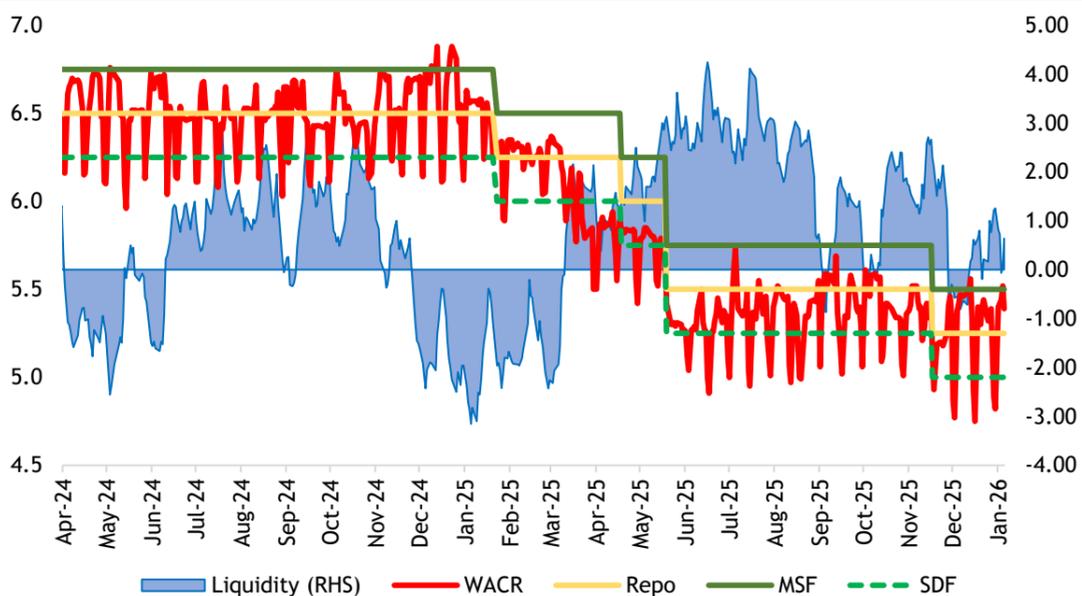
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Table 1: Market Snapshot Instrument	Yield (Jan 23)	Weekly Change	Commentary
10 Year G-Sec (6.33% GS 2035)	6.66%	-2 bps	Market focuses on state borrowings amid OMO announcement
1 Year T-Bill	5.67%	+6 Bps	Liquidity tightened due to Fx impact as Rupee volatility widens
US 10 year Yield	4.22%	- bps	Political & Economic concerns
Credit Growth (%) (as of 31 <sup>st</sup> Dec'25)	14.5%	+255 bps	Credit & Deposit growth increased on fortnight basis and the gap widened
Deposit Growth (%) (as of 31 <sup>st</sup> Dec'25)	12.7%	+332 bps	
Credit Deposit Wedge (bps) (as of 31 <sup>st</sup> Dec'25)	186	-77bps	

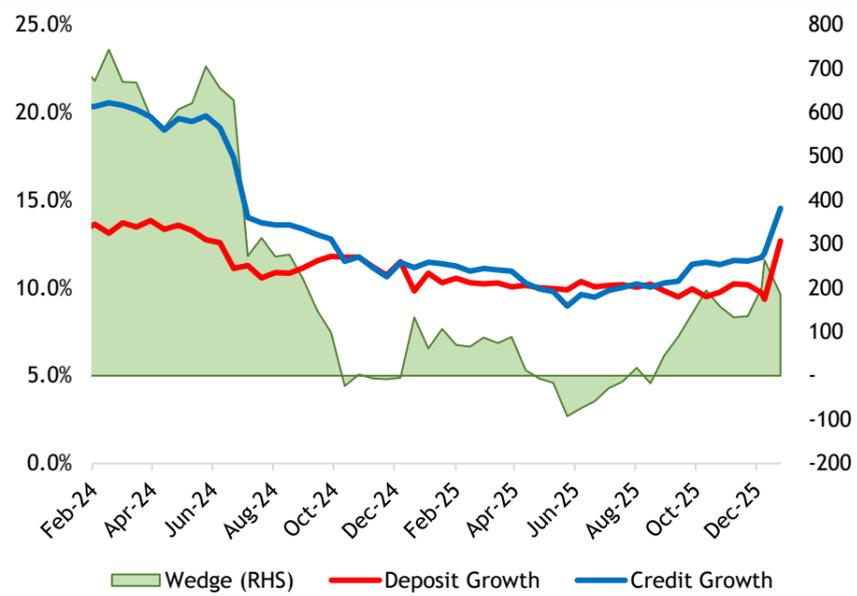
Source: RBI, CCIL, UBI Research

Fig.3: WACR moved to lower band liquidity conditions eased; (%)



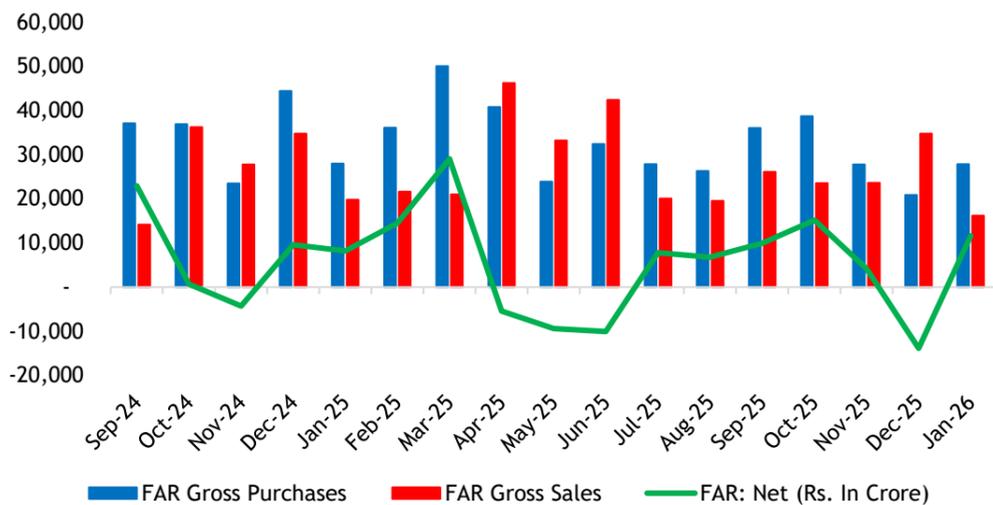
Source: Bloomberg, CEIC, UBI Research

Fig.4: Credit Deposit Gap widened at ~186 bps in fortnight ending 31<sup>st</sup> Dec'25



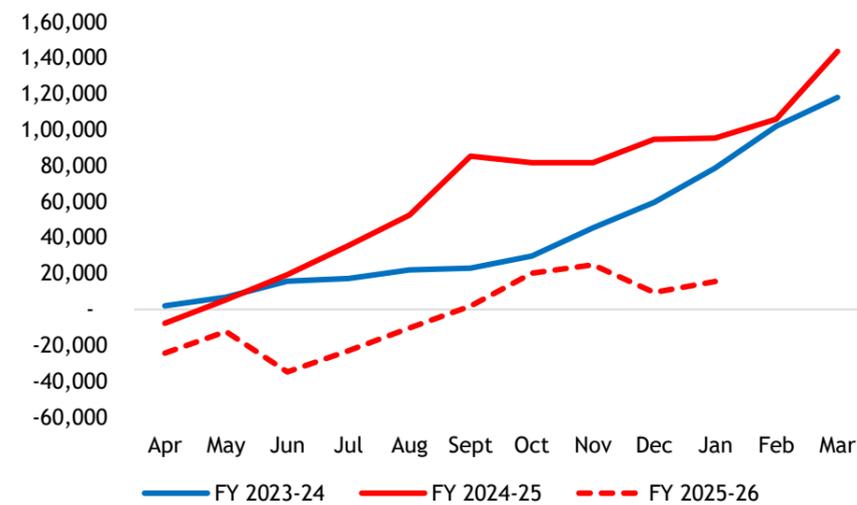
Source: CEIC, UBI Research

Fig.5: Negative Flows in FAR securities in Dec'25 Since Jun'25; (Rs. In Crore)



Source: CEIC, UBI Research

Fig.6: 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
<b>Growth</b>																						
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	56.80
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	59.30
GST Collection (YoY Gr%)	12.42	9.96	7.63	10.28	9.99	6.47	8.92	0.65	-0.20	12.29	9.09	9.89	12.58	16.39	6.20	7.50	6.49	9.11	4.59	3.56	6.07	
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		
Vehicle registrations (% y/y)	25.22	4.38	2.80	14.51	4.58	-5.29	33.50	10.54	-8.65	6.32	-4.91	1.17	2.61	6.13	5.70	-2.48	3.94	6.72	41.95	1.36	13.57	
Exports (% y/y)	14.97	10.95	3.27	-5.25	-14.09	-0.96	16.60	-5.34	-1.54	-2.64	-10.86	0.85	-3.82	-1.23	-1.34	13.27	5.75	6.08	-12.37	19.33	1.88	
Imports (% y/y)	11.08	7.35	5.25	11.91	10.44	8.29	3.22	16.75	2.66	10.66	-14.81	12.13	19.99	-1.33	-3.41	9.10	-9.54	17.67	16.97	-1.98	8.76	
<b>Inflation</b>																						
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	
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	
<b>Transmission</b>																						
Bank Credit (YoY Gr%)	19.21	20.72	17.40	13.71	14.03	12.34	11.80	11.16	11.16	12.54	12.26	11.03	10.09	8.96	9.48	10.04	10.12	10.79	12.00	11.53	14.54	
Bank Deposits (YoY Gr%)	12.56	14.02	11.12	10.57	12.72	10.38	11.50	11.25	9.83	12.06	12.01	10.28	9.79	9.89	10.06	10.17	9.31	9.36	10.84	10.19	12.68	
C-D Ratio (%)	79.90	79.90	79.70	79.70	78.80	79.60	79.80	79.90	80.80	80.70	80.80	81.10	80.10	79.30	79.30	79.60	79.30	80.50	80.50	80.80	82.00	
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	9.32	9.26	9.24	9.21		
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		
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		
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		
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	

Source: CEIC, UBI Research

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