



Indian Bond Market Resilience Amid Global Volatility: Why India's Benchmark Bond Yields Remain Relatively Stable

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Recent Developments:

- The **Indian bond market** has remained comparatively resilient amid heightened global volatility, with the **10-year benchmark government bond yield** reportedly increasing by only **8 basis points** over the six months ending **14 August 2026**, substantially less than the increase recorded across several major economies.
- Over the same period, benchmark yields increased by **60 basis points in the United States**, **66 basis points in Japan**, **56 basis points in the United Kingdom**, **72 basis points in South Korea**, **78 basis points in Indonesia** and **61 basis points in the Philippines**, highlighting India's relative stability.
- The resilience has occurred despite external pressures arising from **geopolitical tensions, energy-price risks, global monetary-policy uncertainty and monsoon-related concerns**.
- Stronger-than-expected foreign-currency inflows have recently supported India's external position. The **Reserve Bank of India** reported that the special **FCNR(B) deposit swap facility** attracted **\$52.3 billion** by 13 August 2026, prompting its early closure on **31 August 2026**, instead of the originally planned 30 September 2026.
- The RBI's current policy framework also provides an important backdrop to bond-market stability. Its published market data show the **policy repo rate at 5.25%**, with the **Standing Deposit Facility rate at 5.00%** and the **Marginal Standing Facility rate at 5.50%** in July 2026.
- The **Economic Survey 2025-26** had already highlighted that active cash and liquidity management, together with strategic government-security issuance, helped reduce borrowing-cost volatility; the weighted average borrowing cost of government securities issued during FY26 was reported at **6.65%**, compared with **6.96%** in FY25.

Understanding Bonds and Bond Yields:

What Is a Government Bond?

- A **government bond** is a debt instrument through which the government raises funds from investors for a specified period and generally pays periodic interest before returning the principal at maturity.
- In India, **Government Securities**, or **G-Secs**, include dated securities issued by the Central Government and Treasury Bills issued for shorter maturities.
- G-Secs are generally considered to carry **negligible credit risk in the domestic-currency context**, although investors remain exposed to market risk arising from changes in interest rates and bond prices.

What Is Bond Yield?

- **Bond yield** represents the return associated with holding a bond and is influenced by its market price, coupon and remaining maturity.

- Bond prices and market yields generally move in an **inverse relationship**; when market interest rates rise, existing bond prices tend to fall, while declining yields generally support higher bond prices.
- Therefore, a rise in the yield of a benchmark government bond generally indicates that investors are demanding a higher return to hold government debt.

Why Is the 10-Year Yield Important?

- The **10-year government bond yield** is widely used as a benchmark for pricing and assessing longer-term borrowing conditions in an economy.
- Changes in the benchmark yield can influence the cost of funds for **banks, companies, infrastructure projects and households**, although actual lending rates also depend on credit risk, liquidity and other financial-market conditions.
- A sustained rise in yields can reflect expectations of **higher inflation, tighter monetary policy, greater government borrowing, increased risk premia or stronger global yields**.
- Relatively stable yields can indicate that investors consider the combination of **inflation, fiscal policy, growth and external-sector conditions** manageable.

Why Indian Bond Yields Remained Relatively Stable:

Global Yield Pressures:

- Major economies experienced substantially larger increases in 10-year benchmark yields during the six-month period ending 14 August 2026.
- **United States:** +60 basis points.
- **Japan:** +66 basis points.
- **United Kingdom:** +56 basis points.
- **South Korea:** +72 basis points.
- **Indonesia:** +78 basis points.
- **Philippines:** +61 basis points.
- **India:** +8 basis points.
- The relatively small movement in India indicates that domestic factors partly offset the global upward pressure on sovereign yields.

Domestic Inflation–Growth Combination:

- India's comparatively favourable **inflation-growth mix** has reduced the immediate need for aggressive monetary tightening.
- A relatively benign inflation trajectory provides the **Monetary Policy Committee** with greater flexibility to assess incoming data rather than responding mechanically to global rate increases.
- The Economic Survey has also highlighted the role of declining borrowing costs and active debt-management practices in limiting volatility in government-security yields.
- Lower and more stable inflation expectations can reduce the inflation premium demanded by bond investors, thereby supporting government-bond prices and limiting upward pressure on yields.

External and Domestic Forces Shaping the Bond Market:

External Pressures:

- **Geopolitical tensions in West Asia** can raise energy prices and thereby create inflationary pressure for energy-importing economies such as India.
- Higher crude-oil prices can simultaneously increase the **import bill, current-account pressure and inflation risks**, creating potential upward pressure on bond yields.

- Concerns surrounding **El Niño and monsoon performance** can also affect food inflation, agricultural output and rural demand.
- Changes in **United States monetary policy** remain important because higher US Treasury yields can increase the relative attractiveness of dollar-denominated assets and exert pressure on emerging-market currencies and bonds.

Domestic Offsetting Factors:

- India has benefited from relatively contained inflation, resilient economic activity, an improving external-sector position and expectations of continued fiscal consolidation.
- These factors can reduce the risk premium demanded by investors and help contain upward pressure on sovereign yields.
- The combination of **stable growth and manageable inflation** is particularly important because a strong growth environment can improve fiscal revenues while lower inflation reduces the need for aggressive monetary tightening.

Monetary Policy: A Relatively Cautious Approach:

Role of the Monetary Policy Committee:

- The **Monetary Policy Committee**, or **MPC**, determines the policy repo rate with the primary objective of maintaining price stability while keeping in mind the objective of growth.
- A relatively stable inflation environment gives the MPC greater scope to maintain an appropriate policy stance rather than immediately following rate increases undertaken by other emerging economies.
- India's approach therefore differs from economies that may raise policy rates to counter stronger inflationary pressures or defend their currencies.
- The RBI's policy-rate framework directly influences short-term money-market conditions, while expectations regarding future policy rates influence longer-term government-bond yields.

Policy Transmission to Bond Markets:

- An expected increase in policy rates can raise short-term yields and, through expectations, put upward pressure on longer-term government-bond yields.
- Conversely, expectations of stable or lower policy rates can support demand for longer-duration government securities.
- Consequently, the stability of India's inflation outlook has helped prevent external pressures from translating into a proportionately large rise in domestic bond yields.

RBI's Foreign-Exchange and Liquidity Measures:

FCNR(B) Deposit Facility:

- The RBI introduced measures to encourage foreign-currency inflows through **Foreign Currency Non-Resident (Bank)** deposits and related swap arrangements.
- The special facility attracted **\$52.3 billion through FCNR(B) deposits by 13 August 2026**, demonstrating a substantially stronger response than initially anticipated.
- The strong response led the RBI to announce that the special swap facility would close on **31 August 2026**, one month earlier than the initially scheduled date.
- Additional inflows were generated through arrangements linked with **External Commercial Borrowings and overseas foreign-currency borrowings**, strengthening the supply of foreign currency to the financial system.

Why Foreign-Currency Inflows Matter:

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- Strong foreign-currency inflows can support the **balance of payments and foreign-exchange liquidity**, thereby reducing pressure arising from external financing conditions.
- A more comfortable external position can reduce concerns about excessive currency depreciation, which is relevant for imported inflation and foreign-investor sentiment.
- Improved external liquidity can therefore indirectly support domestic financial stability and government-bond markets.

Liquidity Impact on the Banking System:

Surplus Liquidity:

- Foreign-currency inflows and RBI liquidity operations can affect the availability of funds within the domestic banking system.
- According to the supplied market assessment, **surplus liquidity averaged around ₹3.2 lakh crore during 1–13 August 2026**, compared with around ₹1.3 lakh crore during the corresponding period in July.
- Greater surplus liquidity can place downward pressure on overnight money-market rates when banks have fewer incentives to borrow funds from one another.
- Easier short-term liquidity conditions can support the transmission of monetary policy and reduce immediate funding stress within the financial system.

Impact on Certificates of Deposit:

- Stronger deposit mobilisation can strengthen the funding base of banks and reduce their dependence on market-based instruments such as **Certificates of Deposit**.
- Lower reliance on relatively costly wholesale funding can reduce the funding pressure faced by banks.
- A stronger deposit base can also support credit expansion without creating excessive dependence on short-term market borrowing.

Foreign Investment in Indian Debt:

Positive Policy Developments:

- India has continued to take measures aimed at deepening the **government and corporate bond markets** and increasing foreign participation.
- Tax and regulatory changes have sought to make Indian government debt more attractive to foreign investors while widening the range of securities accessible to them.
- The RBI has also progressively expanded the securities available for foreign investment, including longer-maturity government securities.
- The Economic Survey recognises the importance of foreign portfolio flows and global financial conditions in shaping Indian debt and equity markets.
- SEBI maintains dedicated frameworks and statistical reporting for **Foreign Portfolio Investors**, including their debt-market investments and utilisation of investment limits.

Bloomberg Global Aggregate Index Setback:

- On **31 July 2026**, Bloomberg Index Services deferred the inclusion of Indian government bonds in its **Global Aggregate Index**, despite recent reforms intended to facilitate foreign investment.
- The deferment temporarily weakened expectations of additional index-driven foreign inflows into Indian government securities.
- Bloomberg's decision was presented as requiring more time for recent market improvements to become sufficiently established in practice.
- The episode demonstrates that **market accessibility, taxation, settlement systems, liquidity and regulatory predictability** all influence India's integration into global bond indices.

Deepening India's Bond Market:

Government Securities Market:

- A deeper government-securities market can improve **price discovery, liquidity and monetary-policy transmission** while providing the government with a broad investor base.
- The RBI notes that India's government-securities market provides liquidity and that retail participation has been facilitated through the **RBI Retail Direct** framework.
- Government securities also provide important reference rates for pricing other debt instruments throughout the financial system.

Corporate Bond Market:

- India needs a deeper **corporate bond market** to reduce excessive dependence of large borrowers on bank credit.
- The **Union Budget 2026-27** proposed a market-making framework for corporate bonds, along with access to funds and derivatives on corporate-bond indices and **Total Return Swaps on corporate bonds**.
- These measures are intended to improve **secondary-market liquidity, price discovery, risk management and institutional participation**.
- SEBI data and official statements indicate that India's corporate bond market has expanded substantially, reaching about **₹58.2 trillion by the end of January 2026**, with the market recording roughly **12% compound annual growth since FY15**.

Municipal Bonds:

- Municipal bonds can provide urban local bodies with an alternative source of long-term infrastructure finance.
- The **Union Budget 2026-27** proposed a **₹100 crore incentive** for a single municipal-bond issuance exceeding **₹1,000 crore**, aimed at encouraging larger and more credible municipal issuances.
- A stronger municipal-bond ecosystem can improve **urban infrastructure financing, fiscal decentralisation and market-based resource mobilisation**.

Key Risks to India's Bond Market Outlook:

Inflation and Food Prices:

- A significant rise in food or energy inflation could reduce the scope for monetary accommodation and increase expectations of higher policy rates.
- A persistent inflation shock could therefore reverse the recent stability in long-term government-bond yields.

Global Monetary Policy:

- Higher-for-longer interest rates in advanced economies, particularly the **United States**, can encourage global investors to shift capital towards developed-market assets.
- Such capital movements can increase pressure on emerging-market currencies, external financing conditions and domestic bond yields.

Fiscal Position:

- Higher government borrowing requirements can increase the supply of government securities and place upward pressure on yields if demand does not increase proportionately.

- The relationship between **fiscal consolidation and borrowing requirements** therefore remains important for long-term bond-market stability.

Geopolitical and Commodity Risks:

- Prolonged geopolitical tensions can increase crude-oil and other commodity prices, creating simultaneous pressure on **inflation, the current account and fiscal management**.
- Such a combination can increase the risk premium demanded by bond investors.

Significance for the Indian Economy:

For the Government:

- Stable government-bond yields can help contain the **cost of public borrowing**, which is particularly important when fiscal resources are required for subsidies, infrastructure and welfare expenditure.
- Lower borrowing costs can reduce the interest burden over time and create greater fiscal space for productive expenditure.

For Banks:

- Stable sovereign yields provide a more predictable benchmark for the pricing of loans and investments.
- Stronger deposit growth and improved liquidity can reduce banks' dependence on expensive market-based funding.

For Businesses:

- More stable benchmark yields can improve the predictability of financing costs for corporations.
- A deeper corporate-bond market can also diversify corporate financing away from excessive dependence on bank loans.

For Households:

- Government-bond yields influence broader financial conditions and can affect the pricing of loans, deposits and fixed-income investment products.
- Greater stability in benchmark rates can therefore improve predictability for households undertaking long-term financial commitments.

For Financial Stability:

- A diversified investor base, deeper bond markets, stronger banking-system liquidity and stable inflation can reduce the vulnerability of the financial system to individual external shocks.
- However, excessive foreign dependence in debt markets can also create vulnerability to sudden global capital reversals, making **domestic institutional investors** important for market resilience.

UPSC Prelims: Key Facts:

- **Government Securities:** Debt instruments issued by governments to finance public expenditure and manage public debt.
- **Bond Price–Yield Relationship:** Bond prices and yields generally move **inversely**.
- **10-Year Government Bond Yield:** An important benchmark for long-term interest rates.
- **G-Secs:** Generally considered to have negligible credit risk in the domestic-currency context, but they remain subject to market risk.
- **MPC:** Determines India's policy repo rate within the monetary-policy framework.
- **FCNR(B):** Foreign Currency Non-Resident (Bank) deposit category.

- **FPI:** Foreign Portfolio Investor.
- **Corporate Bonds:** Debt securities issued by companies to raise funds from investors.
- **Municipal Bonds:** Debt instruments issued by eligible urban local bodies or related entities to finance public infrastructure.
- **Yield Curve:** Represents the relationship between yields and maturities of debt securities.
- **Term Spread:** The difference between yields on securities of different maturities and an important indicator of market expectations.

UPSC Mains Perspective:

Why has India's bond market shown greater resilience than several emerging markets?

- India's relative resilience reflects the interaction of **moderate inflation, resilient growth, fiscal credibility, external-sector management, domestic institutional demand and targeted RBI interventions**.
- The RBI's ability to use liquidity and foreign-exchange tools without relying exclusively on policy-rate changes has provided additional flexibility.
- Strong domestic demand for government securities can also reduce India's dependence on volatile foreign portfolio flows.
- The resilience should therefore be interpreted as the outcome of **macroeconomic stability and policy flexibility**, rather than as immunity from global shocks.

What reforms are required to deepen India's bond market?

- India should strengthen **secondary-market liquidity, market making, corporate-bond participation, municipal-bond financing, bankruptcy resolution, credit enhancement and investor diversification**.
- Greater participation by pension funds, insurance companies and retail investors can provide a more stable domestic investor base.
- Improved market infrastructure and predictable taxation can make Indian debt securities more attractive to global investors.
- The objective should be to develop a bond market capable of efficiently mobilising **long-term capital for infrastructure and productive investment** without creating excessive financial instability.

Conclusion:

- The relative stability of Indian government-bond yields amid global volatility reflects the combined influence of **moderate inflation, resilient growth, fiscal management, external-sector resilience, domestic demand and targeted monetary and liquidity interventions**.
- The recent surge in foreign-currency inflows through the **FCNR(B) facility** demonstrates the RBI's ability to use targeted instruments to address external financing pressures without depending solely on policy-rate changes.
- Nevertheless, India's bond market remains exposed to **global interest rates, geopolitical shocks, commodity prices, inflation, fiscal borrowing and capital-flow volatility**.
- The long-term policy objective should therefore be not merely to maintain stable yields during individual episodes of global turbulence, but to build a **deep, liquid, diversified and resilient domestic debt market** capable of financing India's investment and development requirements.

Value Addition for UPSC:

One-Line Analytical Statement:

- “India's bond-market resilience reflects not the absence of global shocks, but the growing ability of domestic macroeconomic fundamentals and targeted policy instruments to absorb those shocks.”

Cause–Mechanism–Outcome Framework:

- **Global shock:** Higher global yields, geopolitical tensions and commodity-price uncertainty.
- **Domestic buffer:** Moderate inflation, resilient growth, fiscal credibility and stronger external-sector management.
- **Policy response:** Targeted foreign-exchange measures, liquidity management and calibrated monetary policy.
- **Market outcome:** Relatively contained movement in India's benchmark government-bond yield.
- **Developmental implication:** Lower and more predictable borrowing costs, deeper debt markets and improved financing conditions.