

FIXED INCOME

Weekly Wrap-Up



Domestic and global macro setup

Global central banks turn more hawkish

The US Federal Reserve raised the Fed Funds rate by 25 bps to 3.75%–4.00%, marking its first hike since July 2023, with its updated dot plot signalling the possibility of further increases. The US 10-year Treasury yield rose to around 4.95%. The Bank of Japan also raised its policy rate by 25 bps to 1.25% in a 7–2 vote, while the Bank of England kept its rate unchanged at 3.75%, with three members dissenting in favour of a hike amid persistent inflation.

CPI inflation rises in August

August CPI inflation rose to 4.82% YoY from 4.45% in July. Food inflation increased to 5.66% from 5.20%, while core inflation rose to 4.16% from 3.87%. Headline inflation moved above the 4% target, while core inflation also edged higher into the low-4% range.

Oil prices remain elevated

Brent crude rose above \$108/bbl amid supply disruptions in the Gulf and Red Sea before easing to around \$104/bbl towards the end of the week following diplomatic developments.

RBI shifts towards durable liquidity absorption

With the Foreign Currency Non-Resident (Bank) [FCNR(B)] swap window closing early after mobilising around \$128 billion, the RBI has turned to outright Open Market Operation (OMO) sales to absorb the resulting surplus liquidity.

Our view

Two of the three major central banks that met this week raised policy rates, while the third held rates with hawkish dissent. This puts additional pressure on the RBI through the interest-rate differential channel, even as domestic food and fuel inflation are picking up. So far, the RBI's response has focused on liquidity rather than policy rates, with OMO sales being used to absorb the surplus created by the FCNR(B) swap window.

We reiterate our expectation of 50–75 bps of rate hikes beginning in Q3 FY27, driven by two factors: (i) risks from higher food and fuel inflation and (ii) the need to maintain an interest-rate differential that remains supportive of capital-account flows.

India-US Interest Rate Differentials



Source: Bloomberg, Reuters, Federal Reserve, BOJ, ECB, PIB, IndiaDataHub, Internal Research Groww Mutual Fund

Liquidity and yield curve dynamics

Liquidity conditions tighten despite LAF surplus

Net Liquidity Adjustment Facility (LAF) surplus stood at ₹7.38 lakh crore. However, underlying banking-system liquidity is tightening, with advance-tax outflows, festive-season currency leakage, foreign-exchange sales and Open Market Operation (OMO) sales all draining liquidity.

OMO sale clears at higher yields

The RBI accepted the full notified amount, with cut-off yields clearing around 7 bps higher than market expectations.

RBI signals preference for tighter liquidity

The RBI appears willing to accept higher yields to absorb surplus liquidity, consistent with its preference for keeping the Weighted Average Call Rate (WACR) closer to the repo rate rather than the Standing Deposit Facility (SDF) floor.

Money market: WACR drifted up to 4.89%, compared with the repo rate at 5.25% and the SDF rate at 5.00%. Secondary Commercial Paper (CP) and Certificate of Deposit (CD) yields softened by 3–5 bps late in the week on institutional demand, while 6-month to 1-year bank CD yields remained sticky at 6.85%–7.15%.

Government securities: The 10-year benchmark (6.94% GS 2036) hardened by around 10 bps mid-week to 7.10%, driven by OMO sales, higher Brent crude prices and rate-hike concerns, before closing near 7.05%. The yield curve flattened following the OMO sales announcement, with the spread between the 1-yr Treasury bill and 10-yr G-Secs narrowing to around 100 bps from approximately 110 bps a fortnight earlier.

Credit: AAA-rated corporate bond curves tightened by 2–3 bps late in the week. One- to three-year high-grade corporate bonds continue to offer a meaningful carry over sovereign securities.

Source: FTRAC, RBI, CCIL, Reuters, Internal Research Groww Mutual Fund

Investment implications (illustrative views only)

Hawkish signals from global central banks, rising domestic CPI inflation and active liquidity absorption by the RBI point towards a barbell approach: accrual at the front end, with long-end exposure added gradually. Capital preservation and carry remain the key priorities. These are generic, non-personalised observations.

- **Money Market Segment (6 months–1 year):**

Certificate of Deposit (CD) and Commercial Paper (CP) yields remain sticky, supporting carry at the shorter end of the curve and limiting exposure to long-end volatility.

- **Short corporates (1–3-year):**

Spreads have tightened by 2–3 bps but remain sufficiently wide, with 1–3-year AAA-rated paper offering scope for roll-down with relatively limited duration exposure. The suitability of such instruments depends on individual risk profiles and investment horizons.

- **Long-End Government Securities (30 years):**

The attractive term premium available at the longer end of the G-Sec curve presents an opportunity for a gradual lock-in strategy, particularly for investors with a longer investment horizon.

Source: CCIL, Internal Research Groww Mutual Fund

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Groww Mutual Fund, SEBI Registration No. MF/068/11/03

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