"Understanding the changing drivers of India 10Y G-sec Yield"

India witnessed a significant shift in banking system liquidity conditions, marked by large-scale RBI interventions through OMO operations, FX Swaps, policy rate cut and Variable rate repo/reverse repo operations which ensured comfortable liquidity conditions. Conventional monetary theory suggests that abundant liquidity should ease long-term bond yields. However, the 10-year Government Security (G-sec) yield did not soften but rebounded in the latter half of FY26.

While liquidity transmission initially reduced yields (Jan-May 2025), the compression of the India-US 10-year yield spread to around 1.8% in May-25 brought Indian bond yields below their relative equilibrium levels. Although US yields declined after May 2025, Indian 10-year yields began to rise. This indicates that the earlier fall in domestic yields driven by liquidity support was not fully sustained. As domestic factors and liquidity conditions normalized, Indian yields rebounded, leading to a widening of the India-US spread.

During H2FY26, elevated government borrowing requirements and heavy auction calendar likely contributed to upward pressure on term premia, limiting the downward impact of surplus liquidity.

This study analyses the relationship between RBI liquidity measures, global yield movements, India-US yield spreads and forex dynamics to understand the behaviour of India's 10-year G-sec yield during Apr 2024-Jan 2026.The analysis explores the structural drivers behind this liquidity-yield disconnect.

"Determinants of 10Y G sec Yield: Liquidity, Global yield & Fx dynamics						
Month	NET OMO (In Rs Crore)	Average of Net Injection (+)/ Absorption (-) (In Rs Crore)	10Y G-Sec month end yield (%)	US 10Y Monthly Average (%)	India-US yield spread	Forex monthly change (In Rs crores)**
Apr-24	0	-76236	7.17	4.54	2.63	-49615
May-24	0	-33867	7.00	4.48	2.52	96497
Jun-24	0	-37451	7.04	4.31	2.73	-1563
Jul-24	-10535	-81021	6.97	4.25	2.72	178565
Aug-24	-7690	-94999	6.90	3.87	3.03	106994
Sep-24	-5815	-95129	6.77	3.72	3.05	192429
Oct-24	-20	-114914	6.83	4.10	2.73	-178648
Nov-24	0	-102413	6.78	4.36	2.42	-163918
Dec-24	20	-40373	6.77	4.39	2.38	-129821
Jan-25	48660	17810	6.70	4.63	2.07	19565
Feb-25	80000	-14448	6.74	4.45	2.29	127572
Mar-25	144551	-101531	6.61	4.28	2.33	122828
Apr-25	120000	-169278	6.40	4.28	2.12	105240
May-25	119203	-194640	6.22	4.42	1.80	97718
Jun-25	10	-259618	6.36	4.38	1.98	71519
Jul-25	0	-178262	6.42	4.39	2.03	59213
Aug-25	0	-160212	6.64	4.26	2.38	89480
Sep-25	10	-110558	6.64	4.12	2.52	80563
Oct-25	0	-111688	6.62	4.06	2.56	-92842
Nov-25	27280	-178626	6.60	4.09	2.51	29773
Dec-25	154155	-124350	6.65	4.14	2.51	28475
Jan-26	217445	-108271	6.77	4.21	2.56	476261*

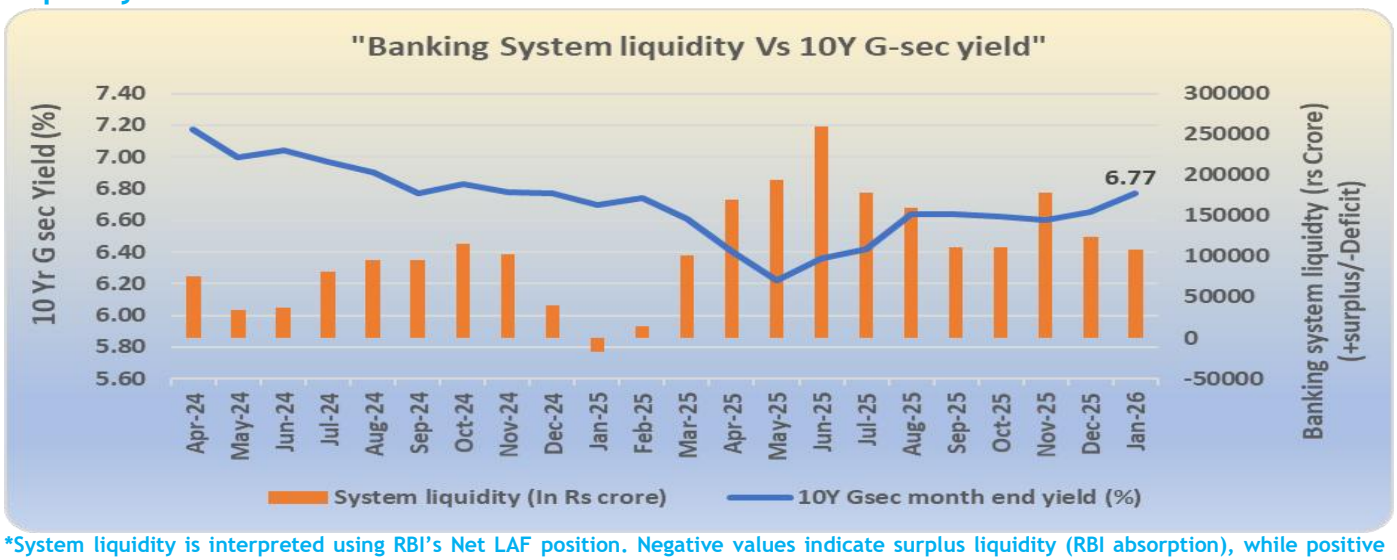
*Jan 2026 based on weekly forex data as on 30.01.2026 (Provisional)

It is noteworthy that although liquidity remained surplus, it consistently remained below the 1% NDTL comfort zone except for a brief period in mid-2025 (Jun-25).

**Negative value (-) indicates surplus liquidity (net absorption), while positive (+) values indicate liquidity deficit (net injection).*

***Forex monthly change represents month on month change in RBI's foreign exchange reserves. Positive value indicate increase in reserves, while negative values indicate decline.*

Liquidity vs 10Y G-sec Yield:



*System liquidity is interpreted using RBI's Net LAF position. Negative values indicate surplus liquidity (RBI absorption), while positive values indicate (RBI injection).

For graphical presentation, the signs are inverted for ease of interpretation.

positive (+) values denote liquidity surplus and negative (-) values denote liquidity deficit.

Phase I: Tight to neutral liquidity (Apr-24 to Dec-24). Liquidity remained in surplus, but the magnitude was moderate.10Y yield gradually declined from ~7.17% to ~6.77%. Yield decline was slow and orderly. Liquidity was not strong enough to cause sharp compression. Yield movement appears influenced by broader macro factors rather than liquidity alone.

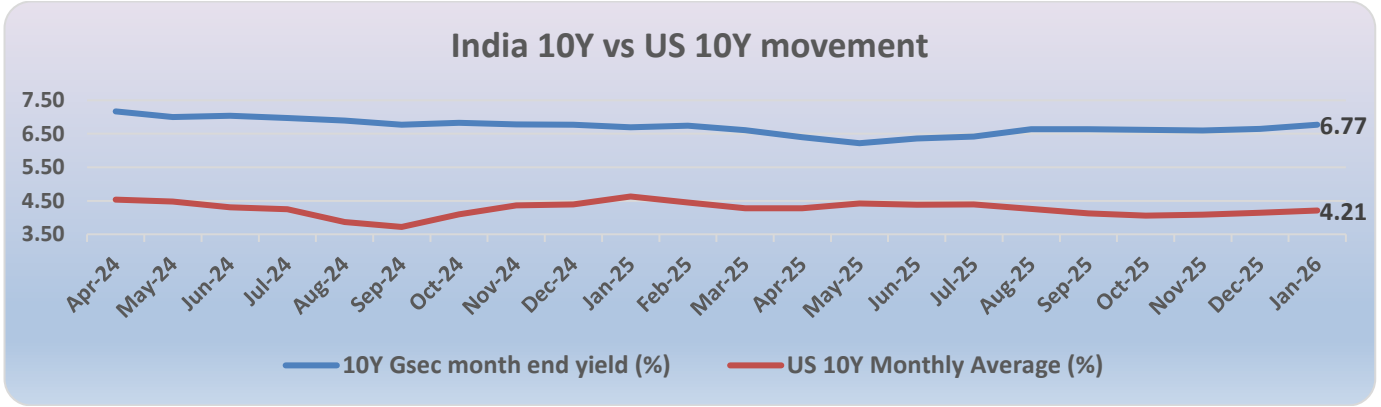
Phase II: Liquidity surge & Yield compression (Jan-25 to May-25). While liquidity conditions were mixed in Jan-Feb 2025, a sharp expansion in surplus became visible from March onwards. Peak surplus visible around May-Jun 2025 (~₹2.5-2.6 lakh crore).10Y yield fell to ~6.22% (lowest point). This period shows the phase marked by high transmission, higher surplus and lower yields. Liquidity was temporarily effective in compressing long-term yields.

Phase III: Yield reversal despite moderated but persistent Surplus (Jun-25 to Jan-26). Liquidity remained in surplus during this period, although the magnitude moderated after the June peak, it remained positive. However, yield hardened, from ~6.22% to ~6.77%. This presents the key disconnect. Even with surplus liquidity, Yields did not remain anchored.

Liquidity alone cannot sustain a long-duration rally. Global yield movements and spread behaviour appear to have played an increasingly important role. Structural supply factors may also have played a role. While liquidity infusion initially supported yield softening in early 2025, the relationship weakened in subsequent months. Despite continued surplus conditions, yields reversed, suggesting that liquidity was no longer the dominant driver of long-term bond yields.

The evidence suggests a diminishing marginal impact of liquidity on long term yields during the latter half of FY 25-26.

India vs US 10Y Yield:



India's 10-year G-sec yield moved from 7.17% in April 2024 to a low of 6.22% in May 2025, before rising again to 6.77% by January 2026. Over the same period, the US 10-year yield declined from 4.54% to 3.72% and later increased to 4.21%. The broad co-movement between the two yields series, particularly around key turning points, suggests the presence of global spill over effects on domestic bond markets.

Phase I (Apr-24 to Sep-24): US yield declined from 4.54% to 3.72%. India yield declined from 7.17% to 6.77%. India followed the US downtrend. This suggests global bond market influence on domestic bond yields. Liquidity was not the only driver and global easing also contributed. The parallel decline suggests that global easing influenced domestic bond yields through improved risk sentiments, relative yield adjustments and portfolio flow expectations.

Phase II (Oct-24 to May-25): US yields fluctuated but remained elevated during much of this period. Indian yield declined gradually from 6.83% to 6.70% during Oct-24 to Jan-25 despite liquidity conditions remaining mixed, suggesting that global factors and policy rate expectations initially drove the decline and again yield softened from 6.61% to 6.22% during Mar-25 to May-25 (except Feb 25 which witnessed 6.74%). Improvement in system liquidity during this phase was partly attributable to moderation in credit growth, which reduced liquidity absorption by banks rather than being solely driven by RBI liquidity injections.

Phase III (Jun-25 to Jan-26): US yields exhibited a two-step pattern during this phase, softening initially during Jun-Sep before firming gradually toward Jan-2026. whereas Indian yields began rising from June itself from 6.22% to 6.77% (6.22-6.36-6.42-6.64). This divergence suggests that domestic factors including moderation in surplus liquidity and likely normalization of term premium gained importance in pricing dynamics.
Although system liquidity remained in surplus throughout this period, its magnitude steadily declined from the June peak, reducing the marginal liquidity support to bond prices. As surplus conditions moderated, yields were less insulated from broader risk repricing pressures.
From September onward, US yields firmed gradually to 4.21% by January 2026, and Indian yields moved higher in tandem, indicating partial resynchronization with global bond markets. This implies that India's long term bond market is becoming more sensitive to global rate cycles, even in the presence of domestic surplus liquidity, global yield dynamics appear to have increasingly shaped the trajectory of domestic long-term rates.

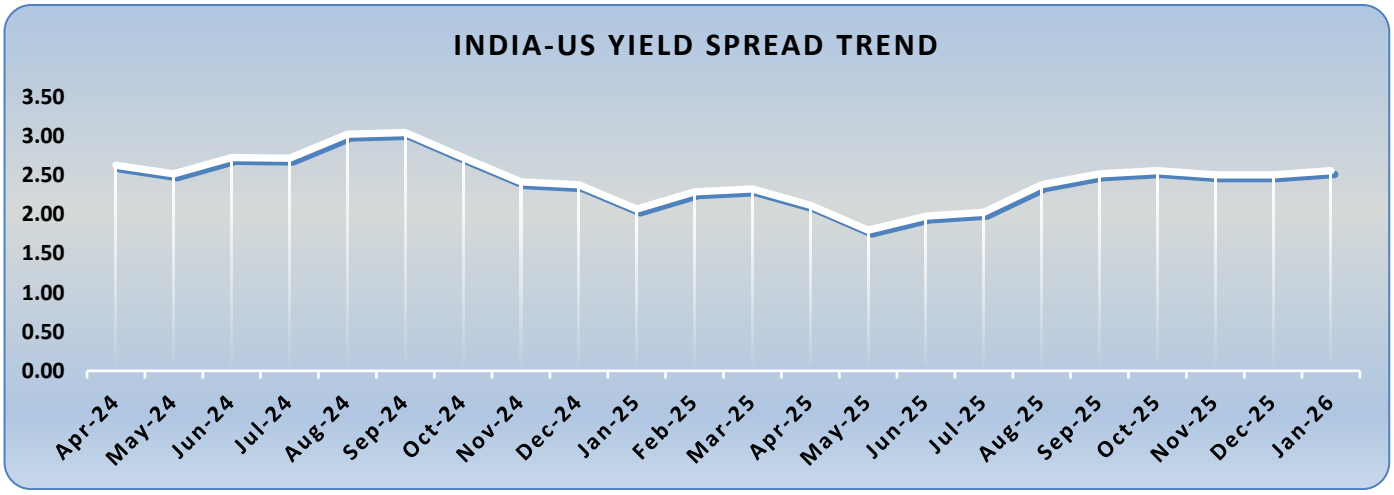
India-US Yield Spread Trend

Spread expansion phase (Aug-24 to Sep-24): India–US yield spread widened to around 3%, reflecting a favourable yield differential for India. This will improve the relative attractiveness of Indian debt for foreign portfolio investors and providing a buffer against global volatility supporting capital inflows during this period.

Spread Compression Phase (Oct-24 to Jun-25): The Spread narrowed steadily. Touched ~1.80% in May-25 (lowest point). Compression was primarily driven by a sharp decline in Indian yields amid improved liquidity conditions, while US yields remained relatively elevated. This reduced India's relative carry advantage.

Yield Re-Widening Phase (Jun-25 to Jan-26): The spread widened again to ~2.5–2.6% by Jan-26. Indian yield adjusted upward as US yield firmed and domestic liquidity support moderated. The re-widening appears aligned with global bond market repricing and evolving domestic supply demand dynamics.

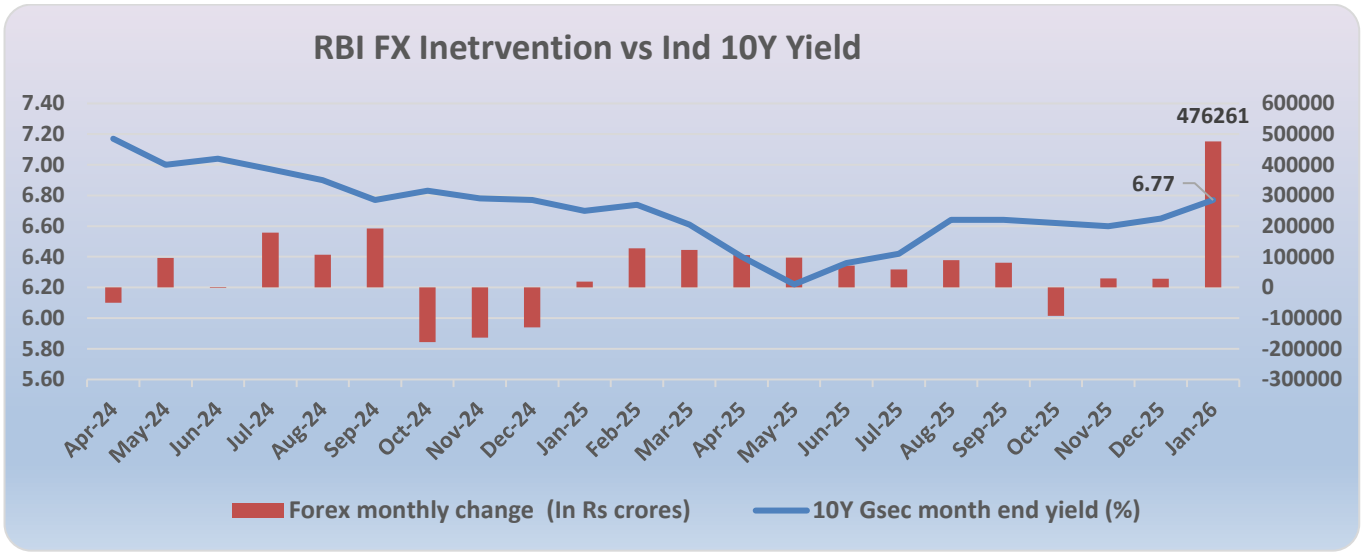
The latest widening does not appear to be liquidity-driven. Instead, it reflects global yield repricing, term premium adjustment and bond supply dynamics. The movement suggests a partial re-alignment of Indian yields with global benchmarks rather than a structural deterioration in domestic conditions.



Forex Intervention vs Yield

Foreign exchange operations influence domestic liquidity conditions. RBI's dollar purchases inject rupee liquidity, while dollar sales absorb liquidity. However, the transmission from liquidity to bond yields is neither immediate nor mechanical.

During the period under review, bond yields were shaped by a broader set of factors including government bond supply, term premium adjustments, evolving policy expectations and global yield movements. Accordingly, yield behaviour reflected the interaction of liquidity conditions with supply-demand dynamics and global spill overs, rather than FX operations alone.



Phase I (Apr-24 to Dec-24): Forex flows were mixed, with intermittent liquidity absorption. Despite this, the 10-year G-sec yield declined from 7.17% to 6.77%. This indicates that FX operations were not the dominant driver of yield movement. Instead, yield moderation was more closely aligned with global yield softening and overall liquidity stance.

Phase II (Jan-25 to May-25) (Yield Compression Phase): Moderate FX inflows seen. Liquidity conditions improved. Yield fell sharply to 6.22%. FX operations may have supported surplus conditions indirectly. Forex monthly inflows strengthened materially from March 2025 onwards. While RBI conducted FX swap operations in January–February 2025, the improvement in FX liquidity conditions became more visible from March. However, yield compression during this phase reflects combined effects of FX-related liquidity support and substantial OMO injections rather than FX swaps alone.

Phase III: Jun-25 to Jan-26 (Yield Reversal Phase): Even during months of significant FX driven liquidity expansion, notably Jan 2026, the yield did not ease materially instead Yield rose from 6.22% to 6.77%. This indicates that FX induced liquidity was insufficient to anchor long term yields. Bond pricing during this phase was increasingly influenced by global yield firming, widening India-US spread, elevated bond supply and rising term premium. While FX intervention created temporary liquidity support, its impact on long-term rates appears limited when broader global and structural forces dominate.

Liquidity is a necessary condition for lower yields but not a sufficient condition. Bond yields are determined by Policy expectation, Inflation expectation, Global yield, fiscal supply and Term premium.

Conclusion

While RBI liquidity infusion initially compressed yields, the transmission mechanism weakened in the second half of FY25-26. Global bond dynamics, widening yield spread and risk premium re-pricing offset the impact of positive liquidity.

Liquidity alone cannot anchor long-term yields.
Bond markets are increasingly sensitive to global term premium dynamics.
Sustained yield compression requires alignment of liquidity, global yields, inflation expectations and supply conditions.

Note: Data Source: RBI & FRED