Index Insights | Fixed Income

Indian government bond market - performance and outlook

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Introduction

The Indian fixed income market in 2025 is navigating a complex macroeconomic landscape. While inflation has sharply declined and the Reserve Bank of India (RBI) has shifted to a more accommodative stance, Indian government bond yields have not fallen as much as those in other Asia-Pacific markets.

This paper explores the key drivers, recent performance, and outlook for Indian government bonds, integrating macroeconomic trends, policy actions, and market data from the latest industry research.

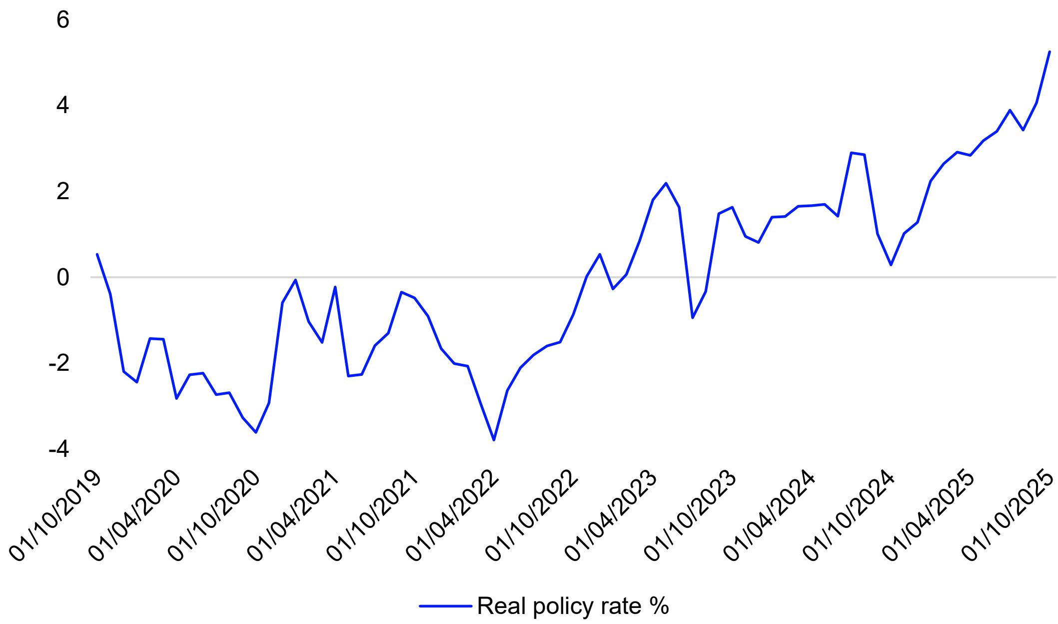
Contents

Macro backdrop: inflation, policy, and growth

Inflation and monetary policy settings

India's CPI inflation has fallen sharply, with official projections for FY26 and FY27 at 4.5% and 4.0% respectively. The sharp drop in inflation, partly driven by the decline in food prices, has resulted in a real policy rate above 5%, making monetary policy exceptionally tight, as Chart 1 shows.

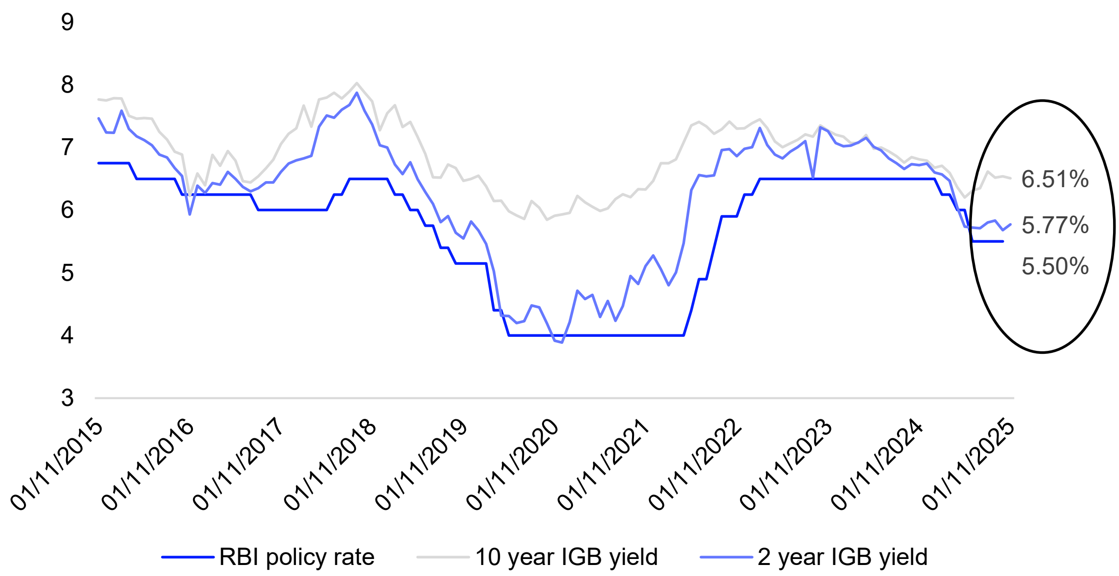
Chart 1: RBI real policy rate (nominal policy rate minus inflation rate YY)



Source: Indian Ministry of Statistics and Programme Implementation, FTSE Russell calculations. Data to October 2025.

In response, the RBI has cut policy rates by 100 basis points in 2025, reducing the repo rate from 6.5% to 5.5%. The central bank also shifted its stance to "accommodative" and implemented liquidity-boosting measures such as CRR cuts and open market operations. However, the transmission of these rate cuts to the bond market has been less effective, with yields remaining sticky, especially at the long end of the curve, see Chart 2 below.

Chart 2: RBI policy rates and government bond yields



Source: FTSE Russell. Data to end October 2025.

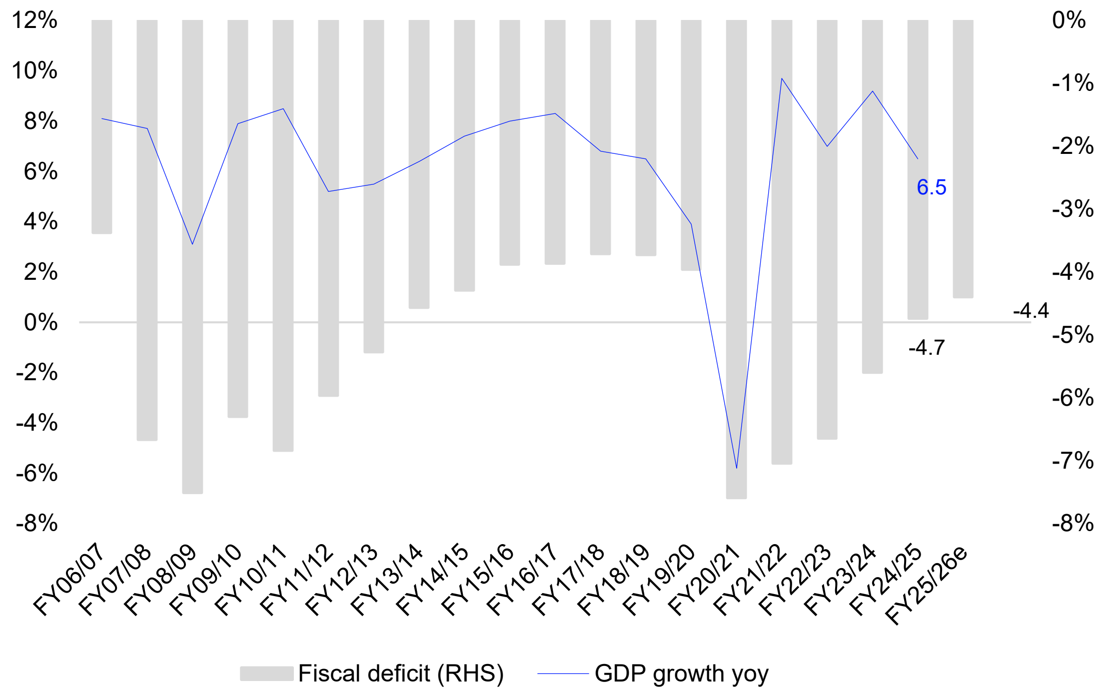
Fiscal policy and supply dynamics

With government debt sustainability becoming a major issue for investors globally, fiscal policy dynamics have become a key market focus in 2025. India's fiscal deficit remains elevated but is on a consolidation path, with the central government focusing on capital expenditure while also introducing tax cuts to boost consumption. Borrowing patterns have shifted, with the government reducing supply in ultra-long bonds and increasing issuance in the 3 to 15 year segment.

After the reduction in the Goods and Sales tax (GST) in September 2025[1], GST revenue growth has been mixed – it was higher than nominal GDP growth in early FY26 but lagging in recent months, raising concerns about fiscal headroom and the sustainability of fiscal consolidation. Chart 3 shows the planned fiscal deficit consolidation.

[1] "GST Reforms 2025: Relief for Common Man, Boost for Businesses"– Press Information Bureau, Government of India, September 4, 2025.

Chart 3: Indian fiscal balance and GDP growth



Source: Indian Ministry of Statistics and Programme Implementation, FTSE Russell. Data to end October 2025.

Growth and consumption

Meanwhile, India's GDP growth outlook remains robust. Sharp disinflation has boosted Indian real incomes and private consumption, with Indian GDP growth forecasts generally being revised higher for 2025-26, i.e., the IMF[2] revised up its forecast of 6.4% to 6.6%, after GDP growth of 7.8% annualised from April to June 2025, despite the tariff turbulence. Stronger growth may also have been a factor in slowing the RBI's policy easing cycle, which has stalled since June.

Consumer expenditure remains over 70% of GDP [3], making the economy highly sensitive to consumption trends. Bank credit growth has picked up, driven by household and MSME lending, while private capex remains subdued, indicating that the recovery is being led more by consumption and credit than by investment.

[2] IMF World Economic Outlook, October 2025.
[3] World Bank Open data, 2025.

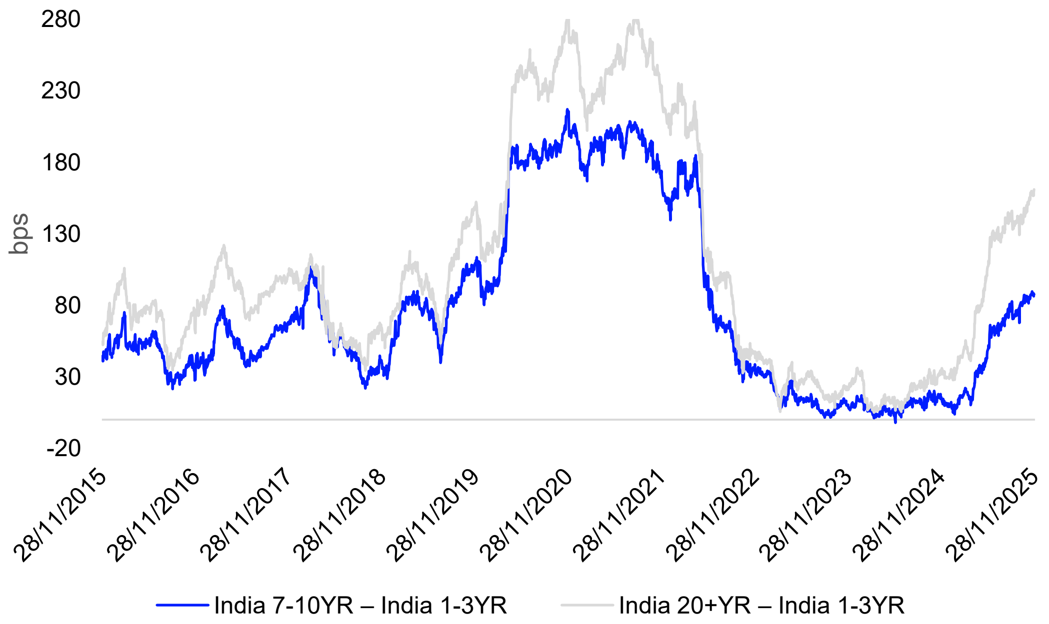
Debt market performance and structure

Yield curve and returns

The Indian yield curve has normalised, with 7 to 10 year bonds offering about 80 basis points of extra yield over 1 to 3 year bonds, and long bonds (30 years) offering about 130 basis points more. This gradient is similar to pre-Covid levels and reflects a mean-reversion in term premia. Despite global volatility and a reduction in foreign inflows in 2025, Indian government bonds have delivered positive returns year-to-date [4], supported by an August credit rating upgrade [5], which confirms the favourable economic fundamentals, and ongoing fiscal consolidation [6].

However, the transmission of policy rate cuts to market yields has proved less reliable in 2025, especially for longer maturities, which continue to reflect supply concerns and global risk sentiment, as Chart 4 shows.

Chart 4: Indian government yield curve: mediums versus shorts, longs versus shorts



Source: FTSE Russell data to end November 2025.

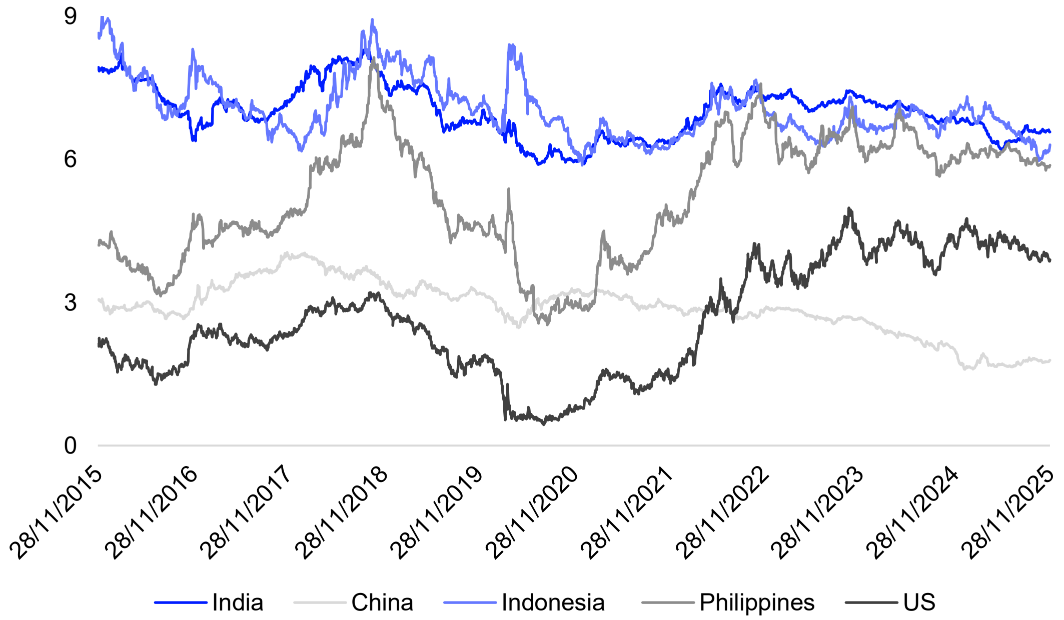
[4] FTSE Russell APAC markets Spotlight, November 2025.
[5] "India upgraded to BBB on Economic Resilience and Sustained Fiscal Consolidation; Outlook Stable", August 14, 2025.
[6] See [A resilient Indian fixed income market | LSEG](), June 2025.

Market drivers and risks

The reduction in GST and the risk of higher government bond issuance have weighed on long-dated bond performance in the second half of 2025. Foreign portfolio inflows have slowed, partly due to unresolved tariff negotiations with the US and global risk aversion. Nevertheless, India's inclusion in global indices, such as the FTSE Russell EMGBI from September 2025, may well provide a structural boost to demand for Indian government bonds.

The RBI has also actively managed liquidity through CRR cuts, open market operation (OMOs) purchases, and FX swaps, resulting in periods of excess liquidity for banks and helping to stabilise short-term rates. It should also be noted that Indian 7 to10 year government bond yields now exceed yields in the APAC peer group, despite lower Indian inflation, as Chart 5 shows.

Chart 5: India, US and selected APAC government bond yields (%)



Source: FTSE Russell, data to end November 2025.

Opportunities and challenges

With inflation well below target and real rates high, there is scope for further RBI rate cuts in 2025–26, if only to return policy to a more neutral setting, now that inflation is below the 4% target level. Improving the effectiveness of monetary transmission—especially to the capital markets—remains a key challenge. With this in mind, the RBI may use additional tools such as Operation Twist and targeted OMOs to address this and ensure that policy actions are more effectively reflected in market yields.

Conclusion and summary

The Indian government bond market in 2025 is shaped by a unique mix of tight real policy rates, fiscal recalibration, and global integration.

While recent performance has been tempered by supply concerns and tariff-related uncertainties, the combination of low inflation, index inclusion, a steep yield curve, and high relative yields versus the APAC peer group increase the appeal of Indian government bonds for both domestic and international investors.

The outlook remains constructive, provided policy transmission improves and fiscal consolidation stays on track.

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