

Annual Market Outlook

DEBT MARKET

2026



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2025: A Year of Resilience Amid Global Disruptions

The year 2025 began with the appointment of Donald Trump as the US President, setting the tone for several key themes that unfolded through the year. Global growth slowed, emerging markets weakened due to newly imposed tariffs, and India experienced lower growth and lower inflation, leading to rate cuts along with liquidity support from the RBI to stabilise the banking system and money market rates.



GLOBAL DEVELOPMENTS

US Economic Landscape

Trump's return introduced new challenges for the **US economy** and the **Federal Reserve**. His **America First policies**, including the imposition of tariffs and restrictions on immigration, affected multiple economies across the globe. These measures pushed **US inflation higher** as imports became more expensive, with inflation rising from **2.3% in May 2025 to 3% in September 2025**. In addition, the longest US government shutdown in history, which lasted 43 days, disrupted government services. Federal agencies, including the Bureau of Labor Statistics, suspended operations, halting the publication of key economic data such as the US jobs report and the CPI.

Commodities

The year 2025 was favourable for precious metals, with **gold** and **silver** touching new highs. Global oil prices remained low, and at the OPEC plus meeting in November 2025, members decided to maintain current oil output levels through Q1 2026 amid concerns of a supply glut and weakening prices. As a result, Brent prices remained subdued.



DOMESTIC DEVELOPMENTS

Growth

GDP growth beat all estimates once again, rising to **8.2% in Q2 FY26**, while GVA growth stood at 8.1%. This takes the average GDP growth in **H1 FY26 to 8.0%**, compared with **6.1% in H1 FY25**. Growth in Q2, like Q1, continued to be influenced by a low base effect and a low deflator. However, even after adjusting for these statistical factors, the Q2 data still reflects a **stronger than expected improvement in economic momentum**, with sequential momentum running above typical seasonal trends.

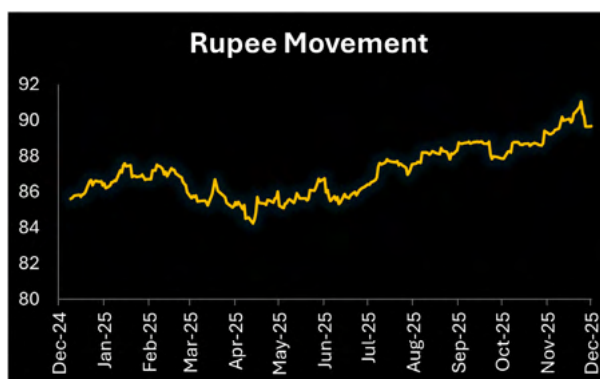
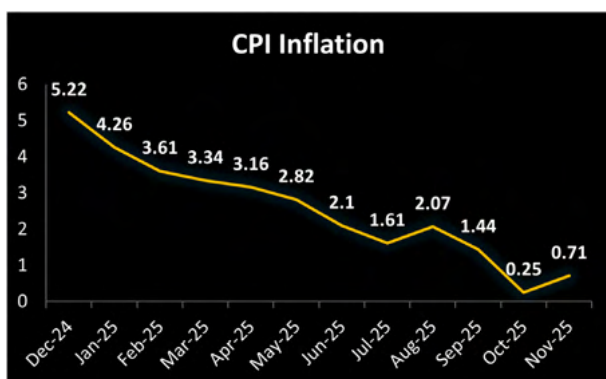
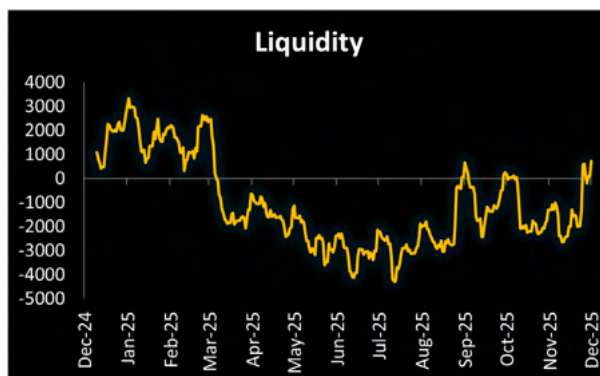
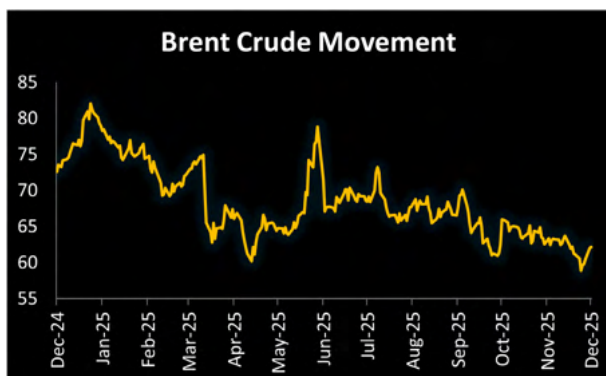
Inflation

Headline inflation fell to a series of lows, reaching a **decade low level of 0.25 %** in October 2025, driven by a favourable base effect, continued easing in food prices and the GST rejig. The **FY26 year to date headline CPI average** now stands at **around 2.1%**, implying a further downside of roughly **50 basis points** to the RBI's forecast of **2.6%**. Core CPI, however, remains **sticky**, holding in the **4.2% to 4.5%** range for the calendar year to date.

Liquidity

Banking system liquidity began the year in a significant surplus, supported by several RBI measures to infuse durable liquidity into the system, including **OMOs, longer tenor VRRs, a large RBI dividend, and staggered CRR cuts**. These actions helped maintain comfortable liquidity conditions. However, at the start of the festive season, factors such as maturing forex swaps, tax outflows, FPI outflows, CIC leakage, and the RBI's forex interventions pushed system liquidity to its lowest level of the year. As a result, expectations have emerged that the RBI may announce additional liquidity tools in the final policy of the year to address these pressures.

Key Macro Indicators Influencing Markets in 2025



Source: Bloomberg



2026: A Year of Macro Stability

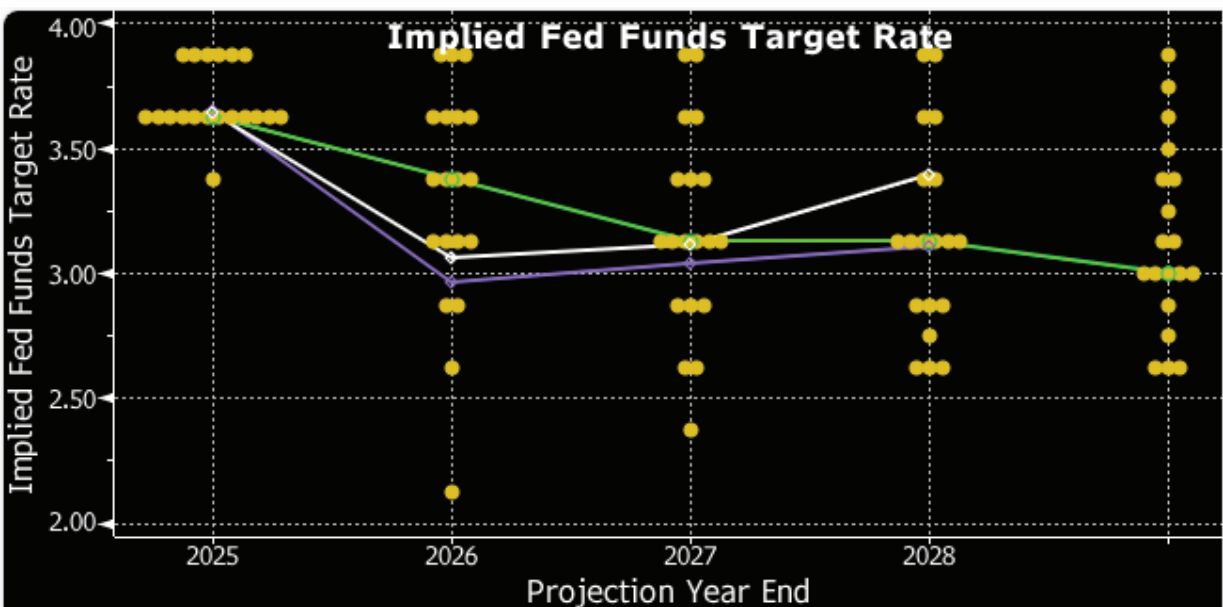
We are likely to end **2025 on a far more sanguine note** than how the year began. Despite material disruptions from trade wars and geopolitical tensions, macro variables have remained broadly resilient throughout the year. While the new macro equilibrium and the path toward it remain uncertain, a stable global environment coupled with favourable monetary policy provides a supportive backdrop for Indian macros. Policy measures, including GST rate cuts and monetary easing, are aiding near-term growth, while benign headline inflation continues to offer room for further rate cuts.

GLOBAL DEVELOPMENTS

US Economy

After the **December 2025 meeting**, we expect the **US Fed to pause in Q1**. **Inflation is likely to remain sticky in Q1 CY26** due to the **gradual passthrough of tariffs** and **adverse seasonal effects**. The **labour market**, although still weak, may begin to **stabilise** as **trade uncertainty recedes following the US-China deal**.

The **FOMC** cut rates by **25 bps** on expected lines in a **9-3 vote**, with one member favouring a **50 bps cut** and two members voting for status quo. Forward guidance in the policy statement indicated that the bar for further rate cuts has increased. The divergence in views among FOMC members was highlighted in the **dot plot**, with the median expectation pointing to a **25 bps** cut each in 2026 and 2027.



Source: Bloomberg

Commodities

Gold and silver are expected to remain **resilient**. Despite near-term headwinds such as China's VAT changes and slowing demand in India, the structural factors supporting strong investment demand remain intact. The **Brent market** is also likely to move past the bearish narrative that has dominated over the past year, particularly in the last **six months**. Prices are expected to stay **range-bound**, though **intermittent volatility** may occur as markets focus on **supply risks** and **signs of demand improvement**.

The oil markets carry a significant degree of uncertainty heading into 2026, primarily due to several key factors that could exert downward pressure:

- **Significant Global Supply Surplus:** The International Energy Agency (IEA) forecasts a surplus exceeding 4 million barrels per day (mbpd) in 2026E, which would represent the highest-ever projected annual surplus.
- **Subdued Demand Outlook:** A weak demand environment is anticipated, driven by the economic ramifications of international tariff disputes and persistent demand weakness in China, attributed to the increasing adoption of electric and hybrid vehicles.
- **OPEC+ Effectiveness and Discipline:** Despite the recent decision by OPEC+ to pause production increases, concerns remain regarding the effectiveness and compliance discipline within the group.
- **Potential Ceasefire in the Russia-Ukraine Conflict:** A cessation of hostilities could facilitate the return of Russian barrels to the market and alleviate existing war risk premiums built into current oil prices.

Conversely, potential upward risks to this includes renewed geopolitical tensions, particularly in the Middle East, or the imposition of additional sanctions on Russia should the conflict be prolonged.

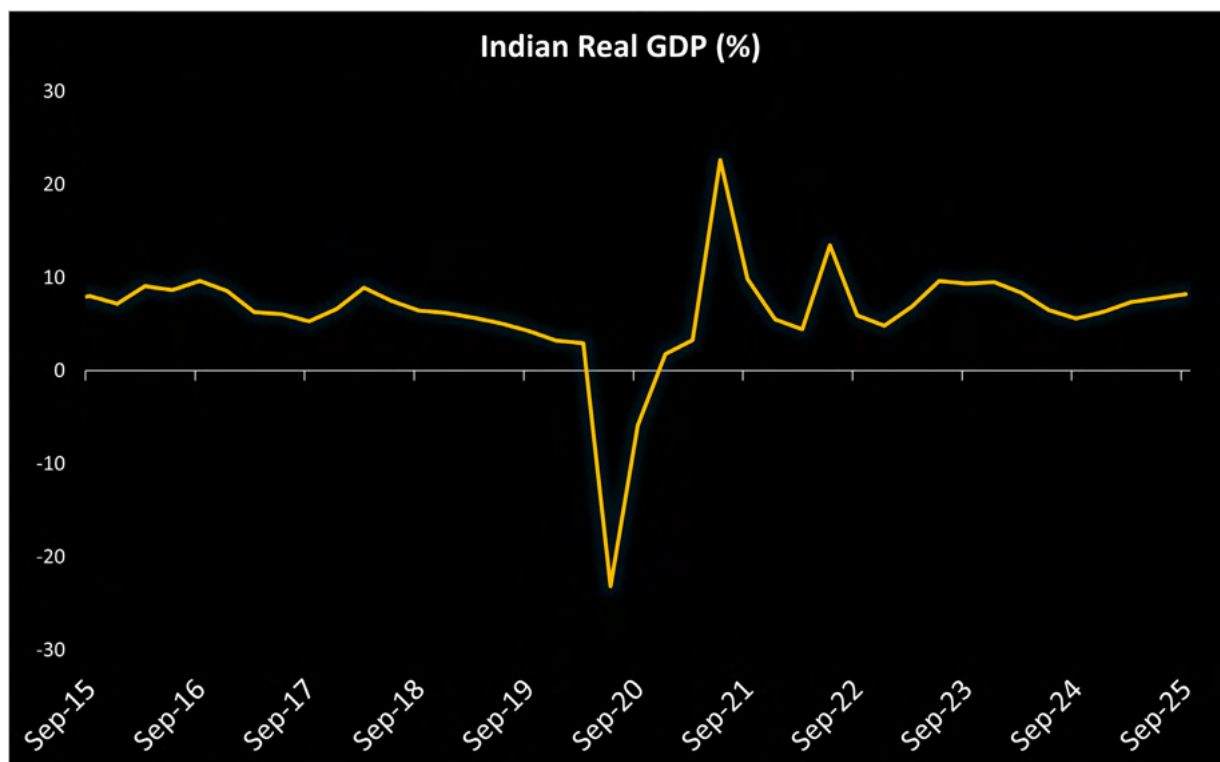


DOMESTIC DEVELOPMENTS

Growth

India's growth has held up well despite ongoing uncertainty surrounding the US trade deal. The delays in India-US trade negotiations and the impact of US tariffs, though not materially significant for the broader economy, have prompted policy responses. The policy focus remains on prioritising domestic growth and addressing bottlenecks related to **ease of doing business**. Recent **GST rate cuts** were intended to support **broad based consumption**. Government policies are also expected to emphasise attracting foreign investments, particularly **foreign direct investment**.

GDP growth is expected to moderate going forward, with overall growth estimated at around **7.5% in FY26F**. However, concerns persist due to global headwinds, including the impact of tariffs, weak consumer demand, subdued private capex, slower government capex, and fiscal consolidation. Taking these factors into account, the RBI has revised its growth forecast upward from **6.80% to 7.30% for FY26**, **6.7% for Q1 FY27**, and **6.8% for Q2 FY27**.

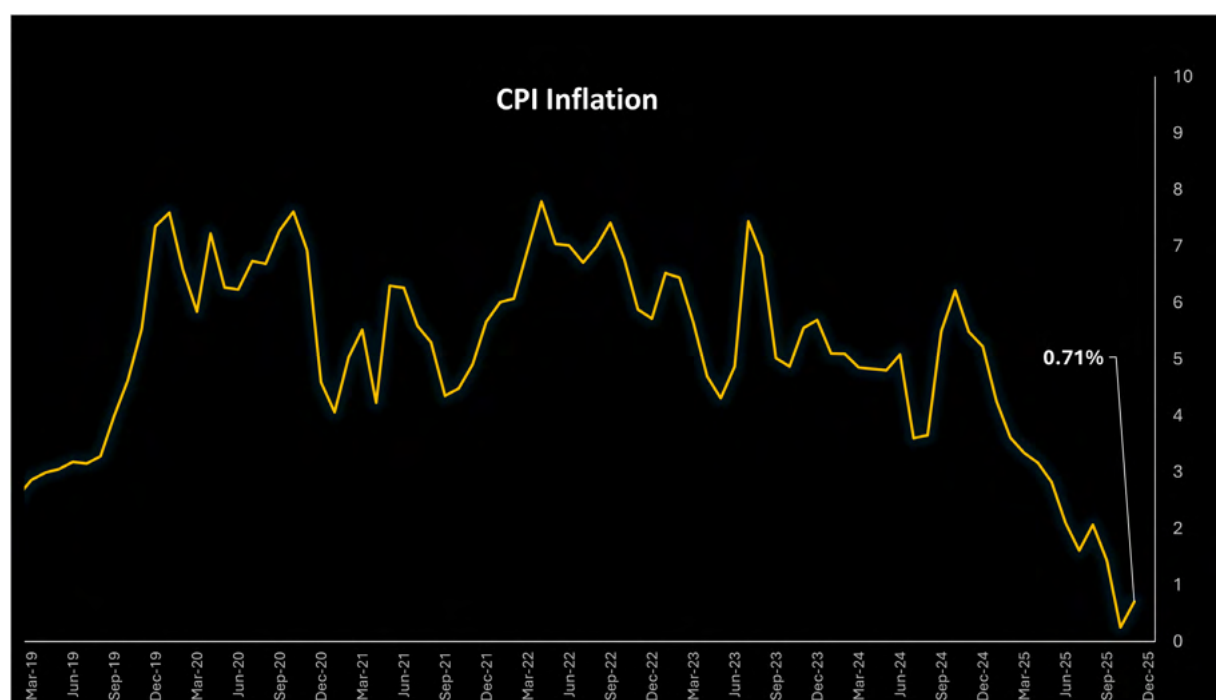


Source: Bloomberg

Inflation

Headline CPI inflation declined to an **all-time low in October 2025**. **Core inflation** (headline CPI excluding food and fuel) remained **largely contained** through the year, despite **price pressures from precious metals**.

Inflation projections have been revised downward, providing the RBI with room to cut rates. The FY26 inflation projection now stands at **2%**, down from **2.6%**. **CPI inflation for Q1 and Q2 of 2026 27** is projected at **3.9% and 4.0%**, respectively comfortably below the RBI's threshold. Going ahead, the **CPI trajectory** is not expected to remain in the disinflationary zone and is likely to gradually stabilise near **4% to 4.5% in FY27**.



Source: Bloomberg

INR Current Dynamics

The **Indian Rupee (INR)** has **depreciated by over 5% against the USD in FYTD26**, falling to record lows of around **90–91 per dollar**, primarily due to **weak capital inflows, trade uncertainties from US tariffs**, and the resulting **Balance of Payments (BoP) pressure**. The Reserve Bank of India (RBI) has intervened to curb excessive volatility, but structural pressures persist.

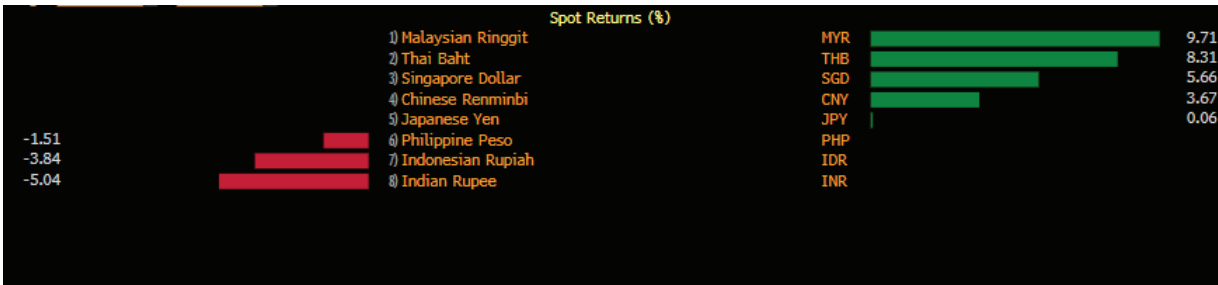
Potential Headwinds and Tailwinds for the INR

- **Anticipated India-US Trade Deal:** The expected announcement of the India-US trade deal within the next one to two months is a significant potential positive. This deal is projected to boost capital inflows, could substantially reduce the Balance of Payments (BoP) deficit in 4QFY26, and provide room for some appreciation in the INR.
- **Bond Index Inclusion:** The scheduled inclusion of Indian government bonds in the Bloomberg bond index in **4QFY2026** is expected to attract a fresh boost of foreign portfolio investment (FPI), further supporting the currency.

Key Risks to the INR

- **Delayed Trade Deal & Tariffs:** An elongated wait for the trade deal exacerbates adverse tariff differentials compared to India's peers, posing short-term headwinds for the USD/INR exchange rate.
- **Weak FPI/FII Inflows:** Ongoing uncertainty around tariffs, weak foreign portfolio investment (FPI) and foreign institutional investor (FII) inflows, and surging global interest rates are currently compounding the pressure on the INR.
- **Global Financial Tightening:** A key external risk includes tightening financial conditions in Japan, with surging bond yields pressuring broader Emerging Market (EM) Asia risk sentiments, which in turn could negatively impact capital flows into India.

INR Trails Asian Market Peers vs USD (December 19, 2025)

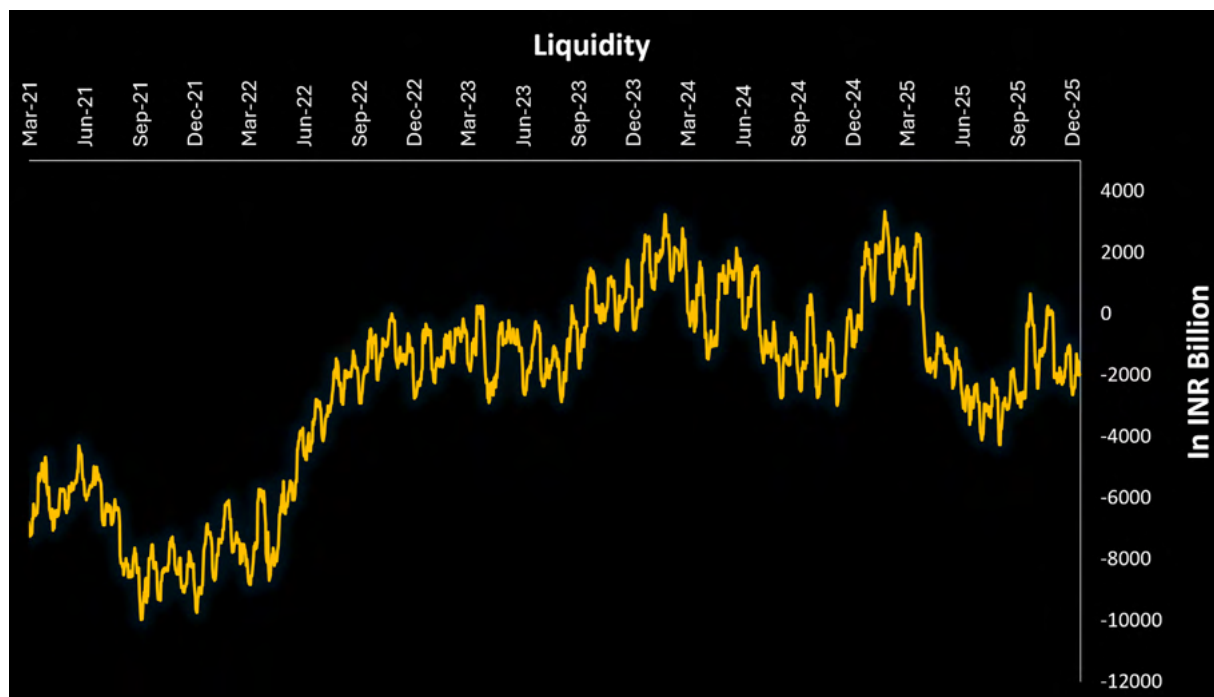


Source: Bloomberg

Liquidity

Excess liquidity has been a **key driver of asset performance in 2025**. The tightening of liquidity conditions is likely to lead to a **partial reversal of the inflows** into non-USD assets that we saw during the year. Banking system liquidity has remained in surplus since March 2025, supported by government cash drawdowns and incremental infusions from earlier **CRR cuts**. However, due to **forex interventions** and **CIC leakage**, system liquidity began moving toward the neutral zone in the latter part of the year. In response, the RBI announced additional liquidity measures in the last policy to offset partial outflows from taxes and maturing forex swaps.

To ensure **easy financial conditions** and a supportive liquidity environment, the RBI aims to keep liquidity **closer to 1% of NDTL**, with more measures expected next year. The neutral stance and liquidity actions reinforce an **accommodative environment for 2026**, setting the stage for a **lower for longer rate regime**.



Source: Bloomberg

AS WE ENTER 2026: FIXED INCOME OUTLOOK

Policy rates are likely to remain on an extended pause. With growth expected to moderate to **6.5% to 6.8%** and inflation gradually stabilising near **4% to 4.5%**, the RBI is expected to hold rates through most of 2026. We are likely to see a **lower for longer rate environment** with minimal policy action next year. With evolving market conditions, fixed income is set to play a meaningful role in portfolios by adding stability and balancing risks. The focus will shift firmly to accrual strategies, supported by stable rates, tightening liquidity, and structural demand for bonds. Additionally, with India's probability of entering the **Bloomberg index** increasing, potential index inflows, **strong macros, and balanced supply and demand dynamics** provide a **constructive outlook for bond markets in 2026**.

Best Regards,



Mr. Amit Modani

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Shriram Mutual Fund

Mr. Amit Modani has over 13 years of experience in fixed income fund management and dealing. Before his current role, he served as Fund Manager - Fixed Income at Mirae Asset Investment Managers (India) Pvt. Ltd. He has also worked with BOI Mutual Fund. Prior to that, he worked as Portfolio Manager - Fixed Income at Quantum Mutual Fund and as Dealer - Fixed Income at PGIM Mutual Fund.

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