Educate Yourself

An initiative by SSL Research Centre

StockHolding Services Limited
(Formerly Known as SHCIL Services Limited)



Educate yourself is an educational debate dedicated to the dissemination of stock market related terminologies in the use of fundamental and technical analysis for traders and investors. Market participants can explore self-developed skills to face the growing threats of volatility through Educate yourself.

Educate yourself is a great way to boost your knowledge in general investing lingo and helps you to trade strategically.

Title of the topic:

" What Are Bonds and Their Impact on Indian Markets? "

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INTRODUCTION

One evening, Rahul and Priya were discussing their investments while having tea.

Rahul: The stock market has been quite volatile lately. I keep hearing experts talking about bond yields, especially US bond yields. But what exactly are bonds?

Priya: Think of a bond as a way of lending your money to the government or a company. In return, they generally promise to pay you interest and return your money after a certain period.

Rahul: So, is it something like a fixed deposit?

Priya: Quite similar in some ways! Both can provide regular income, but bonds can also be bought and sold in the market, and their prices can change depending on interest rates and other factors.

Rahul: Interesting! But why does everyone get worried when US bond yields rise? How does that affect our stock market?

Priya: Because money moves across countries. If US bonds start offering better returns, some global investors may prefer investing there instead of markets like India. This can affect our stock market, currency and borrowing costs.

Rahul: So bonds are not just another investment option. They can also influence the entire economy?

Priya: Exactly! Understanding bonds helps us understand not only fixed-income investments but also why stock markets, interest rates and currencies move.

Bonds are an important part of the financial system, helping governments and companies raise funds while offering investors an alternative to equities. Their yields influence borrowing costs, investment decisions, currency movements and overall market sentiment. Understanding how bonds work and how global bond markets influence India can help investors make more informed financial decisions.

WHAT ARE BONDS AND HOW DO THEY WORK?

A **bond is a financial instrument through which an investor lends money to a government, company or another eligible institution for a specified period**. In exchange, the issuer generally agrees to pay interest and repay the principal amount on maturity.

For example, suppose a company issues a bond with a face value of ₹10,000, an annual interest rate of 8% and a maturity period of five years.

- **Investment Amount:** ₹10,000
- **Annual Interest (Coupon):** ₹800
- **Maturity Period:** 5 years
- **Principal Repaid at Maturity:** ₹10,000

The investor receives ₹800 every year and gets back the original ₹10,000 at the end of five years, provided the company meets its payment obligations. This example assumes the bond is purchased at face value and pays interest annually.

Unlike shareholders, bondholders do not own a portion of the company. They are lenders who receive interest according to the bond's terms.

Understanding Bond Prices and Yields

One of the most important concepts in bond investing is the relationship between bond prices and yields.

Bond prices and market yields generally move in opposite directions.

Suppose an investor owns a bond paying ₹800 annually on a face value of ₹10,000, equivalent to an 8% coupon rate.

If newly issued comparable bonds begin offering higher interest rates, the existing bond becomes less attractive. Its market price may fall to compensate investors for the lower interest it offers. Conversely, if market interest rates decline, the existing bond may become more valuable.

For example, if its market price falls to ₹9,500, its current yield increases to approximately 8.42% (₹800 ÷ ₹9,500), even though the annual coupon remains unchanged. The investor's actual return until maturity also depends on the purchase price, remaining coupon payments and maturity value.

This is why bond prices can fluctuate even when their coupon payments remain fixed.

DIFFERENT TYPES OF BONDS

Bonds can be classified according to who issues them, how they pay interest and their specific investment features. Some commonly encountered types in India include:

1. Government Bonds (G-Secs)

Government securities are issued by the Central Government to raise money for public expenditure and other funding requirements. They are generally considered to have very low default risk in rupee terms because they are backed by the sovereign government.

For example: An investor purchasing a 10-year Government of India bond lends money to the government and receives interest according to the bond's terms. However, its market price can fluctuate before maturity.

2. Corporate Bonds

Corporate bonds are issued by companies to raise funds for business expansion, refinancing existing debt or meeting other financial requirements. They usually offer interest rates based on the company's creditworthiness and prevailing market conditions.

For example: A manufacturing company may issue bonds to finance the construction of a new factory. Investors receive interest, while the company uses the borrowed funds to expand its operations.

Corporate bonds generally carry higher credit risk than Central Government securities, and stronger issuers typically borrow at lower rates than weaker ones.

3. State Development Loans (SDLs)

State Development Loans are debt securities issued by Indian state governments to meet their borrowing requirements.

For example: A state government may raise funds through SDLs to finance infrastructure and development expenditure. Investors receive interest and repayment according to the securities' terms.

SDLs provide exposure to state government debt, although their yields and market liquidity may differ from Central Government bonds.

4. Treasury Bills (T-Bills)

Treasury Bills are short-term government securities with maturities of up to one year. In India, they are commonly issued for 91, 182 and 364 days. Unlike regular coupon-paying bonds, T-Bills are issued at a discount and redeemed at face value.

For example: An investor purchasing a T-Bill for ₹9,700 that matures at ₹10,000 earns ₹300 on maturity, before applicable taxes and costs.

5. Tax-Free Bonds

Certain government-backed entities have historically issued tax-free bonds where the interest income is exempt from income tax under applicable provisions. Their tax treatment depends on the specific issuance.

For example: Eligible tax-free bonds issued by infrastructure financing institutions can provide interest income exempt from income tax, subject to the conditions of the issue.

New issuances may not always be available, although existing listed bonds may be accessible in the secondary market.

6. Floating-Rate Bonds

Unlike fixed-rate bonds, floating-rate bonds have interest payments that reset periodically based on a specified benchmark or formula.

For example: If the applicable benchmark interest rate increases, the coupon on a floating-rate bond may also rise at the next reset date, according to its terms.

This can help investors adjust to changing interest-rate conditions, although returns are not necessarily fixed or guaranteed.

HOW DO GLOBAL BOND MARKETS AFFECT INDIA?

Bond markets are closely connected across countries because international investors continuously compare interest rates, economic conditions, currencies and investment opportunities.

Changes in major global bond markets can influence Indian government bond yields, foreign investment flows, the rupee and equity-market performance.

1. United States – US Treasury Bonds

US Treasury securities are among the most closely watched debt instruments globally. Their yields serve as an important benchmark for international borrowing costs and investment decisions.

Impact on India: When US Treasury yields rise, dollar-denominated assets may become more attractive. This can encourage some foreign investors to reduce exposure to emerging markets, including India. Such movements may put pressure on Indian equities, the rupee and domestic bond prices.

For example: If the US 10-year Treasury yield rises from 4% to 5%, some global investors may reconsider whether Indian assets offer sufficient additional returns after accounting for currency and other risks. If this leads to foreign selling, Indian financial markets may experience volatility.

However, the impact depends on why US yields are rising, along with India's own economic fundamentals and investor sentiment.

2. Japan – Japanese Government Bonds (JGBs)

Japan has historically maintained relatively low interest rates, making its monetary policy important for global investment flows.

Impact on India: When Japanese bond yields rise, Japanese investors may find domestic investments more attractive and could reduce some overseas holdings. Higher Japanese interest rates can also influence the yen carry trade, where investors borrow in yen and invest in higher-yielding assets elsewhere.

For example: If borrowing in yen becomes more expensive, investors using yen-funded strategies may reduce positions in emerging-market equities and bonds. This could contribute to volatility in Indian markets.

3. United Kingdom – UK Government Bonds (Gilts)

UK government bonds, commonly known as gilts, reflect the country's inflation expectations, fiscal conditions and monetary policy outlook.

Impact on India: A sharp rise in UK bond yields may signal concerns about inflation, government borrowing or financial stability. Such developments can influence global investor confidence and borrowing costs.

For example: If UK gilt yields rise sharply due to fiscal concerns, global investors may become more cautious and reduce exposure to riskier assets, potentially affecting Indian financial markets indirectly.

4. China – Chinese Government Bonds

Chinese government bond yields reflect domestic economic conditions, monetary policy and demand for relatively safer investments within China.

Impact on India: Changes in China's bond market can provide signals about economic growth, consumption and policy support. These developments may affect commodity demand, global trade and investor perceptions of Asian economies.

For example: If Chinese bond yields decline amid concerns about weak economic growth, expectations of lower Chinese demand for industrial commodities could affect global commodity prices. This may influence input costs for Indian companies.

China's impact on India is therefore often indirect and depends on broader economic developments.

5. Europe – Eurozone Government Bonds

Government bonds issued by major Eurozone economies, particularly Germany, France and Italy, are important indicators of European borrowing costs, fiscal stability and monetary policy expectations.

Impact on India: Rising European bond yields can tighten global financial conditions, while economic uncertainty may influence foreign portfolio flows and demand for Indian exports.

For example: If European borrowing costs rise significantly, businesses may reduce investment and expenditure. Slower European demand could affect Indian exporters, particularly in sectors with meaningful exposure to European markets.

HOW CAN INVESTORS INVEST IN BONDS IN INDIA?

Indian investors can participate in the bond market through several channels, depending on their financial goals, investment horizon and risk appetite.

1. RBI Retail Direct Platform

The Reserve Bank of India's Retail Direct platform allows eligible individual investors to invest directly in Government of India securities, Treasury Bills and State Development Loans through a Retail Direct Gilt account.

For example: An individual can purchase a government security through the platform and receive interest according to its terms, without investing through a mutual fund.

2. Stock Exchanges and Online Bond Platforms

Investors can purchase eligible listed bonds through the debt-market facilities of stock exchanges, participating intermediaries and SEBI-regulated Online Bond Platform Providers.

For example: An investor interested in a listed corporate bond can review its credit rating, interest rate, maturity date and available trading price before deciding whether to invest.

However, some bonds may have limited trading activity, making them difficult to sell quickly at a favourable price.

3. Debt Mutual Funds

Debt mutual funds invest in a portfolio of fixed-income securities such as government securities, corporate bonds, money-market instruments and other permitted debt investments.

For example: Instead of selecting an individual corporate bond, an investor may invest in a corporate bond mutual fund, which holds debt instruments from multiple issuers.

Debt funds offer professional management and diversification, but their net asset values fluctuate with market conditions and their returns are not guaranteed.

4. Bond Exchange-Traded Funds (ETFs)

Bond ETFs invest in a basket of debt securities and trade on stock exchanges like shares.

For example: A target-maturity bond ETF tracking an eligible government or public-sector debt index allows investors to gain exposure to multiple bonds through a single exchange-traded investment.

Their market prices and returns can fluctuate, and investors should consider the underlying securities, maturity profile and liquidity.

TAX IMPLICATIONS OF BONDS IN INDIA (2026)

Investment Type	*Tax Applicable*
Government & Corporate Bonds (Interest)	Taxed as per investor's income-tax slab
Listed Bonds (Held for more than 12 months)	12.5% capital gains tax without indexation
Listed Bonds (Held for 12 months or less)	Taxed as per income-tax slab
Unlisted Bonds & Debentures	Deemed Short-Term Capital Gains (STCG) across any holding period, taxed at your regular tax slab.
Debt Mutual Funds (Specified Funds)	Gains generally taxed as per income-tax slab, irrespective of holding period
Tax-Free Bonds	Interest exempt from income tax on eligible notified bonds
TDS on Bond Interest	Generally 10%, where applicable, subject to exemptions

WHAT SHOULD INVESTORS CHECK BEFORE INVESTING?

Factor	*Why Does It Matter?*
Credit Rating	Indicates an independent assessment of the issuer's credit risk, but does not guarantee repayment
Coupon Rate	Shows the interest payable on the bond's face value
Yield to Maturity	Estimates the annualised return if the bond is held to maturity and payments are made as scheduled
Maturity Period	Helps match the investment with the investor's financial goals
Liquidity	Indicates how easily the bond can be sold before maturity
Interest-Rate Risk	Bond prices can fall when prevailing market yields rise
Taxation	Interest income and capital gains may be taxed differently depending on the investment

CONCLUSION

Bonds play an important role in both investment portfolios and the wider economy. They help governments and companies raise capital while providing investors with opportunities to earn interest income and diversify beyond equities.

However, the influence of bonds extends far beyond regular interest payments. Changes in bond yields across major economies, particularly the United States, can affect foreign investment flows, the Indian rupee, domestic borrowing costs and stock-market movements.

Although bonds are generally considered less volatile than equities in many circumstances, they are not entirely risk-free. Interest-rate changes, credit quality, liquidity and inflation can affect investor returns.

Sources: *SSL Research Centre, SEBI, NSE.com, RBI, Income Tax Department*

StockHolding Services Limited
(Formerly known as SHCIL Services Limited)
CIN NO: U65990MH1995GOI085602 SEBI - RA: INH000001121
Plot No. P-51, T.T.C. Industrial Area, MIDC Mahape, Navi Mumbai – 400 710

Call to us: 91-080-69850100 **E_Mail:** customerdesk@stockholdingservices.com **www.stockholdingservices.com**

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S. Devarajan
MBA (Finance & Foreign Trade), Ph.D. (Financial Management)
Head of Research & Quant Strategist

Sourabh Mishra
MMS (Finance)
Research Analyst

Mahesh R. Chavan
MSC (Finance)
Research Analyst

Kuldeep Malviya
MBA (Finance)
Research Analyst

Mahima Satish
BSC (Finance)
Research Associate