

# India global bond index inclusion

## Godot has arrived

Economics

FX and Rates

September 22, 2023

The much-anticipated inclusion of India in JP Morgan GBI-EM index will be effective from 28<sup>th</sup> Jun'24, accounting for post-announcement operational lags. India's weight of 10% will be staggered over 10 months, leading to passive inflows of USD22bn (USD26bn accounting for addition in other smaller indices). The actual flows though may be higher, contingent on market dynamics and active flows. Structurally, this will lower India's risk premia/cost of funding, enhance the liquidity and ownership base of G-Secs and help India finance its fiscal and CAD. This does not immediately pave way for inclusion in FTSE and Bloomberg indexes, which have more stringent conditions (FPI taxation/Euroclear). But it could have a demonstration effect in the medium term as the lower risk premia could trigger positive externalities. Near term, we expect bond yields and INR to reverse gains after the initial euphoria, tracking global markets. However, the trend will again reverse in favour of bonds by end-Mar'24, with 10-yr yield coming off well below 7%. For 2HFY24, we see USD-INR ranging 82.25-84.25, with tactical RBI intervention keeping it middle of EM Asia pack.

### India finally enters the global bond index universe with JPM GBI-EM

After having been on the watch list for nearly two years, India will be finally included in the JPMorgan GBI-EM index suits. However, operation lags like setting up the new FPI accounts implies inclusion from 28<sup>th</sup> Jun'24. India has entered the GBI Global Diversified bond index with 10% weight cap (maximum limit) and other smaller JPM EM indices, which will be achieved in a staggered manner over 10-months period. This could prompt overall ~USD26bn of passive inflows as a one-off stock adjustment over the scale-in period, while actual flows may be higher, depending on market dynamics.

### Structurally positive for fiscal and CAD financing

Apart from the passive flows owing to the one-time stock adjustment, this move could lead to fresh active flows in the debt market, which remains underpenetrated on external financing. This will not only result in lower risk premia, but also help India to finance its fiscal and CAD as well as enhance the liquidity and ownership base of G-Secs. Beyond the near-term euphoria, this should structurally augur well for rates and FX markets, leading to lower cost of borrowings for the economy at large and more accountable fiscal policy-making. We see upside risk to our FY24E BoP surplus of USD10-12bn, but keep an eye on net flows, which may be influenced by factors other than bond inclusion (such as global risk appetite, external growth dynamics).

### Bonds & INR to reverse some gains; 10-yr yield to be well below 7% by end-Mar'24

The index inclusion rumors has helped India bonds to stay afloat, even as most of the EM universe has followed global bonds sell-off since Apr'23. Thus, as initial euphoria fades, the 10-year yield may reverse gains after having nearly reached our initial target of **7.05% by end Sep-2023** — tracking global yields and Brent prices. However, we think the trend will again reverse in favor of bonds by end-Mar'24, with 10-yr yield coming off comfortably to sub-7%. Meanwhile, the INR has behaved relatively well, helped by the RBI, despite the widening trade deficit, higher Brent prices and FPI equity outflows. Near-term, the balance of risk is tilted to a mildly weaker INR. With our base case of bullish-to-neutral DXY ahead, we see USD-INR ranging 82.25-84.25 for 2HFY24, with tactical RBI intervention keeping INR in the middle of the EM Asia pack.

### Investable universe via FAR for FPIs to increase over the years

The RBI introduced the Fully Accessible Route (FAR) in Mar'20, allowing FPIs to invest in bonds without restrictions. About 35% of the outstanding G-Secs are FAR bonds (FAR outstanding: ~USD400bn/3% ownership from FPIs) and, incrementally, 75-80% of new issuances are FAR bonds (5Y, 10Y and 30Y). At present, 23 FAR bonds with a combined value of USD330bn are eligible for inclusion in the index. Given the index inclusion criteria (securities with residual maturity >2.5yrs and notional O/S above USD1.0bn are included), we estimate the investable universe for the index at ~USD490bn by end-FY25 (assuming ~USD40bn of FAR issuance during H2FY24 and ~USD120bn during FY25).

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### Key highlights:

- India's JPM GBI-EM inclusion to entail ~USD26bn passive flows
- India to enjoy lower risk premia, deeper bond market and easier financing of fiscal and CAD
- 2HFY24 INR-USD in the 82.25-84.25 range; 10-yr to be sub 7% by Mar'24

### India's inclusion in the FTSE and Bloomberg indices still seems far-fetched

We note that India's bond market is the third-largest after China among EMs, with a market cap of more than USD1.2trn (nearly triple of Indonesia's and almost similar to Brazil's). Nonetheless, factors like capital controls, restricted market access and operational issues led to the lack of inclusion in any major global bond index. FPI ownership of India G-Secs is <2% (3% FPI holdings in FARs), significantly lower than EM peers'. However, the recent progress on resolving operational issues, such as posting margin requirements and extended settlement times, have been instrumental in India securing JPM GBI-EM inclusion. This was further bolstered by Russia's removal, which made the index slightly more concentrated, with India's inclusion helping to diversify holdings.

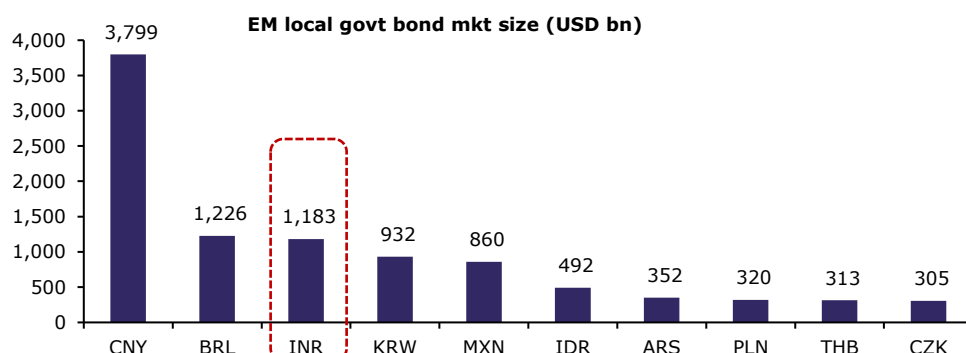
Changes to laws for taxing FPI capital gains, which would have helped India adhere to Euroclear requirements, were not a major impediment for India's inclusion in the JPM index. However, this is still a major stumbling block for the Bloomberg indices, though not so much for the FTSE indices. Nevertheless, we do not think India will be in a rush to become Euroclear-compliant in the near future. India meets the minimum credit rating requirement for the FTSE EMGBI (C/Ca), but is not compliant with the requirement for the broader FTSE GMBI (A-/A3).

However, we reckon that India's inclusion in the JPM GBI-EM could have a demonstration effect and the lower risk premia could trigger positive externalities in the medium term. For context, assuming that it eases capital controls and other barriers, India is estimated to receive a ~0.5% weight in the Bloomberg GAI, implying passive flows of ~USD10bn, given the estimated AUM (USD2.3-2.4trn) of passive funds tracking the index.

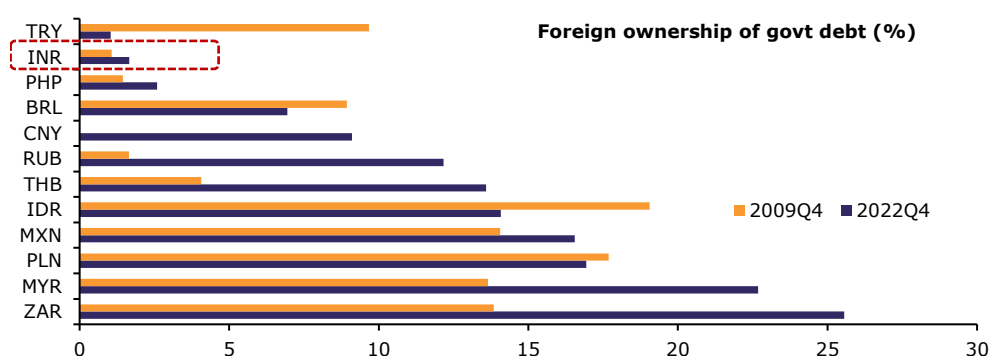
**Exhibit 1: Composition of the JP Morgan GBI-EM Global Diversified Index**

JPM GBI-EM Global Diversified (Country Weights, %)			
Country	As of 31st Aug 2023	As of 31st Mar 2025	Delta
India	0	10	10
China	10	10	0
Indonesia	10	10	0
Mexico	10	9.99	-0.01
Malaysia	10	9.49	-0.51
Brazil	10	9	-1
Thailand	9.79	8.14	-1.65
South Africa	8.11	6.75	-1.36
Poland	7.57	6.29	-1.28
Czech Republic	6.18	5.14	-1.04
Colombia	4.5	3.72	-0.78
Romania	3.84	3.2	-0.64
Hungary	3.09	2.57	-0.52
Peru	2.39	1.98	-0.41
Chile	2.01	1.67	-0.34
Egypt	1.04	0.87	-0.17
Turkey	0.74	0.62	-0.12
Serbia	0.29	0.24	-0.05
Uruguay	0.22	0.18	-0.04
Dominican Republic	0.17	0.14	-0.03
Philippines	0.06	0	-0.06

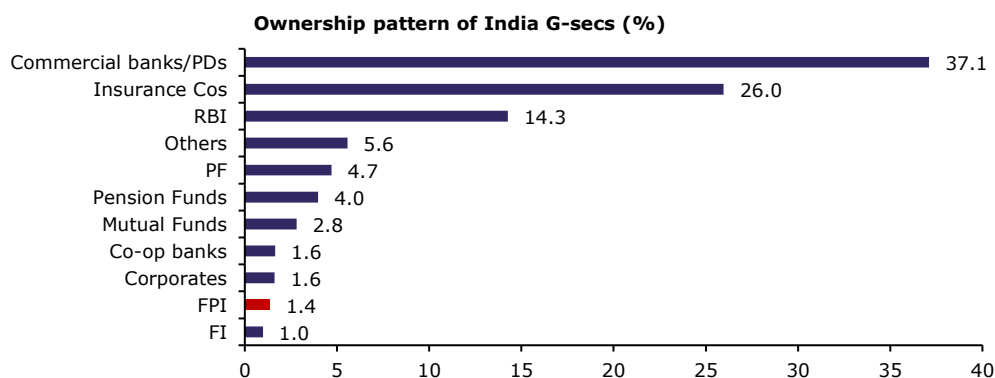
Source: JP Morgan, Emkay Research

**Exhibit 2: India has the third-largest government bond market among EMs**

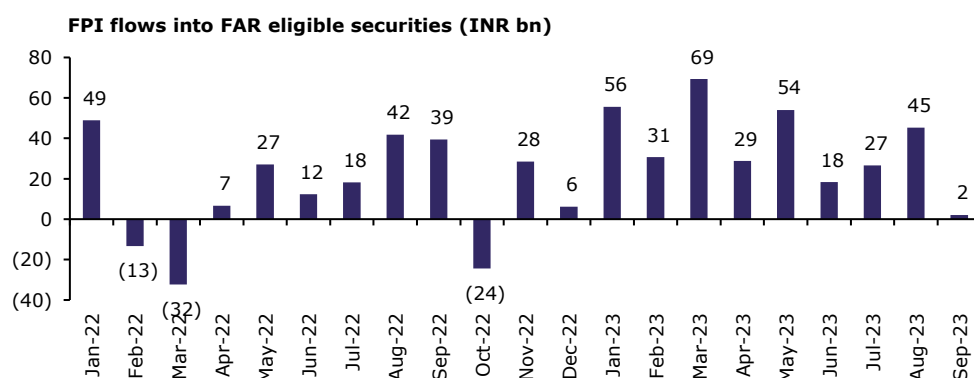
Source: Bloomberg, Emkay Research

**Exhibit 3: Indian government debt is among the least owned by foreign investors**

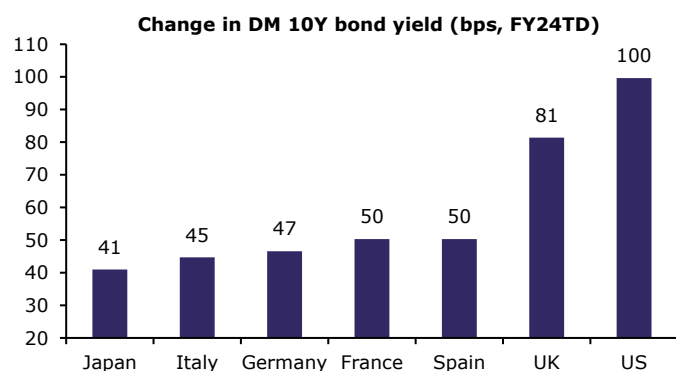
Source: IMF, Emkay Research

**Exhibit 4: Indian government debt is overwhelmingly owned by domestic participants (~98%)**

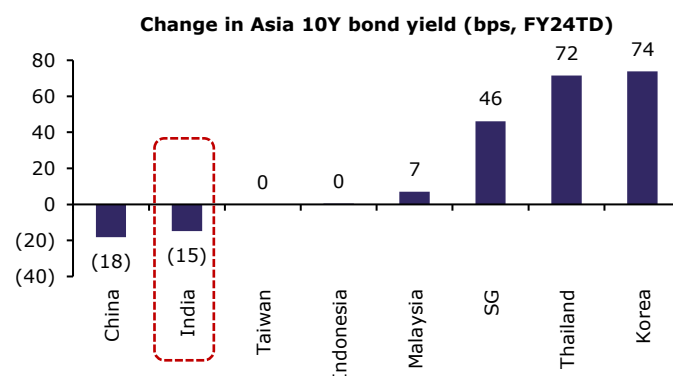
Source: RBI; Note: Data as of 31-March-2023

**Exhibit 5: While FPI flows have moderated in Sep-2023, they have stayed robust the whole year**

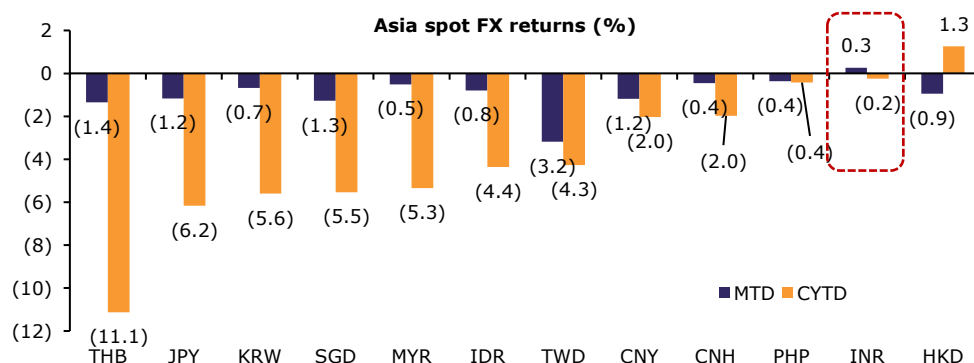
Source: CCIL, Emkay Research; Note: Data for the latest month is as of 21-Sep-2023

**Exhibit 6: DM bonds have sold off heavily since Apr-23...**

Source: Bloomberg, Emkay Research; Note: Data as of 21-Sep-2023

**Exhibit 7: ...pressuring Asian bonds, though India is an outlier**

Source: Bloomberg, Emkay Research; Note: Data as of 21-Sep-2023

**Exhibit 8: The INR has been one of the best-performing currencies in Asia in 2023**

Source: Bloomberg, Emkay Research; Note: Data as of 21-Sep-2023

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