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STCI
Primary Dealer Ltd

Macroeconomic Update: India's inclusion in the Global Bond Index

Godot arrives…finally

Highlights:

- ***India will be included in the Global Bond Index-Emerging Markets(GBI-EM) Global Index suite beginning 28th June 2024.***
- ***India is expected to reach the maximum weight of 10 per cent in the GBI-EM Global Diversified Index (GBI-EM GD) over a 10 month period over which the inclusion will be staggered at the rate of 1 per cent per month.***
- ***Estimated inflows from index inclusion are ~USD 20-30 billion since GBI-EM GD accounts for 90 per cent of the USD 236 billion benchmarked to the GBI-EM family of indices.***

Aditya Vyas
aditya@stcipd.com
022-66202245

Sadhika Nimbutkar
sadhika@stcipd.com
022-66202241

India's inclusion in global bond indices will begin in the first half of FY25, or 28th June, 2024, as the Indian sovereign bonds find place in the J.P. Morgan Global Bond Index –Emerging Markets (GBI-EM).This event was awaited by domestic policy makers since 2021, when India was on index watch positive, and now the probability of being included in the two other major global bond indices i.e. FTSE Russell and Bloomberg Global Aggregate Index (BGAI), in their emerging market bond indices, has significantly increased. The noteworthy feature is that the capital inflow is estimated to be about USD 20-25 billion spread out over the period of 10-12 months since the inclusion date .These will be passive investor flows, which means that the inflows will be relatively stable.

India joins the club: India was on index watch positive since 2021, post the Indian government's initiation of the Fully Accessible Route (FAR) for FPIs in 2020, and other reforms facilitating foreign portfolio investments, although index inclusion was not done largely due to the issues on withholding tax and regulatory issues like clearing and settlement. According to the eligibility criteria specific to the GBI-EM, all securities having an outstanding of more USD 1 billion (~INR 8300 crore) and a maturity of at least 2.5 years are eligible. 23 such securities have been enlisted as eligible for the index, and all of these are FAR securities, with a total outstanding maturity of USD 330 billion (~INR 27 Lakh crore).

The shortest maturity is June 2027 and the longest being June 2053, i.e. 3 years to 29 years. Moreover, according to the FAR regulation, all the new issuances of tenors 5, 7,10,14 and 30 are automatically designated as FAR securities and so once these new issuances reach the critical level of USD 500 million (~INR 4200 crore) they will be index eligible. Notably, government securities remain ineligible for GBI-EM Narrow/Diversified series due to taxes levied on foreign investors. The total index weight of India in the GBI-EM Global is estimated to reach 8.7%, GBI-EM Global Diversified (GD) is to reach 10%.The total benchmarked assets under management for the GBI-EM is at USD 236 billion as of August 31, 2023; expected inflows are USD ~20-23 billion.

Table 1 : India's weight across various J P Morgan Global Bond Indices

JP Morgan Index	Current Weight (%)	Estimated Weight (%)	Change (%)
JADE Broad Diversified	10	20	10
JADE Global Diversified	-	18.48	18.48
GBI-EM-GLobal	-	8.74	8.74
GBI-EM GD	-	10	10
JESG GBI-EM GD	-	6.73	6.73

Source: J.P.Morgan as of Aug 31, 2023

Table 2: Emerging Market Indices benchmarked AUM

Current Benchmarked AUM (USD Bn)	Current Benchmarked AUM (INR)
GBI-EM	236
CEMBI	130
EMBI	371
Total	**737**

Source: J.P. Morgan as of Aug 31, 2023

Fiscal Arithmetic and Bond Inclusion: Assuming that a minimum of USD 20 billion are expected over the year. This translates to ~Rs.1.7 lakh crore for the year and roughly Rs.17,000 crore per month, over a period of 10 months. At a per month auction size of Rs.25-30,000 crore this equals a monthly share of 68-56 per cent. The current auction size range is R.33,000-39,000 crore which is expected to moderate in FY25, if the government sticks to fiscal consolidation. It is necessary to emphasize that these are estimates based on assumptions and even the total AUM of GBI-EM will undergo a change by the time we reach the inclusion date next year.

Overall, this will alter the current demand and supply dynamics, and will eventually result in a lower cost of borrowing for the central government over FY25. Traditionally, banks have been the major investors in the government bond market with close to 35-40 per cent share; although in recent times there has been significant increase in the demand from investors like insurance companies and pension funds.

The index inclusion will also pave the way for India to be included in FTSE Russell (FTSE EMGBI), and assuming a country weight of 5 per cent, there will be flows equaling ~USD 75 billion, resulting in a monthly inflow of USD 2.1 billion, over a period of 36 months, estimated based on the index's current market value. There will be additional flows from the Bloomberg Global Aggregate Index inclusion, it sums up to an additional capital flow of USD 2-4 billion per month in sovereign fixed rate assets. Moreover, these are just passive investor flows; there will be active investors' flows which track these index funds. This will have a significant impact and lower the cost of capital.

Balance of Payments and Index flows: Going ahead, a monthly inflow of roughly USD 2-4 billion might prove somewhat of a challenge to RBI depending on other external conditions as the rupee might tend to appreciate faster than expected over FY25, and in essence even as we approach the inclusion date. Assuming an average USD 3 billion additional inflow per month, a total inflow of USD 25-30 billion over FY25 is expected, bulging up the RBI's FX reserves, to that extent, and possibly leading to a heavy Bop surplus in FY25,assuming the real economy situation does not alter drastically.

Outlook: The event of India being included in the global bond indices has been much awaited and is a game changer in many ways. It will lead not only to increased dollar capital flows, strengthening the balance of payments equation but also lead to a lower cost of capital for the sovereign in the near term. An additional inflow of USD 25-30 billion is expected over FY25, considering that the other two major indices also include India in their portfolios**.** Rupee will see strength, and IGB yields will soften ceteris paribus. The RBI's job will be to manage the FX flows in a way which does not disrupt the FX or the rupee asset markets. This will likely lead to an increase in FX reserves, as RBI buys the dollars and sterilizes the same with OMO purchases to maintain the balance on rupee liquidity. Increased volatility might be witnessed in the coming years as foreign capital assumes a significant share of the onshore markets.

STCI Primary Dealer Ltd.
CIN: U67110MH2006PLC165306
A/B1- 801, A Wing, 8th floor, Marathon Innova, Marathon Next Gen Compound,
Off. Ganpatrao Kadam Marg, Lower Parel (w), Mumbai 400013.
Dealing Room: (022) 66202217-20 ● Settlements: (022)66202262-64, Fax (022) 66202288
Delhi Office: (011) 47676557-58 ● Kolkata Office: (033) 40611435-36● Bengaluru Office: (080) 42183166/1021
Please mail your feedback to stcipd@stcipd.com
● Website: http://www.stcipd.com
● Twitter: https://twitter.com/stcipd
● LinkedIn: https://www.linkedin.com/company/stci-primary-dealer-ltd/

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