Our Views

Inclusion in the Global Bond Index could witness flows jumping Tenfold

On Friday, J.P. Morgan made a significant announcement revealing the inclusion of Indian Government Bonds in the Government Bond-Emerging Markets Global Diversified Index (GBI-EM-DM) index. GBI-EM-DM accounts for approximately USD 216 billion of the USD 236 billion benchmarked to the suite of GBI-EM Indices. The inclusion will happen in a phased manner with 1% additional weight per month from June 28, 2024, through March 31, 2025.

This event has been a long pending ask and expectation of the financial markets, which both the Indian central bank and the government had been actively pursuing and consistently putting forth the Indian point of view. Bond indices serve as crucial benchmarks for the fixed-income market and aid investors in assessing the performance of various debt instruments. J.P. Morgan's bond indices enjoy widespread recognition among institutional investors, fund managers, and policymakers globally. This inclusion signifies India's growing significance on the international financial stage and has direct implications in terms of a substantial influx of global funds into the world's fifth-largest economy.

An inclusion in such indices not only enhances a country's global visibility, but also makes the country's debt market more appealing to foreign investors. It thrusts Indian bonds into the spotlight as a global investment opportunity and provides international investors with a straightforward and transparent means to gain exposure to the Indian debt market. This heightened visibility holds particular significance for emerging economies like India, as it leads to inflow of foreign capital which in turn stimulates economic growth.

However, this pivotal moment is not just about the immediate inflow of approximately USD 22 billion (10% of GBI-EM-DM fund). It could potentially attract further investments, including direct participation by foreign investors and inclusion in other global bond indices like Bloomberg and FTSE Russell, among others. Furthermore, while the indexed flows will flow in only when inclusion in the index becomes effective, global institutional investors engaged in India fixed income may become more active well ahead of the actual inclusion. Apart from them, front-running flows could come from hedge funds and banks. These non-indexed flows could lend further depth to the market and may ease the bond yields.

At present, the total available limit for foreign investors to invest in Indian government securities, both central and state, stands at approximately USD 61 billion, with only around USD 9 billion having been subscribed to. The additional liquidity inflow resulting from this inclusion, and its positive impact on other inflows, will lead to a more efficient utilization of these limits, strengthening government bonds as a secure investment option for foreign investors.

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Additionally, the inclusion of government bonds in global indices often leads to a decline in borrowing costs for the government. The broader market acceptance and heightened demand for the country's debt securities, will help lower the interest rates at which the Indian government can borrow. The liquidity in government bonds also improves as trading volumes increase significantly with more investors, both domestic and international, participating in the market. This will benefit both issuers and investors, as the transaction costs will decline, and the market will become more efficient. The substantial influx of investment in local currency-denominated government debt will also provide crucial support to the rupee. The rupee opened 27 paise higher against the US dollar following J.P. Morgan's announcement yesterday.

In conclusion, J.P. Morgan's decision to include Indian bonds in its indices represents a momentous milestone for the Indian financial market. It not only highlights India's growing importance on the global economic stage but also offers numerous advantages, including heightened visibility, significant influx of foreign funds, reduced borrowing costs, enhanced liquidity, and support to currency. Overall, this inclusion is a significant step towards greater financial integration between India and the global financial community and has the potential to further drive the economic growth of the nation.

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