

# India's Inclusion in JPMorgan GBI-EM Index

For Prelims: India's Inclusion in JPMorgan GBI-EM Index, Government Bond, Sovereign Bonds, <u>Fiscal Deficits</u>, <u>Yield Curve</u>, <u>Reserve Bank of India</u>.

For Mains: Significance of India's Inclusion in JPMorgan GBI-EM Index and Challenges.

#### Source: IE

# Why in News?

Recently, JPMorgan Chase & Co. will include India in its **Government Bond Index-Emerging Markets (GBI-EM) index from June 2024**, anticipating significant inflows to India. This move is expected to widen the investor base and **potentially lead to the appreciation of the Rupee.** 

# What is the JPMorgan Government Bond Index-Emerging Markets (GBI-EM) index?

- About:
  - The JP Morgan GBI-EM is a widely followed and influential benchmark index that tracks the performance of local-currency-denominated Sovereign Bonds issued by emerging market countries.
  - It is designed to provide investors with a **representative measure of the fixed income market** within emerging market economies.
  - It Includes government bonds issued by various emerging market countries.
  - The composition may change over time based on eligibility criteria.
- India's Inclusion:
  - JPMorgan has identified 23 Indian government bonds with a combined nominal value of USD 330 billion as eligible for inclusion in the GBI-EM.
  - India's weight is expected to reach the maximum weight threshold of 10% in the GBI-EM
     Global Diversified, and approximately 8.7% in the GBI-EM Global index.
  - India's local bonds will become part of the GBI-EM index and its suite of indices, which serve as benchmarks for approximately USD 236 billion in global funds, as per JPMorgan.

## What is the Significance of India's Inclusion in GBI-EM Index?

- Enhanced Investment Attractiveness:
  - India's inclusion in the GBI-EM index positions India as a **coveted investment** destination.
  - It can attract global investors seeking opportunities in emerging markets, potentially **resulting in substantial inflows of USD 45-50 billion** over the next 12-15 months.
- Economic Stability and Financing Ease:
  - It can ease financing constraints related to India's Fiscal and current account

#### deficits by providing an alternative source of funds.

- It structurally lowers **India's risk premia and funding costs**, fostering economic stability.
  - Risk premia refers to the amount by which the return of a risky asset is expected to outperform the known return on a risk-free asset.
  - Equity market exposure is the best-known risk premium, rewarding investors for taking exposure to **long-only equity investments.**

#### Positive Impact on Various Sectors:

- Corporate Sector: The inclusion is expected to lower the entire Yield Curve, reducing the cost of financing for the corporate sector. Narrower corporate bond spreads will stimulate investment and business growth.
  - The **Yield Curve** is a graphical representation of the interest rates on debt for a range of maturities.
- Banking Sector: With lesser pressure to absorb government bonds, banks can allocate more resources for lending to the private sector, promoting economic expansion.
- Infrastructure Development: India's ongoing infrastructure development initiatives receive a boost as the inclusion provides a sustainable source of long-term financing through government securities.

#### Currency Appreciation and Stability:

- The inclusion will lead to an appreciation of the Indian rupee due to increased investor confidence.
- A stable exchange rate enhances the attractiveness of investing in India.

#### Market Development and Innovation:

- Integration into global markets, supported by ongoing reforms and increased market access, propels market development and encourages long-term capital inflows.
- It sets the stage for the introduction of innovative financial products.

#### Par with other Countries:

 India is expected to reach a maximum weightage of 10 % in the GBI-EM Global Diversified Index, putting it at par with others like China, Brazil, Indonesia and Malaysia.

# What are the Challenges of India's Inclusion in GBI-EM Index?

#### Market Fluctuations:

- Inclusion may introduce volatility in local debt markets, especially during global economic turmoil or uncertainty, requiring the <u>Reserve Bank of India (RBI)</u> to manage and stabilize the markets effectively.
- The RBI will need to carefully manage its monetary policy decisions to balance the impact of increased foreign investment while also ensuring domestic economic stability and growth.

#### Geopolitical Risks:

High foreign holding of debt exposes Indian markets not only to external macroeconomic shocks but also to geo-political risks. The recent experience of how Russia
was ousted from international currency markets and the <u>SWIFT (Society for Worldwide Interbank Financial Telecommunications)</u> is a cautionary tale of how geopolitics can impact financial flows and hence economic well-being.

## Currency Management:

• The inclusion may impact the **domestic currency's value**, posing challenges in managing exchange rates and ensuring the rupee remains competitive to support exports.

## Transparency and Fiscal Responsibility:

• It may subject India to **increased scrutiny regarding government finances**, necessitating greater transparency and fiscal responsibility in managing the **fiscal deficit**.

#### Taxation Challenges:

- Unresolved tax treatment for foreign investors may deter potential investors, necessitating clarity and favorable tax policies to attract foreign capital into Indian government bonds.
- The behavior of foreign investors, especially during global economic shifts, could result in sudden surges or withdrawals of funds, impacting market stability and capital flows.

# **Way Forward**

- There is a need to work on **resolving operational challenges** related to custody, settlement, and tax implications to facilitate smooth participation of foreign investors.
- Strengthen the regulatory environment to ensure market integrity, transparency, and investor protection, encouraging long-term participation.
- Strengthen India's economic fundamentals to better withstand global economic shifts and fluctuations, minimizing risks associated with external factors.

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