India Inclusion in JP Morgan EM Bond Index

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Why in News?

- India officially became part of JP Morgan's Government Bond Index-Emerging Markets (GBI-EM).
- The inclusion is likely to bring nearly $20-25 billion into the country (over the next 10 months) and will help India manage its external finances and boost foreign exchange reserves and the rupee.

Indian Bond Market – Challenges and Solutions:

- **Importance of bond markets:**

    - They are a boon for corporate bodies and government entities, providing a **flexible and efficient way to raise capital.**
    - One of the critical advantages for companies is the **avoidance of equity dilution.**
    - Moreover, the cost of capital is reduced as the interest expenses on debt instruments are tax-deductible, making it a more attractive option than other forms of financing.
- **India's bond market:**
    - India's bond market is pivotal in the country's economic structure.
    - As of September 2023, the government bond market **size stands impressively at $1.3 trillion**, with corporate bonds at $0.6 trillion.
- **Challenges in Indian bond markets:**
    - Narrow investment base,
    - Insufficient participation by foreign investors,
    - Virtually absent secondary market and
    - Private placement (a sale of stock shares or bonds to pre-selected investors and institutions rather than publicly on the open market).
- **Panacea:**
    - Inclusion in the Global Indices
    - Presence of market makers on both buy and sell-side
    - No credit default swaps
    - Bonds bhi 'Sahi Hain': A marketing campaign which can catch the eyeballs of all the age groups of the society.
    - Credit enhancement frameworks
    - Incentivising the issuer

What is the JP Morgan Emerging Market Index?

- **Created in the early 1990s**, it is the most widely referenced index for emerging market bonds and has become benchmarks for local market and corporate EM bonds.
- **It began with the issuance of the first Brady bond** – denominated in U.S. dollars and issued by developing countries and backed by the U.S. Treasury bonds.
- **It has since expanded to include** the GBI-EM (in 2005) and the Corporate Emerging Markets Bond Index (CEMBI).

What was JP Morgan's Announcement?

- JP Morgan has announced that it would include **Indian Government Bonds (IGBs)** to its emerging markets bond index (starting June 28, 2024).
- **There are 23 IGBs that meet the index eligibility criteria**, with a combined notional value of approximately Rs 27 lakh crore or $330 billion.
- **Only IGBs designated under the Fully Accessible Route** (FAR was introduced by the RBI in 2020 to enable non-residents to invest in specified Government of India dated securities) are index-eligible.

Impact of IGBs Inclusion:

- India is expected to reach the **maximum weight of 10%** in the GBI-EM Global Diversified Index (GBI-EM GD).
- A higher weightage will prompt global investors to **allocate more funds** (~ $ 2-3 billion flows to India every month) for investment in Indian debt.
- It will not only result in **lower risk premia**, but will also **help India to finance its fiscal and current account deficit (CAD).**
- **It will also help India to enhance the liquidity and ownership base** of government securities (G-secs; debt instruments issued by the central government to meet its fiscal needs).
- The inclusion of certain Indian sovereign bonds will **support a diversification of the investor base** for Indian government securities.
- **It could help lower funding costs slightly**, and support further development of domestic capital markets.

Will Higher Inflows be a Concern for RBI?

- When the Reserve Bank of India (RBI) removes dollars from the market, it must release an equal amount in rupees.

● This means, while higher inflows will boost the rupee, the RBI will have to use the instruments in its armoury **to check the resultant inflationary pressures**

Q.1. What is fiscal and current account deficit (CAD)?

While both CAD and fiscal deficit relate to a country’s financial health, they operate in different spheres. CAD focuses on the trade balance between a country and the rest of the world, while fiscal deficit pertains to the government’s budgetary situation.

Q.2. What do you mean by the credit default swap?

A credit default swap (CDS) is a contract between two parties in which one party purchases protection from another party against losses from the default of a borrower for a defined period of time.

Source: Indian govt bonds now part of JP Morgan’s bond index. Here’s what it means | IE