

SBI Research

India's inclusion in Bond Indices will help in supplementing the BoP surplus while ensuring incremental 'Indianisation' of Global hot money

Shifting contours of portfolio funds allocation to multiple asset classes across different clusters of geographies, driven by strong currents of surging liquidity in an era of QT and pivot by Central Banks, positions India's foray into global bond indices a Win-Win proposition, structurally strengthening the macros, credit markets and Yield Curve with benchmark likely to test 6.80% going ahead despite vagaries

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Inflows tickle into the Indian Bonds post inclusion in JP Morgan's EM-GB index..

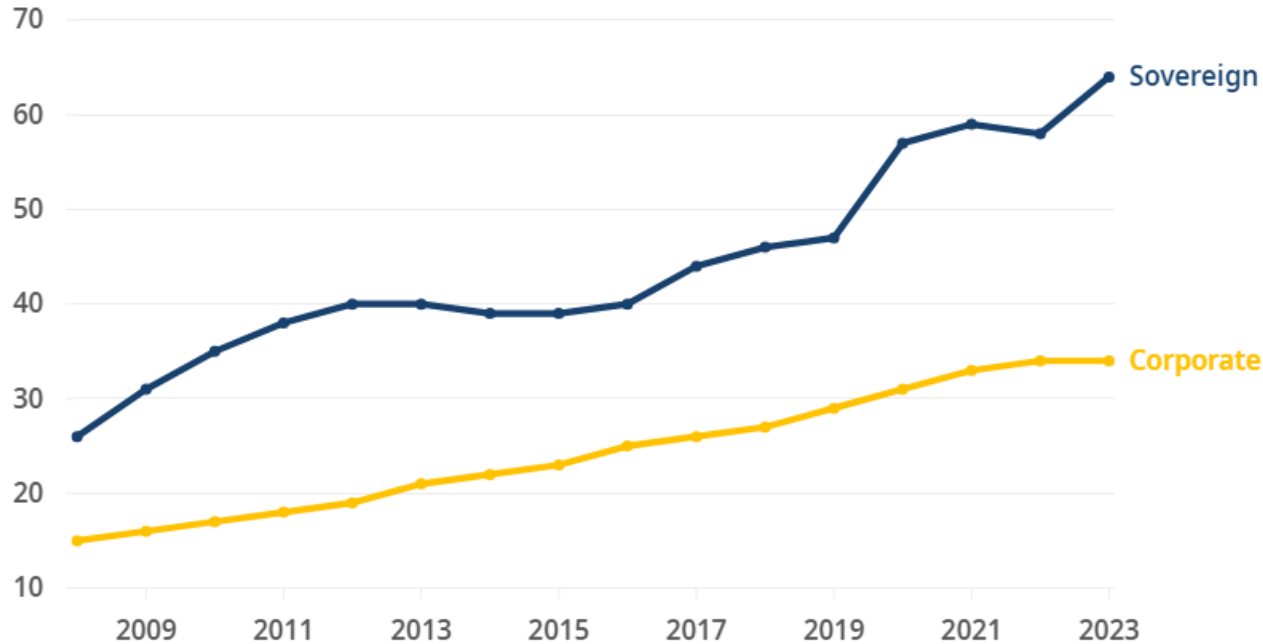
- JP Morgan Chase, largest US commercial bank, had announced last September slated inclusion of Indian Government Bonds (IGBs) to its benchmark Emerging-market Index Global Diversified (GBI-EM GD) index.
- The index provider has thus added the securities starting June 28, 2024. Monthly net inflows into FAR securities have already touched **~Rs 90,000 crore during Oct'23-June'24 post the announcement.**
- Only Indian government bonds issued by the Reserve Bank of India under the Fully Accessible Route (FAR) are included in the index. All FAR-designated IGBs maturing after December 31, 2026 are eligible. The **GBI-EM GD had benchmarked AUM of \$213 Billion** as per last public available data (Aug'23).
- India's weight, post inclusion, 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 (**thus, ensuring likely passive flows of ~\$20-22 Bn at current AUM/holdings by March'25**).
- We believe choosing the JPM GBI-EM **first** could be a deliberate move on part of Gol/RBI to ensure future developments have a natural progression, evolving & maturing organically to mitigate possible points of friction along taxation / capital control
- Adding to this the Bloomberg Barclays EM bond index which would incorporate Indian bonds into its Bloomberg EM Local Currency Government indices **starting January 2025**, and the funds flow numbers further inch up. There are already a host of marquee ETFs (iShares, Vanguard, SPDR) modelled along these benchmark indices that should further crowd in inflows
- Though Indian bonds continue to remain on watch list by another major index provider, **FTSE Russell (which cited criteria around taxation, FPI registration and settlement process for Indian markets)** for inclusion in its Emerging Markets Government Bond Index (EMGBI), the next annual revision due could put a strong case for the Index managers, with the FOMO (Fear of Missing Out) effect as global trading platforms like MarketAxess, Bloomberg and Tradeweb, working closely with CCIL, are now awaiting the RBI's approval for new launches.

- Several global marquee funds, at present clients of multiple indices forming a passive investment channel, and taking proxy exposures to India via instruments such as total returns swaps and supranational bonds, have evinced keen interest to enter the most rapidly growing Large Economy directly, indicating **incremental Indianisation of global flows**, and making the country compete directly with China in AXJ (Asia Ex Japan) category with foreign ownership in its bonds standing a tad above \$750 billion.
- **India stands tall meeting the dual mandate for global funds- risk diversification and Total Returns (TR)**. Bond issuances in China totaled 71 trillion yuan (about 10 trillion U.S. dollars) in 2023, PBOC data showed. Going by trends, India should ascend to second largest bond market among EMs, post China, overtaking Brazil soon that could pitch it directly with the mainland for funds allocation.
- With the world economy geared for a soft launch, the global bond issuances should witness traction due to a sizeable portion of both sovereign as also Corporate bonds due for maturity by 2026. However, the enhanced borrowing costs, with embedded refinancing at likely higher rate of interest (as against issuance RoI) is making the investors quite sensitive to arbitrage opportunities that should benefit nations like India.
- Anticipated Inflows along with fiscal consolidation and easing of inflation, as also resulting higher possibility of rate cut should further **support sobering of yield which should head south further, remaining range bound with a lower bound of 6.80% though remaining susceptible to multiple actors/situations**. The substantial foreign investment will enhance the government bond market depth and support system liquidity further. **Thus, the liquidity situation which has been affected due to the adoption of JIT mechanism through its impact on government surplus cash balances might get some respite.**
- However, it should also be emphasized that increase in primary liquidity from index inclusion flows is expected to be drained out. **We expect RBI's deft handling of debt as also Fx markets to smoothen the frictions going forward while the Central Bank remains committed to protect the foreign currency debt to GDP levels as India pitches for a strong case to major agencies to revisit the rating.**

Bond Markets have grown handsomely since GFC...

Outstanding bonds

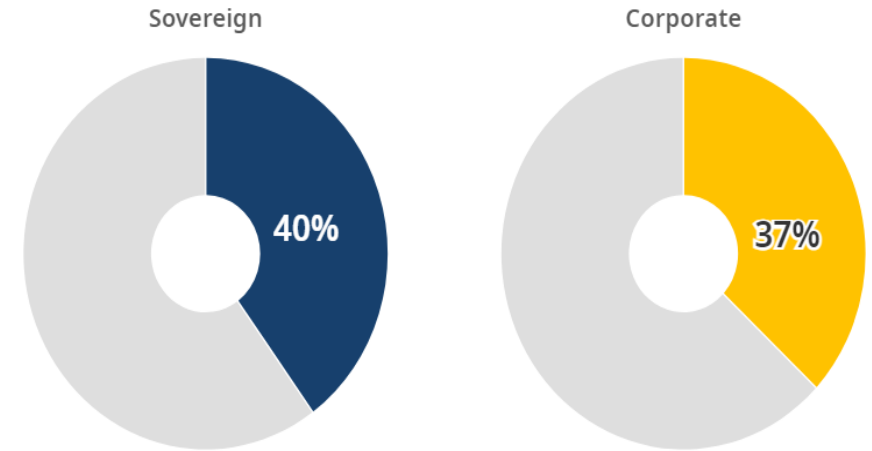
USD trillion



Bonds issuances have truly been a stabilizing factor for the world at large post GFC and PIIGS crisis (sovereign inching up during pandemic), financing the humongous growth and investment needs across jurisdictions though USA and China corner a sizeable part of outstanding pie.. With close to 40% of O/S debt maturing in next 2-3 years, the elevated borrowing costs pose a significant refinancing risk due to higher interest costs (than prevailing at issuance) furthering stretched Debt-to-GDP ratios when major economies are resorting to QT regime.. Truly, Indian bonds have a competitive edge, attracting global investors with a further pass-through effect on incremental issue of GSS (Green, Social and Sustainability) Bonds to help the country meet its climate transition goals along milestones envisaged

Outstanding bonds due in the next 3 years

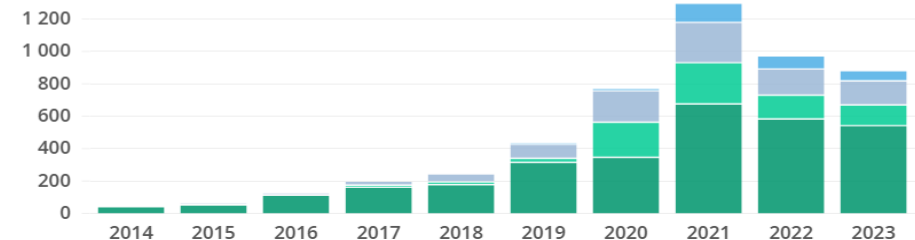
Percentage, maturing in 2024-26



Sustainable bond issuance

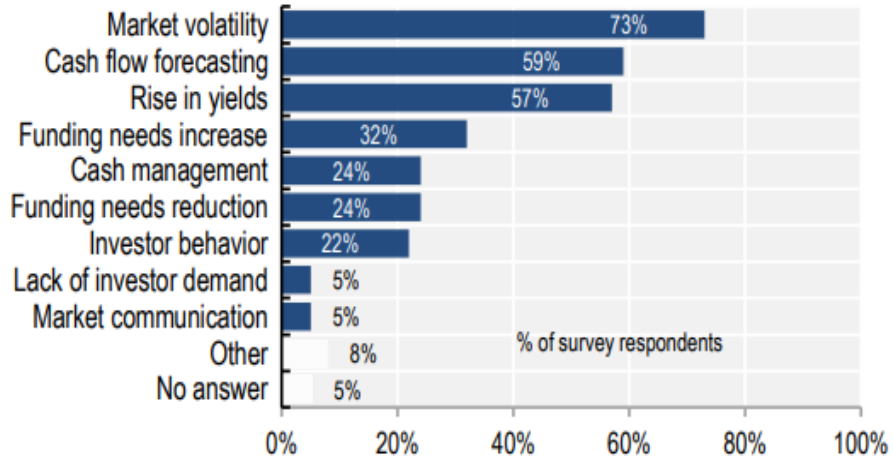
2023 USD billion

- Sustainability-linked
- Sustainability
- Social
- Green

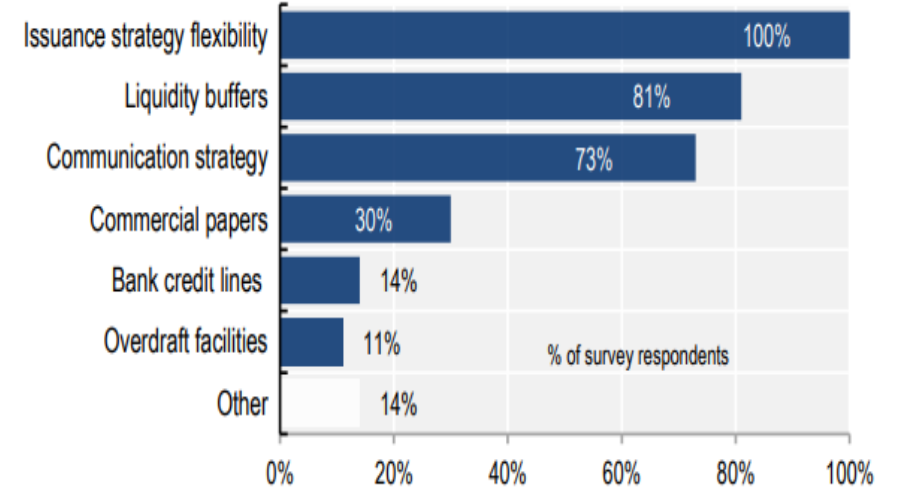


The OS amount of sustainable bonds globally rose to \$4.3 trillion as on end-2023, up from \$641 billion just five years back, with Eurozone leading the pack

Major areas of challenges experienced over the last 12 months.

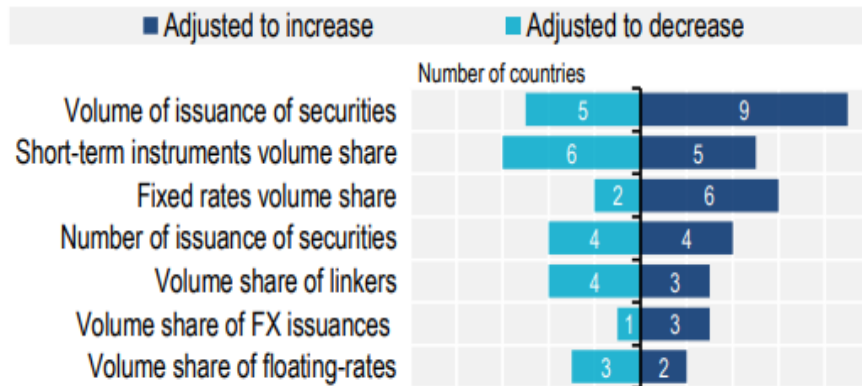


Tools in place to manage market risk

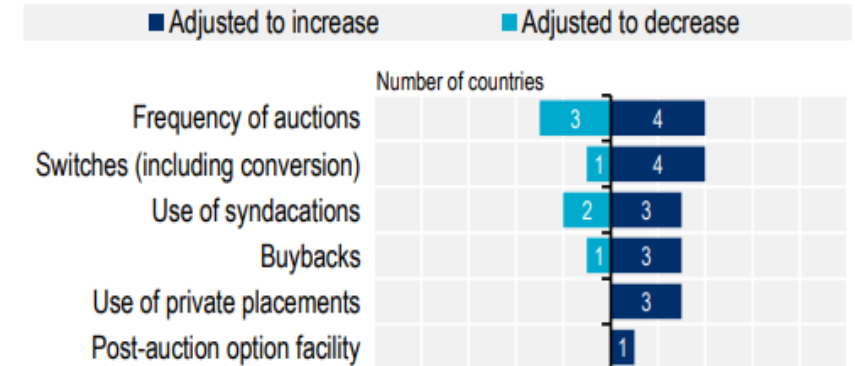


Even with uber volatility plaguing the global Bonds markets, multiple headwinds checkmating Central Bank's ability to manoeuvre through the maze dotted with still hot price prints, RBI appears to have deftly managed the debt issuance at favorable terms of trade, sans irrational choppiness

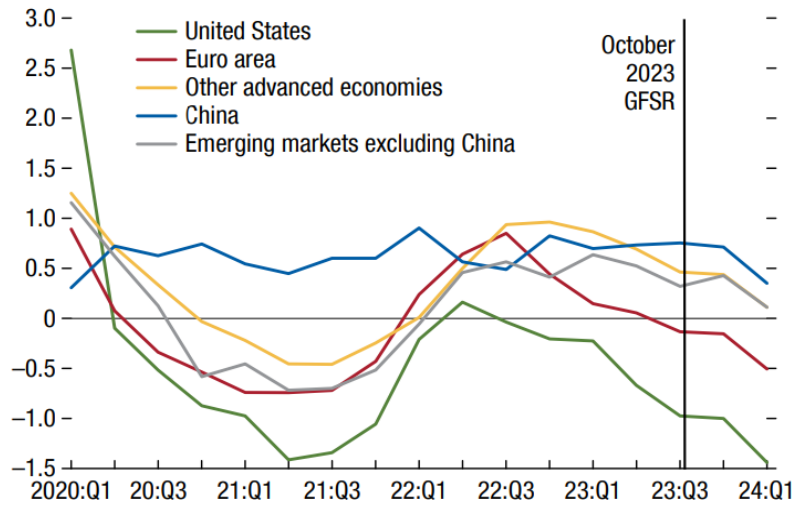
Issuance volume related changes in the issuance strategy



Issuance techniques related changes in the issuance strategy

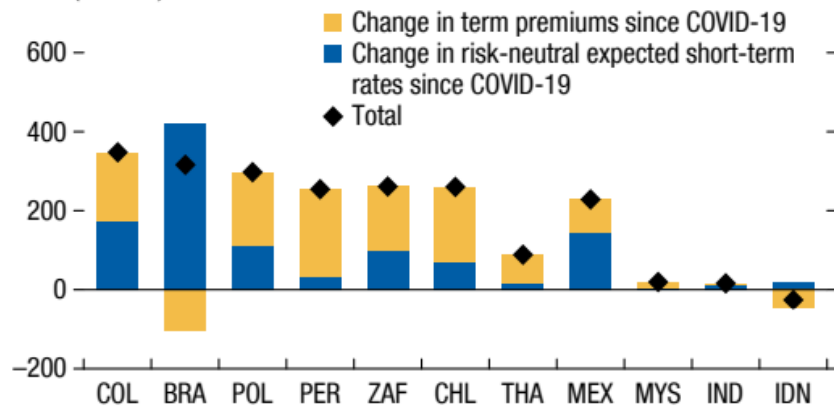


Financial Conditions Index (Non-conductive conditions across DMs)

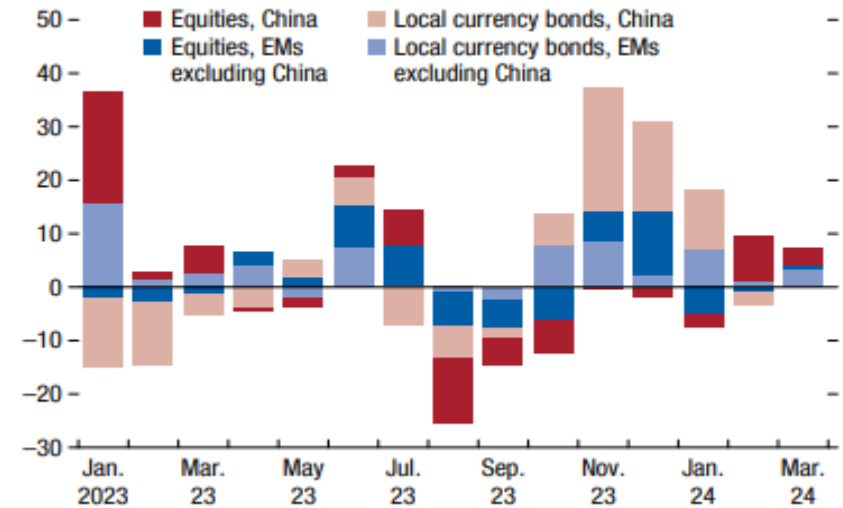


Even with mercurial jump in global equity markets valuations post-pandemic, front led by Big Tech and sizeable flows to alternate assets classes by hedge/wealth funds, Fixed Income securities remain the single largest asset class providing near stable cash flows with abundant liquidity, meeting the sovereign as also corporate borrowing needs ensuing a strong appetite for new markets, away from DMs

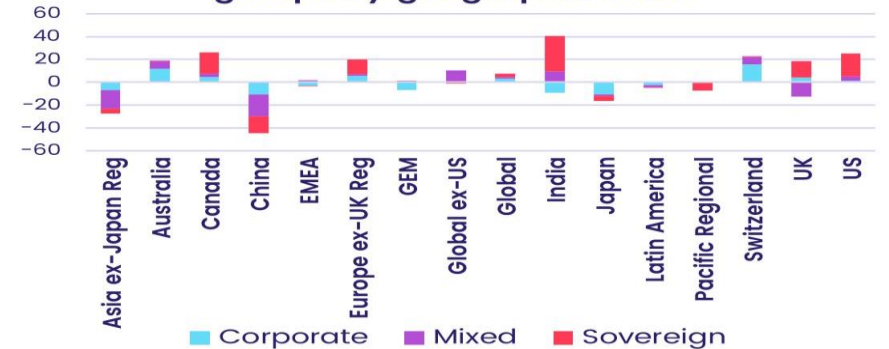
Change in 10-Year Yields since 2019 (Q4): Decomposition %



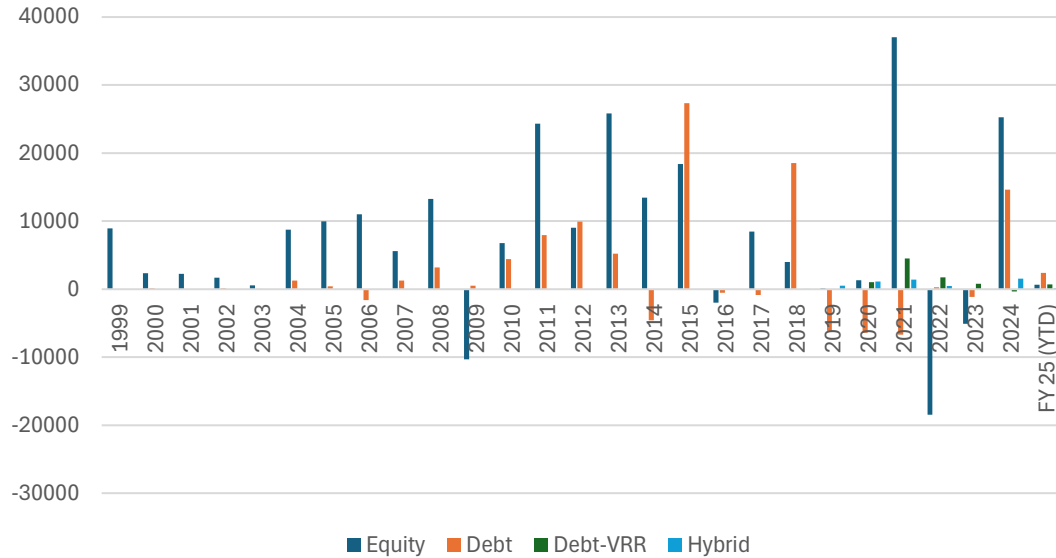
Emerging Markets Portfolio Flow Tracking Local Currency Bonds and Equities (\$ Bn)



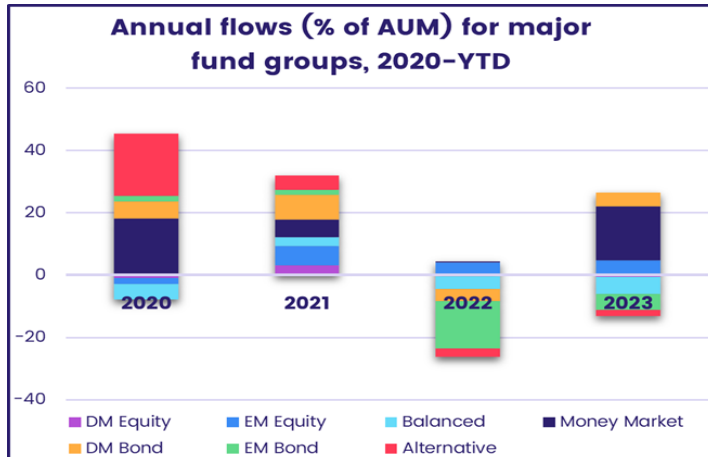
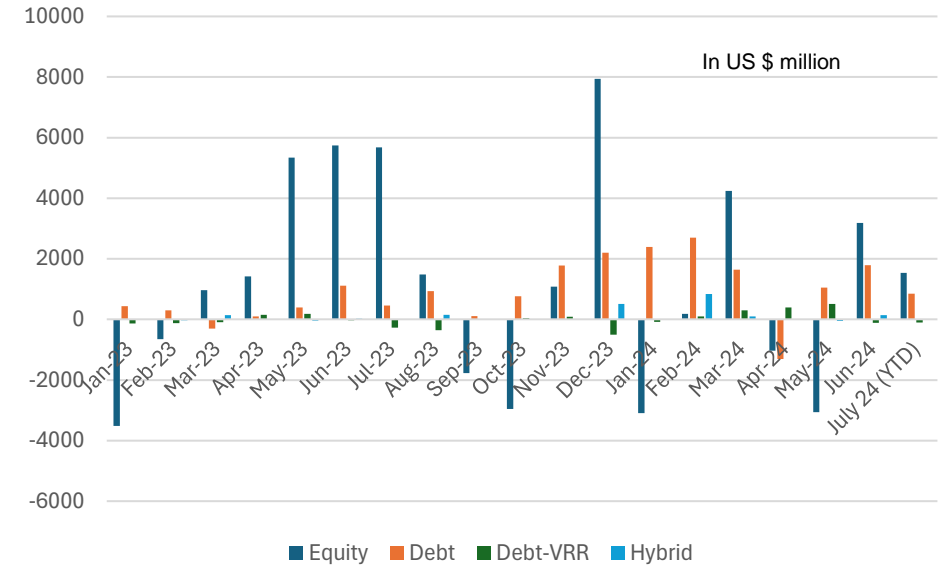
YTD flows (% of AUM) into Sovereign, Mixed and Corporate Bond Fund groups by geographic focus



Two and a Half Decades of FPI Inflows

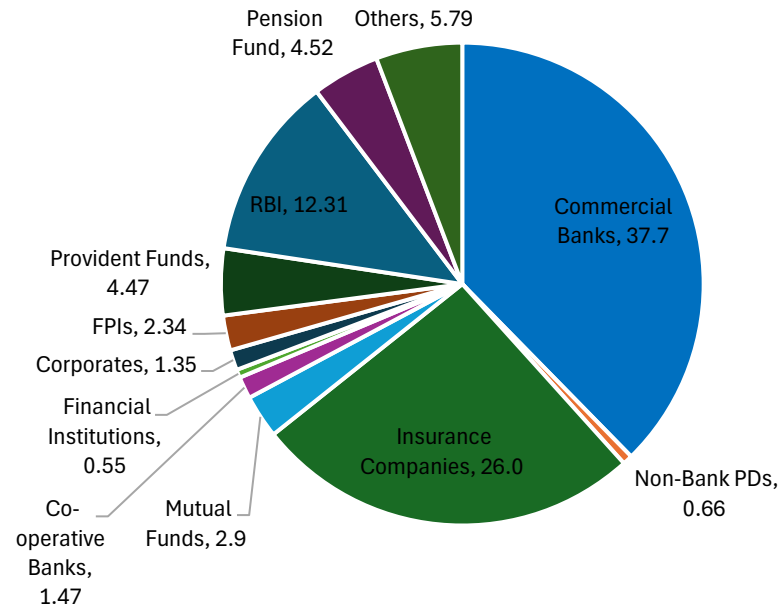


FPI DEBT INFLOWS IN CY-23 & CY-24 SHOWCASE THE UPTREND

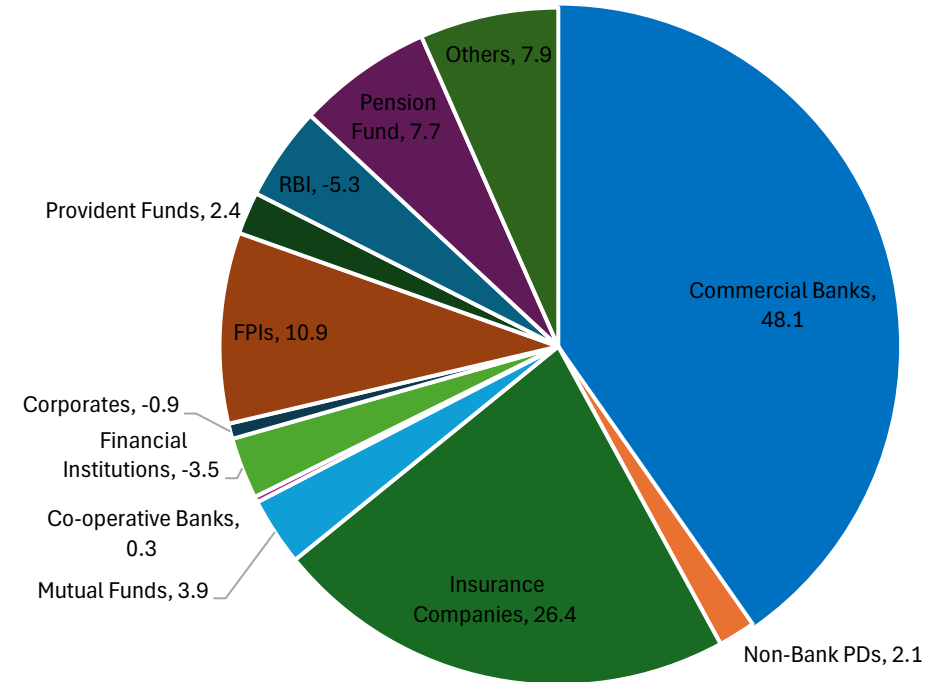


Existing literature shows benchmark driven investments (BDI) growing correlation with portfolio flows to emerging markets, as investment benchmarks are increasingly shaping portfolio allocation dynamics in EM countries... The growing role of benchmark-driven investments appears to reflect the confluence of several factors and may be contributing to more synchronized portfolio flows. Thus, India could be the recipient of sustained incremental portfolio flows in the future.... For example, portfolio flows to EM local bond markets have traditionally been much more synchronized for countries in a benchmark index (viz. the J.P Morgan GBI-EM Global) than those that were not in the index (IMF Working Paper WP/20/192).

Ownership Pattern of Gsec (% share, Mar 24)



Ownership Pattern of Incremental Gsec O/S (% share , Mar24-Mar23)



Issuance Pattern of Outstanding G-Sec

Tenure	% Share	Amount
2/3 Years	1	129295
4/5 Years	8	857430
5/10 Yers	23	2394533
10/15 Years	21	2213327
15/30 Years	31	3250388
30/50 Years	12	1277693
FRB(5/15 Years)	4	408751
Source: RBI, SBI Research		10531416

Gross/Net borrowing budgeted

	Rs. in crore
Market Loans (Net)	11,75,182
Market Loans for Repayments	2,37,818
Market Loans for Switching	1,00,000
Less Payments for Switching	-1,00,000
Market Loans (Gross)	14,13,000

Aggregate holding of FPI has increased by Rs 16,990 crore (~\$2.0 bn) since June'24 and Rs 95,687 crore (\$11.7 bn) since the announcement of bond inclusion by JP Morgan

Debt Utilization status of eligible securities under the FAR (10 Jul 24)				
ISIN	Security Description	Indicative Value Of Aggregate Holding of FPIS (INR CR)	Outstanding Position Of Govt Securities (INR CR)	Sec Holdings (%)
IN0020230085	07.18 GS 2033	24440	201000	12.2
IN0020230101	07.37 GS 2028	7879	75000	10.5
IN0020230010	07.06 GS 2028	11297	111000	10.2
IN0020220037	07.38 GS 2027	10601	130000	8.2
IN0020200112	05.22 GS 2025	8125	115700	7.0
IN0020230135	07.32 GS 2030	4120	70000	5.9
IN0020220011	07.10 GS 2029	9071	158598	5.7
IN0020230077	07.18 GS 2037	9636	172000	5.6
IN0020220060	07.26 GS 2032	7944	148000	5.4
IN0020240019	07.10 GS 2034	5226	100000	5.2
IN0020240076	07.02 GS 2031	568	11000	5.2
IN0020220102	07.41 GS 2036	7166	155080	4.6
IN0020220151	07.26 GS 2033	6782	150000	4.5
IN0020180454	07.26 GS 2029	5104	130709	3.9
IN0020230051	07.30 GS 2053	7192	195000	3.7
IN0020220144	07.29 GOI SGRB 2033	288	8000	3.6
IN0020210244	06.54 GS 2032	5540	156000	3.6
IN0020210095	06.10 GS 2031	5405	152366	3.6
IN0020230036	07.17 GS 2030	3652	103000	3.6
IN0020190362	06.45 GS 2029	3909	114840	3.4
IN0020240050	07.04 GS 2029	713	24000	3.0
IN0020200153	05.77 GS 2030	3631	123000	3.0
IN0020220029	07.54 GS 2036	4025	149009	2.7
IN0020200070	05.79 GS 2030	2671	111619	2.4
IN0020200252	06.67 GS 2050	3159	149162	2.1
IN0020200294	05.85 GS 2030	2196	120832	1.8
IN0020220086	07.36 GS 2052	2658	161967	1.6
IN0020230150	07.24 GOI SGRB 2033	69	5000	1.4
IN0020210194	06.99 GS 2051	1673	148359	1.1
IN0020200054	07.16 GS 2050	861	102696	0.8
IN0020190032	07.72 GS 2049	612	84540	0.7
IN0020220136	07.10 GOI SGRB 2028	51	8000	0.6
IN0020230176	07.37 GOI SGRB 2054	0	10000	0.0
IN0020230143	07.25 GOI SGRB 2028	0	5000	0.0
Total		166263	3660476	4.5

Source: CCILL, SBI Research

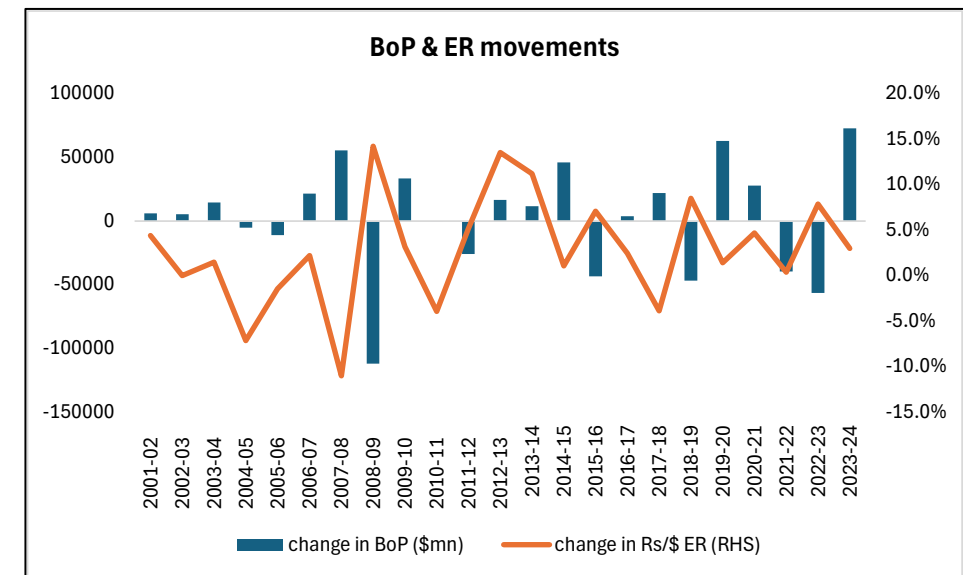
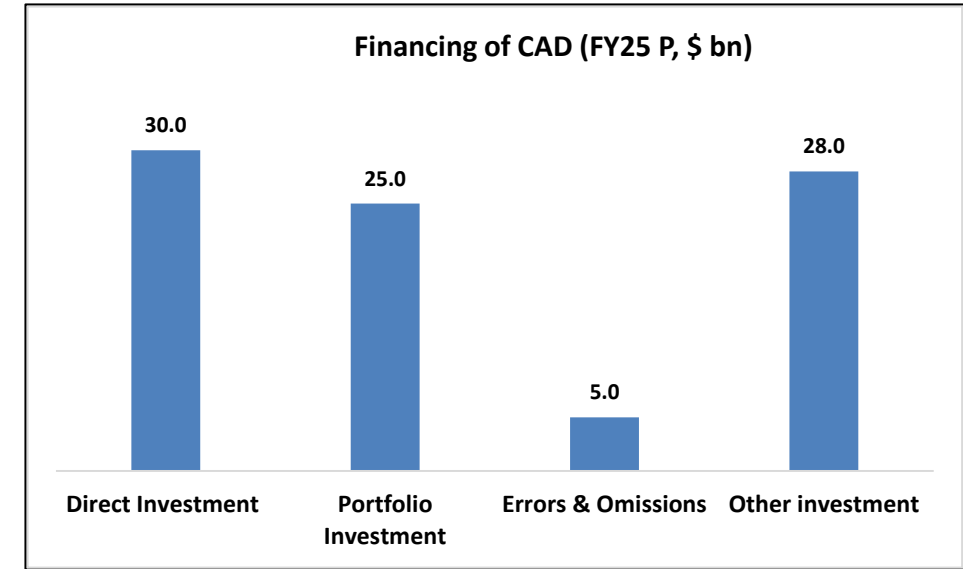
Monthly Inflows into FAR securities (Rs crore)	
23-Oct	7,466
23-Nov	9,657
23-Dec	16,290
24-Jan	18,982
24-Feb	17,671
24-Mar	7,098
24-Apr	-9,857
24-May	5,208
24-Jun	17,239

- ❑ The Net liquidity was in deficit mode **from 22 Apr'24 to 27 Jun'24** (except for 03 Jun'24 to 06 Jun'24, where it was in surplus mode with an average of Rs 0.4 lakh crore, mainly on account of month end government spending) with an average deficit of Rs 1.1 lakh crore. It came to **surplus mode since 28 Jun'24 with an average of Rs 0.94 lakh crore till date**
- ❑ RBI has been actively managing liquidity through main and fine tuning operations
- ❑ Average supply of liquidity by way of variable rate repo auction held in FY25 is Rs 1.3 lakh crore, and average absorption through variable rate reverse repo auction amounts to Rs 0.27 lakh crore
- ❑ Durable/core liquidity surplus has went up to Rs 3.69 lakh crore as on 10th July

Average Liquidity Position (Rs lakh crore)		
	FYTD25 average	10-Jul-24
Repo Outstanding	1.16	0.04
Reverse Repo Total	0.15	0.55
SDF	0.81	0.69
MSF	0.09	0.02
Net LAF (-absorption)	0.39	-1.08
Government Cash Balance (net LAF-core liquidity)	3.08	2.90
Core Liquidity (-Surplus) system liquidity adjusted with GOI Balances	-2.65	-3.69

- ❑ The index inclusion of Indian bonds is expected to result in monthly inflows of around \$2 bn for the next 9 months, which in turn is expected to boost demand of government papers, leading to lower yields with greater and faster impact on short-end tenor
- ❑ Inflows along with fiscal consolidation and easing of inflation, and resulting higher possibility of rate cut should further support softening of yield
- ❑ The substantial foreign investment that is likely to come after inclusion in the indices will enhance the government bond market depth and support system liquidity
- ❑ Thus, the liquidity situation which has been affected due to the adoption of JIT mechanism through its impact on government surplus cash balances might get some respite
- ❑ However, it should also be emphasized that increase in primary liquidity from index inclusion flows is expected to be drained out during the year. RBI holding of G-secs maturing in the current FY also shall lead to decline in primary liquidity
- ❑ Furthermore, any global event which triggers outflows would make the Indian financial system more prone to bouts of market volatility

- For FY25 we expect the current account deficit at \$36 bn (0.9% of GDP) with exports of goods around \$455 bn and imports at \$708 bn. Meanwhile, service exports are expected to grow to \$171 bn.
- Net FDI which dropped to the lowest level since 2007 in FY24 (on account of higher repatriation \$ 44 bn) is expected to recover in FY25 to around \$30 bn
- FII inflows which are \$3.5 bn so far this fiscal are expected to be around \$25 bn getting the support through the debt inflows on account of bond inclusion (\$2.3 bn so far plus another \$18 bn expected)
- We estimate overall Balance of Payment surplus to be around \$52 bn in FY25**
- However, we do not expect any major change in Re/dollar exchange rate. The majority of the flows are likely to result in FX reserves accretion. The historical data also shows that positive (negative) change in BoP is not always associated with major appreciation (depreciation) of rupee viz-a-viz dollar



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