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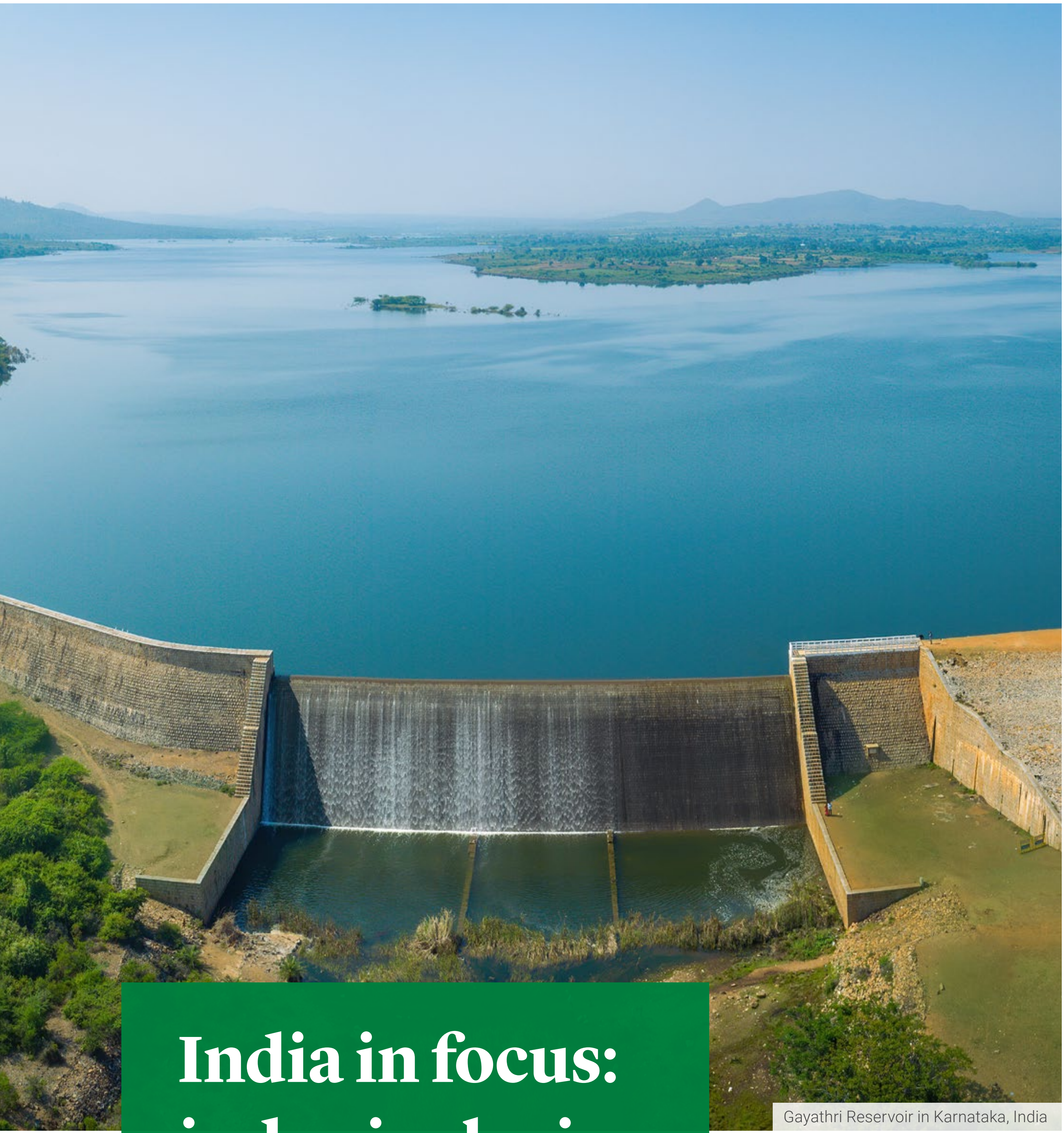


Gayathri Reservoir in Karnataka, India

India in focus: index inclusion and inflows

In the wake of the election result and with index addition just one week away, we examine recent patterns in flows, and the practical considerations for investors tracking the JPMorgan index.

After a six-week-long election, India's Narendra Modi succeeded in securing a third term in office. In contrast to the 2014 and 2019 elections, his Bharatiya Janata Party has no majority in parliament, weakening his reform mandate.

The result initially disappointed equity markets, with the MSCI India benchmark declining more than 5% in the wake of the news.[1] Although we believe Modi's weakened position could slow the pace of labour and land reforms given, we still think Modi's government will pursue infrastructure investment, sound monetary policies and fiscal consolidation. We also note that coalition governments in India have succeeded in delivering change previously, such as in 1991 when the country was opened to the world.

Having fallen in the immediate aftermath of the election, Indian markets have rapidly bounced back,[2] as attention returns to the longer-term outlook for the country. The underlying case for India remains positive, in our view, given its steady growth trajectory, which we believe should see it become the world's third-largest economy by 2030.[3]

Index inclusion nears

Structurally, the country's capital markets are about to receive a shot in the arm from long-awaited inclusion in a major emerging market index. On 28 June, Indian government bonds (IGBs) will be added to JPMorgan's widely followed GBI-EM Global Diversified Index. The weighting of IGBs in the index will begin at 1%, steadily rising over the coming months to reach the full 10% in March 2025 – putting India's importance to the index on a par with China's.

As the index is tracked by around $236 billion in global funds[4], roughly $23 billion can be expected to land in the Indian market.

Momentum is growing for IGBs, with Bloomberg recently announcing that it too will add IGBs to its emerging market local currency government index from January 2025.

Erik Bartolucci
ETF Capital Markets Specialist

1. Source: one-day decline between 3 and 4 June 2024 was 6.4%, according to Refinitiv data.
2. Source: the MSCI India passed its 3 June 2024 level on 12 June, according to Refinitiv data.
3. Source: Macrobond and LGIM calculations as at 28 May 2024.
4. Source: India gets green light to join JPMorgan bond index; rupee, bonds gain | Reuters

Assumptions, opinions and estimates are provided for illustrative purposes only. There is no guarantee that any forecasts made will come to pass.

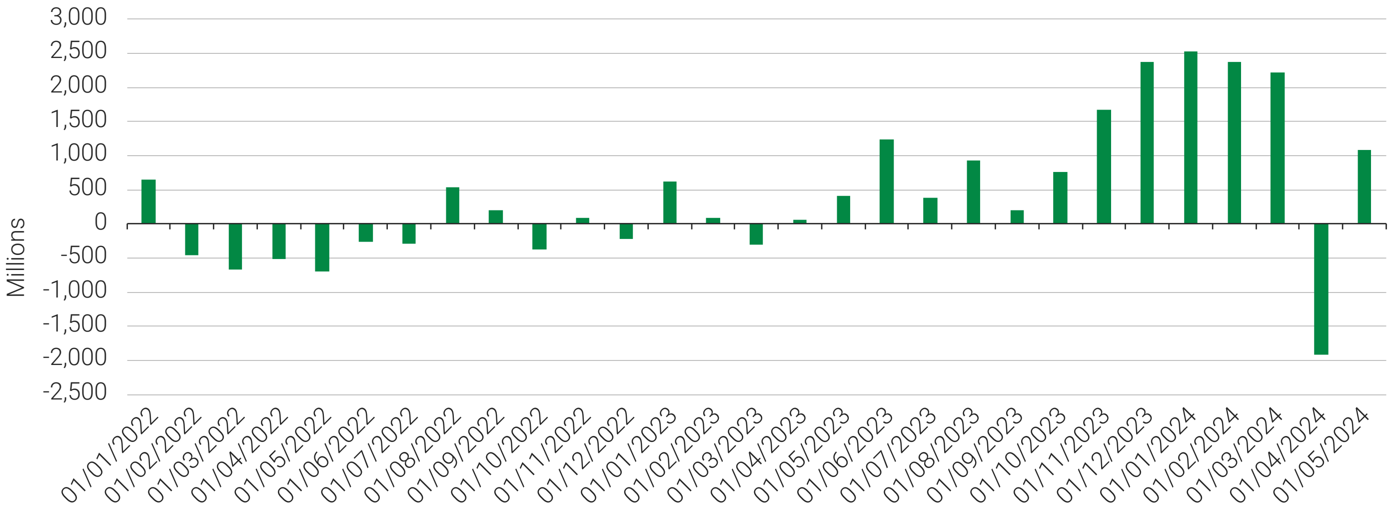
Foreign fund flows

Foreign debt investments in India have significantly picked up since JPMorgan's index inclusion announcement.

Since September we've seen inflows every month apart from April[5], when negative sentiment led to outflows across emerging market debt.

This was followed by a rapid return of overseas appetite for Indian debt, with $358 million of bonds bought on Monday 27 May alone – the highest daily total in two months – bringing net purchases for May to over $700 million.[6]

India Net Foreign Debt Investment ($)



Source: Bloomberg – FIINDMTD Index, Data is released by Securities and Exchange Board of India (SEBI) as at 30 May 2024. **The value of an investment and any income taken from it is not guaranteed and can go down as well as up, you may not get back the amount you originally invested.**

ETF versus direct bond investments

With IGB index inclusion now just around the corner, investors will need to evaluate how to access this market.

We believe direct investment in IGBs may potentially be attractive for investors seeking greater control over bond selection – an investor buying IGBs directly has the option to select those bonds with the specific characteristics to which they wish to gain exposure.

ETFs, meanwhile, could offer a straightforward, cost-effective and potentially tax-efficient option for some investors*:

- Easy access to a highly regulated market
- No need to deal with an additional restricted currency
- No need to onboard tax advisers and local brokers
- Potential tax benefits via the reduced withholding tax (WHT) rate applied to Irish-domiciled ETFs (10% WHT vs 20% standard rate)*
- The standard rate on capital gains is 10-30% for IGBs depending on how long the bonds have been held for, but Irish-domiciled vehicles are tax exempt

Regardless of how investors choose to access the market, next week marks the beginning of a new chapter for India's capital markets.

5. Source: Bloomberg – FIINDMTD Index, as at 30 May 2024.
6. Source: Bloomberg article Foreign Funds Return to Indian Bonds as JPMorgan Inclusion Nears, published 29 May 2024.

*** Tax treatment is dependent on individual circumstances and is subject to change.**

Contact us

For further information about LGIM, please visit lgim.com or contact your usual LGIM representative

Key risks

The value of an investment and any income taken from it is not guaranteed and can go down as well as up, you may not get back the amount you originally invested.

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