Manulife Investment Management

Investment Note

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In this investment note, Rana Gupta, Senior Portfolio Manager and Koushik Pal, Director of India Equities Research, explain how India's impending inclusion in the JPMorgan Government Bond Index-Emerging Markets (GBI-EM) index should lead to an increase in global inflows that will help underpin its current account, stabilise yields, and reduce the cost of capital, which would reinforce India's transition to its next stage of growth and the case for considering Indian equities to participate in the long-term structural growth story.

Index inclusion reinforces India's transition to its next stage of growth

The key takeaway from the release of the 2023 EM Index Governance Results is that from 28 June 2024, India will be included in the JPMorgan Government Bond Index-Emerging-Markets (GBI-EM) Global index suite, which encompasses all relevant derivative benchmarks, including custom indices[1]. India has been classified as "Index Watch Positive" since 2021 (for inclusion in the GBI-EM Global index suite). This development follows the Indian government's introduction of its Fully Accessible Route (FAR) programme in 2020 and substantive market reforms to aid foreign portfolio investments.

Post inclusion, India is expected to reach as much as a 10% weighting in the GBI-EM Global Diversified index (GBI-EM GD), making it the second largest constituent member. At present, 23 Indian government bonds meet the eligibility criteria of the index, with a combined notional value of approximately INR 27 trillion/US$ 330 billion.

Inclusion in the GBI-EM GD will be staggered over a 10-month period that will conclude on 31 March 2025 (i.e., the inclusion of 1% per month)[2] and is expected to generate US$30 billion in fixed-income flows.

What are the implications for the Indian equity market?

The Indian government has introduced several structural measures to pivot from deficit to savings and consumption to investments. Its goal is to build a resilient and sustainable growth engine (refer to our latest thought leadership piece Transitioning to India's next stage of growth). The fruition of these measures and India's inclusion in the GBI-EM Global index suite is viewed as positive. More significant foreign inflows should help fortify its current account, which could help mitigate the impact of higher oil prices.

We believe the recent announcement and expected global inflows into Indian government bonds will help stabilise yields with some downside bias over the medium term. When combined with improvements in infrastructure and incentives, this should contribute to an ongoing reduction in the cost of capital. It also further supports our view that Indian corporate profits are on an upward trend. Indeed, the earnings per share (EPS) of companies in the NIFTY50 index rose from 5% (on a Compound Annual Growth Rate, CAGR basis) from FY2014-FY2019 to 12% FY2019-FY2023. We expect such growth rates to continue with a strong outlook for domestic-oriented companies.

Meanwhile, the inclusion is an added positive for wholesale-funded businesses, such as non-bank

[1] India gets green light to join JPMorgan bond index; rupee, bonds gain | Reuters, 22 September 2023.

[2] Morgan Stanley, 22 September 2023.

lenders and rate-sensitive domestic consumption; investment sectors like autos, capital goods, and real estate.

The Indian government's policies and reforms that are put in place have laid the foundation and established a visible, long-term growth path. As the most populous country in the world today, this event is another step that gives India a greater presence on the global stage.

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