India's time to shine

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AS THE WORLD'S biggest democracy goes to the polls, we examine the political powerhouse that is the Bharatiya Janata Party (BJP) and consider how index inclusion could energise the country's capital markets.

India kicked off elections for its lower house of parliament on 19 April. The sheer scale of the process – which involves nearly a billion voters – means elections will take 44 days, with the results expected on 4 June.

Although the size and diversity of the electorate imply a noisy democracy, elections generally pass without incident, and results are broadly accepted. We expect this to continue. There are more than 2,500 registered political parties, but the national contest will be between the ruling BJP-led coalition, the National Democratic Alliance (NDA), and the Indian National Developmental Inclusive Alliance (INDIA), an opposition coalition led by the Indian National Congress.

The NDA is widely expected to secure a third five-year term in office, with Prime Minister Narendra Modi leading the central government for a third time, taking the BJP's incumbency to 15 consecutive years by 2029.

Modi mania

Although decentralisation in India means all politics is local, the expected BJP win at the national level reflects an efficient and well-funded party machine and an opposition unable to counter Modi's widespread popularity – his approval rating stands at 75%, among the highest globally.[1]

While this will likely lead the BJP to another majority, winning more seats will require further inroads into southern and eastern India. That will pit the BJP against two key allies of the Congress: India's third-largest party, the DMK, in the south; and the TMC, India's fourth largest party, in the key eastern state of West Bengal.

We expect financial markets to take the incumbent's likely victory positively, as it signals policy continuity, and given the administration's track record of institutional reforms and infrastructure investment.

Index inclusion: a milestone for India's capital markets

In September JPMorgan confirmed Indian government bonds (IGBs) would be added to its widely followed GBI-EM Global Diversified Index. Inclusion will be phased over 10 months, starting in June; once it is complete, IGBs will account for 10% of the index – putting India on a par with China.[2]

This decision reflects the increasing accessibility of the country's local currency government debt market, thanks to the issuance in recent years of Fully Accessible Route (FAR) government bonds, which are free of quotas and more readily investible by foreign investors.

In March, momentum grew with confirmation that IGBs would be included in the Bloomberg Emerging Market (EM) Local Currency Government Index from 2025.[3]

Longer term, it's expected that foreign ownership of IGBs will rise from the current level of around 2% to 9% by 2030.[4]

We continue to anticipate further consultations on potential India bond inclusion in the Bloomberg Global Aggregate index and FTSE's WGBI index. Inclusion in these indices would further increase foreign investor flows into IGBs.

Accessing the market

Index inclusion of IGBs raises practical considerations for investors. Adding exposure to IGBs ahead of this 'wall of cash' may appeal to investors with a positive view on India, who seek to actively pre-empt potential spread-compression following inclusion – as well as to those simply desiring a pragmatic way of implementing a passive position.

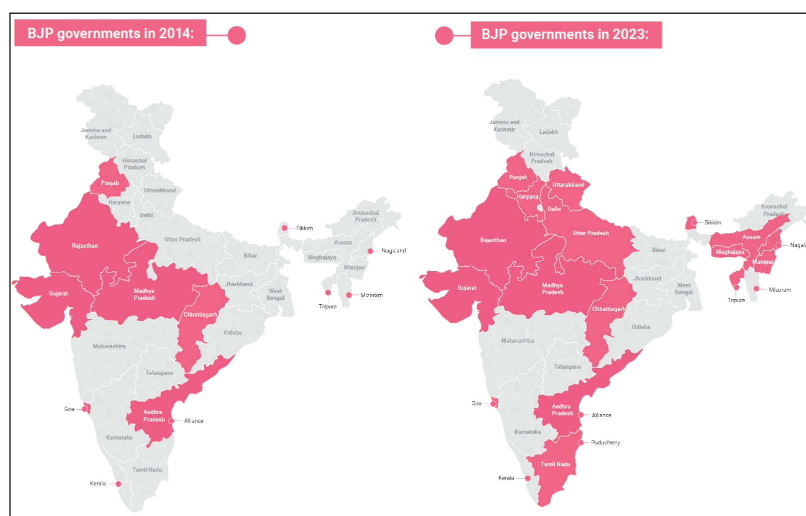
In terms of gaining exposure, direct investment in IGBs may potentially be attractive for investors seeking greater control over bond selection – an investor buying IGBs directly has the option to select those bonds with the specific characteristics to which they wish to gain exposure.

Equally, ETFs could offer a straightforward, cost-effective and potentially tax-efficient option for some investors:[5]

- 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 to Irish-domiciled ETFs (10% WHT vs 20% standard rate). In addition, Irish-domiciled ETFs are subject to zero capital gains tax (CGT), compared with other domiciles, which pay rates of 10-30% CGT.[6]

Regardless of whether investors choose to access the market directly or via ETFs, the inclusion of IGBs in major fixed income indices signifies international recognition of India's growing significance as a leading global economy, and will likely result in more foreign investments in the country's capital markets.

And while any investment in emerging market debt entails some risk – especially when the macro backdrop is so fragile – we see the idiosyncratic allure of IGBs, detailed above, as highlighting the importance of taking a selective approach to the asset class.



[1] Source: https://www.ipsos.com/en-in/approval-rating-pm-narendra-modi-soars-75-feb-2024-10-jump-sept-2023-wave-ipsos-indiabus-survey
[2] Source: Goldman Sachs, Global Market Daily report, 16 August 2022.
[3] Source: https://www.bloomberg.com/company/press/bloomberg-announces-india-far-bonds-inclusion-in-the-bloomberg-emerging-market-em-localcurrency-government-index/
[4] Source: Morgan Stanley and JPM estimates, August 2022
[5] Tax treatment is dependent on individual circumstances and is subject to change
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