

A likely surge in FPI Flow (Debt)

The inclusion of Indian government bonds in the Bloomberg and JP Morgan global bond indices has excellent implications for Indian market and the economy as a whole, raising its standing amongst its global peers. The optimism surrounding growing prospects of economy, coupled with lower inflation, stable currency and stability in reforms remains favorable and reflects optimism towards India's growth potential. This serves as a strong background for potential investors and opens new sources of investment avenues for domestic capital, given there is availability of funds. This is touted to be the shining moment for Indian economy.

Indian economy remains a favored place for investment as has been reflected by strong FPI flows in the past few months. After China and Brazil, India's government bond market is the third largest amongst emerging economies. The foreign ownership stands at a mere 2%, much lower when compared to other emerging economies. Back in Sep'23, it was announced that starting from 28 Jun 2024, JP Morgan will include India in its Government Bond Index-Emerging markets. The GBI EM GD (Global diversified Index) comprises of fund from across the globe with the AUM totaling to US\$ 213bn. India is assigned a weightage of total 10% in the index. With this weightage, India is expected to garner total inflows close to US\$ 30bn in FY25. There will be an investment in over 23 Indian government bonds with the notional value to the tune of US\$ 330bn. In addition to this, Indian securities are also expected to be included in the Bloomberg EM local currency government Index. The index could possibly include 34 Indian securities. This is likely to happen by Jan'25 with an initial weightage of 10%. With this, India's rupee will become the third largest currency, component wise after China's renminbi and South Korean won. Overall, we expect this will bring in combined (equity and debt) FII flow to the tune of US\$ 40-45bn.

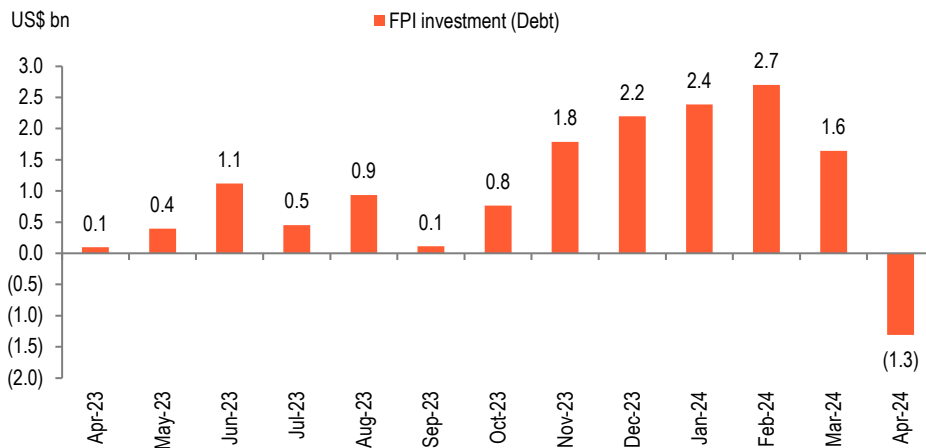
Global market trends and macro updates have influenced the global movement of FPI flows. The news of inclusion of India in the government bond index has driven FII flows higher across segments including, in the debt segment. There has been a steady increase starting from Oct'23 (Fig1), with FII flows in the debt segment at US\$ 0.8bn and climbing to US\$ 2.7bn, highest level in over 5-years. Secondly, the sector wise data under the sovereign segment (Fig 2) has noticed a gradual increase in investment scaling as high as US\$ 29bn in Mar'24, signaling greater demand and sharp uptick since Oct'23 given the announcement of inclusion of India in the global bond indexes. This is based on the following factors:

- India's economy remains on strong footing with the economy expected to clock 7.6% in FY24 according to government estimates. For FY25, RBI expects the economy to register a growth of 7%. Even other global agencies have forecasted India to grow at a healthy pace of 6.8% (IMF) with the possible upward revision and 6.6% (World Bank) for FY25.

- Strong optimism surrounding India's growth story, signs of traction in domestic demand, supported by benign oil prices. Additionally, robust capital markets coupled with returns and conducive environment will attract more FII flows in to the country.

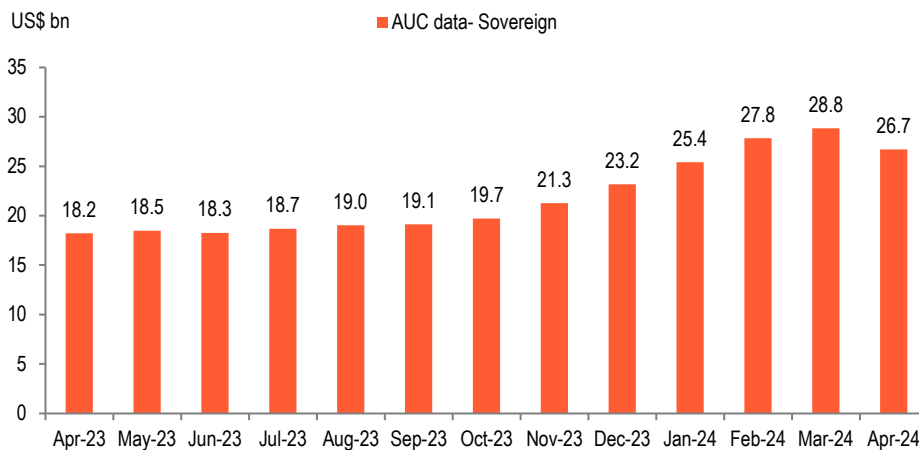
Figure 1 below shows that FPI inflows in the debt segment have started increasing from November right up to March. In April the decline can be attributed to market expectations of the Fed deferring the decision on rate cuts beyond June. This means that interest rates will remain high for longer in the US markets.

Fig 1: FPI investment



Source: CEIC, Bank of Baroda

Fig 2: Assets under Custody-Sovereign



Source: NSDL, Bank of Baroda

Figure 2 shows that AUC under sovereign bonds had increased to an all-time high of \$ 28.8 bn in March 2024. Until September 2023, it had remained range bound at \$ 18-19 bn.

However, there has been some moderation lately and the reasons for this include: 1) Uncertainty over interest rate movement by global central banks. 2) Uneven growth in global economies with

divergence in global central banks actions. According to OCED, US is expected to witness slowdown, with growth forecasted at 2.6% in CY24, followed by 1.8% growth projected in CY25. China's economy is projected to grow at a much slower pace from 4.9% to 4.5% in CY24 and CY25 respectively. On the other hand, Japan is projected to rebound and register a growth of 0.5% and 1.1% for the same period. Europe is likely to witness some recovery, with a growth of 4.9% (CY24) and 4.5% (CY25). 3) Escalated geo-political tensions continues to remain a cause of concern with elevated risk of higher inflation.

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