

REUTERS

Exclusive: India in talks with JP Morgan, others to join bond indexes – sources

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India is talking with JP Morgan and others to gain entry to benchmark indexes for emerging market debt in hopes of attracting billions of dollars in investment and may ease some restrictions on foreign inflows in order to do so, sources said.

Finance Minister P. Chidambaram and other officials plan to meet next week in the United States with big fund managers that track such indexes including Pimco, Capital International and Standard Life, one of the sources with direct knowledge of the matter said.

To qualify for entry into the widely-followed JP Morgan Government Bond Index - Emerging Markets, India needs to ease rules on registration, documentation, due diligence rules for the entry of foreign institutional investors (FIIs) in the Indian debt market, besides allowing them to invest more in the government debt, two sources said.

The sources declined to be identified because of the sensitivity of the matter.

A finance ministry spokesman declined to comment.

With a wide current account gap and a weakened rupee, India wants to attract some of the billions of dollars managed passively by tracking global indexes. However, Indian restrictions limit foreign investment in onshore debt, which exclude it from indexes managed by JP Morgan and others.

India has been taking steps to ease investment rules but is also skittish about fully removing limits given worries about the volatility of global flows. Its credit rating also stands just one notch above junk status, although a downgrade would not disqualify it from an emerging market index.

Inclusion in popular government bond indexes could attract \$20 billion-\$40 billion in additional flows into India over a year, Standard Chartered Bank wrote in a report last month.

"This is kind of opening up the debt market completely, with all the good and bad that comes with it," said Dilip Parameswaran, head of Asia Credit Advisors, an independent fixed-income consultancy in Hong Kong.

"It won't solve its balance of payments problems immediately as both the government and the index providers need to finalise details and following which investors will have to readjust their portfolios," he said.

Indian government bonds and the rupee gained after the Reuters report, with the benchmark 10-year bond yield falling 4 bps on the day to 8.42 percent.

The rupee rose to close at 61.39/40 per dollar on Thursday, strengthening from around 61.95 before the report.

MODIFYING RULES

In seeking index inclusion, India may modify rules to allow foreign institutions to invest more in government debt, now capped at \$30 billion.

While India doesn't want to do away with caps entirely, it is considering further loosening rules that allow higher limits once investors reach 80 percent of the cap, one of the sources said.

Another source with a bank said Indian officials approached banks seeking feedback on what New Delhi can do to include its government bonds in indexes. While talks have shown progress, a final decision on timing and India's index weight is at least a couple of months away, the source said.

One obstacle to index inclusion is India's withholding tax on foreign investment in government debt.

Earlier this year India reduced withholding tax of as much as 20 percent on coupon payments to 5 percent. India argues that the effective rate is zero for the majority of investors covered under bilateral tax treaties with countries such as the United States and Singapore.

India last month eased rules to allow foreign institutions to invest in government bonds on an "on tap" basis, or without first requiring the purchase of debt limits. It is also in the process of easing registration and due diligence rules for foreign investors to buy government debt, one of the sources said.

India's preference is to get into the JPMorgan index, one of the sources said, but authorities are also in touch with other index operators such as Barclays and Citi, sources said.

JP Morgan, Barclays and Citi declined to comment.

One of the sources said India hopes to reach an agreement with JPMorgan by the end of November.

Some \$250 billion in global funds is invested tracking JP Morgan's Government Bond Index - Emerging Markets - Global Diversified, Standard Chartered Bank said.

Foreign holdings in Asian bond markets have swelled to record highs in recent months, reaching as high as 35 percent of outstanding debt in Indonesia, but in India foreign holdings account for just 4 percent, according to BNP Paribas.

(Additional reporting by Suvashree Dey Choudhury, Himank Sharma and Archana Narayanan; Editing by Kim Coghill)