IMF bats for India's entry into global bond indices

NIKESH SINGH
New Delhi, 20 July

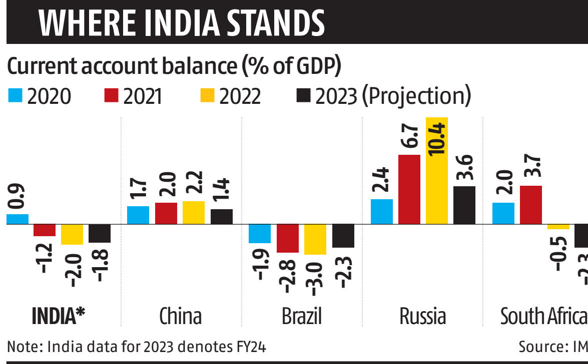
The International Monetary Fund (IMF) has said India's expected inclusion in the international bond indices could "significantly increase" foreign participation in the country's bond market and support portfolio inflows to finance the current account deficit (CAD) over the medium term.

It maintained that volatile portfolio investments are "very sensitive" to changes in global financial conditions and country risk premia.

Global bond index providers have been reaching out to India for the inclusion of its sovereign debt on their platforms, as the exclusion of Russia from international capital markets has led to the need to bring in a large emerging market economy.

However, the finance ministry has been reluctant to provide any tax incentive such as rationalisation of capital gains tax for inclusion of G-Sec into global bond indices.

Inclusion in a global bond index is also expected to exert pressure on the government to adhere to fiscal discipline and ensure that its bonds retain investment grade.



The report said that India's trade and capital account regimes remain relatively restricted despite some progress made in external trade promotion and the liberalisation of FDI and portfolio flows.

"During FY23, Indian authorities made further steps toward capital account liberalisation by further increasing limits on external borrowing and widening the scope of government bonds available for foreign investors. While FDI inflows covered a part of the CAD in FY23, further structural reforms and improvement of the investment regime to promote FDI are needed," IMF added.

The IMF has projected India's CAD to narrow in financial year 2023-24 to 1.8 per cent of GDP from 2 per cent in FY23 as reflected by buoyant services exports and expected decline in oil import costs, before converging to its estimated norm of 2.4 per cent of GDP over the medium term.

India's CAD declined sequentially to 0.2 per cent of GDP in the March 2023 quarter (Q4FY23) from 2 per cent of GDP in the December quarter of FY23. This was mainly due to a moderation in the trade deficit coupled with robust services exports.

"In the near term, the government's additional infrastructure spending will contribute to raising the CAD, thereby reducing the positive current account gap. To facilitate external rebalancing over the medium term, fiscal consolidation, development of export infrastructure, and negotiation of free trade agreements with main trading partners to provide a sustainable boost to exports of goods and services should be accompanied by further investment regime liberalisation and a reduction in tariffs, especially on intermediate goods," the report said.

"Structural reforms could deepen integration into global value chains and attract FDI, hence mitigating external vulnerabilities. Exchange rate flexibility should act as the main shock absorber, with intervention limited to addressing disorderly market conditions," it said.

The report added that in view of India's moderately strong external position and adequate reserves level, forex interventions should be limited to addressing disorderly market conditions.

In the first half of 2022, widening CAD and portfolio investment outflows resulted in depreciation pressures on the rupee. These pressures abated and reversed when the CAD narrowed and investor sentiments improved in the second half of 2022 and early 2023. The average real effective exchange rate (REER) in 2022 appreciated by about 1 per cent from its 2021 average.