

EMERGING MARKETS

EM MONITOR: CHINA INCLUSION IN THE JP MORGAN GBI-EM GD INDEX

Waiting for China

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After years of anticipation we might be nearing the entry of China into the widely used JP Morgan GBI-EM GD index.

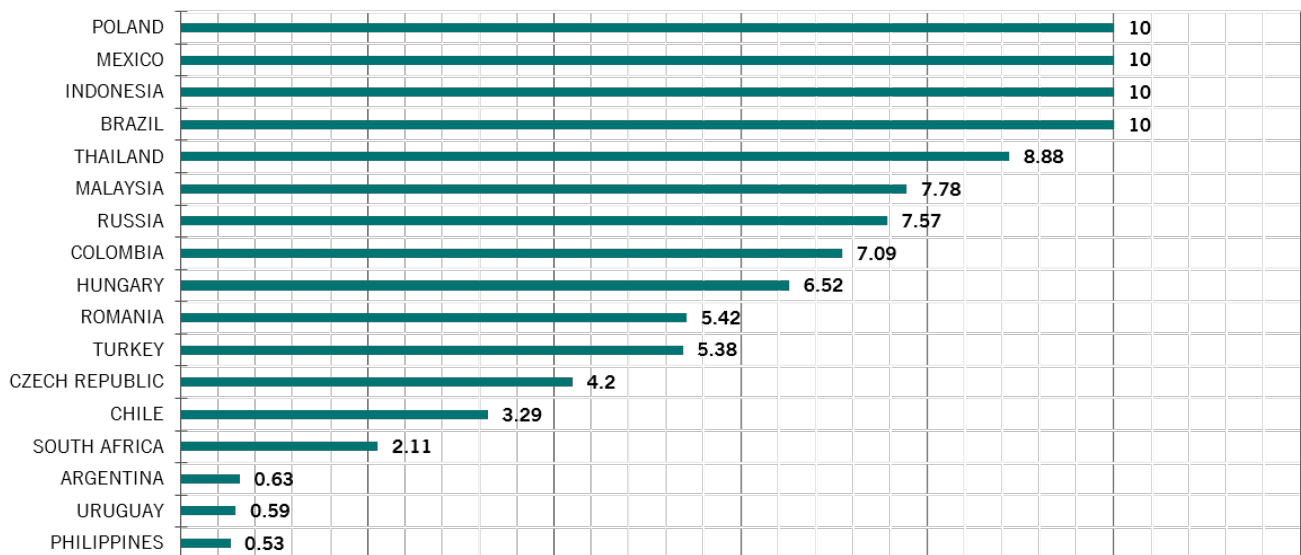
Almost there?

We believe that Chinese bonds are on the verge of entering the most tracked and invested emerging market local currency sovereign debt index.

This April saw China **included** in the Bloomberg Barclays Global Aggregate and Bloomberg Barclays Emerging Markets Local Currency bond indices, but China's bonds still remain excluded from the more widely used JP Morgan GBI-EM GD.

So far the JP Morgan GBI-EM GD index has excluded countries such as India and China due to historical hurdles in accessing these bond markets by foreign investors. GD stands for "global diversified" and this index is designed to be the most easily 'replicable' for investors. [Note: the JP Morgan GBI-EM Broad series of EM local currency debt indices has included India and China since their inception in 2005, however very few active investors use this index series.]

WEIGHTS IN JP MORGAN GBI-EM GLOBAL DIVERSIFIED BY COUNTRY (%)



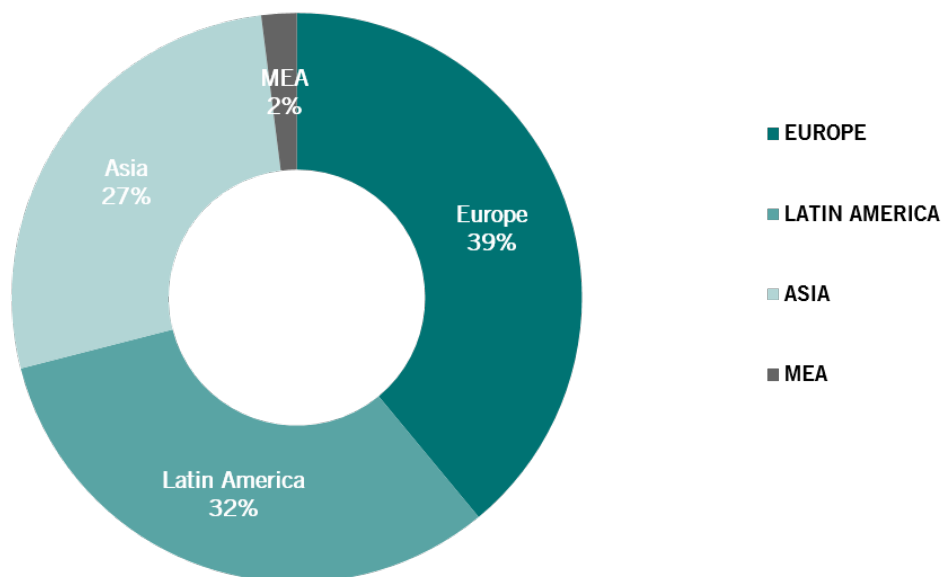
Source: Pictet Asset Management / JP Morgan, as at 30.06.2019

Given the size of China's bond market, the indications are for a weighting between 7-10 per cent in the JP Morgan GBI-EM GD. Ten per cent is the maximum permitted for a single country in this index and would put China alongside Poland, Mexico, Indonesia and Brazil (see above).

Phased entry

If and when China's index inclusion is announced by JP Morgan, it is most likely to be in a phased approach of 1 per cent per month until it reaches the target weight, and would increase the weighting of the overall Asia region to a level close to that of Europe and more than Latin America.

WEIGHTS IN JP MORGAN GBI-EM GLOBAL DIVERSIFIED BY REGION (%)



Source: Pictet Asset Management / JP Morgan, as at 30.06.2019

Access to the Chinese local bond market has significantly opened up in recent years particularly with the advent of Bond Connect, which allows overseas investors access to Chinese local bonds directly through the Hong Kong exchange. Prior to this, foreign investors needed to go through a lengthy process applying for a QFII (Qualified Foreign Institutional Investor) quota to be granted by SAFE (China's State Administration of Foreign Exchange) and finding a local clearing agent with international settlement.

This was a complex and lengthy process and the quotas granted were often well below what investors requested. Almost all these types of hurdles have now been eliminated, which should now make Chinese bonds eligible for inclusion in the JP Morgan GBI-EM GD index.

What are the implications?

In the near term, the impact of China's inclusion would not be earth shattering. We have already been investing in Chinese local markets through interest rates and the currency for many years. Our Asian Local Currency Debt strategies for example use the JP Morgan JADE Broad index where Chinese onshore bonds already represent 10 per cent of the index. Many of our funds already invest in Chinese onshore bonds via Bond Connect as we have been an early adopter.

“ Index inclusion would be another important milestone in the internationalisation of China's renminbi currency.”

– Mary-Therese Barton

However one should not underestimate the importance of China's entry in the medium to long term. As we outlined in a recent [article](#), the ongoing opening up of China's onshore bond market is a very big deal. In our view, the inclusion in the JP Morgan GBI-EM GD index would be another important milestone in the internationalisation of China's renminbi currency.

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