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Analysing developments impacting business

FPI INVESTMENT IN MUNICIPAL BONDS

9 May 2019

The Reserve Bank of India (RBI) issued a notification on 25 April 2019 allowing foreign portfolio investment (FPI) in municipal bonds (Muni Bonds). This was followed by a notification by the Securities and Exchange Board of India on 8 May 2019 also allowing FPI in Muni Bonds.

Key Highlights

- The amendment is meant to broaden access of non-resident investors to debt instruments in India.
- FPI in Muni Bonds will be counted within the limits for FPI in state development loans (SDL). The current limits are:

Time period	Limit for SDL - General (in Rupees billion)
Half year from April - September 2019	1,037
Half year from October 2019 - March 2020	1,151

- All other conditions for FPI in debt remain unchanged.

Background

- RBI and thinktanks have been pressing for reforms in the municipal fiscal sector for a number of years. The Indian urban local bodies (ULBs) have far lesser revenues than their counterparts in developed nations. Consequently, the growth needs of infrastructure in Indian cities and towns far exceed the resources at the disposal of their ULBs.
- The Central Government has long contemplated facilitation of the municipal bond market. In October 2018, the Central Government issued a scheme for monetary incentives to ULBs for issuance of Muni Bonds, to achieve this objective.
- Further to the Central Government initiative, a number of ULBs (including, amongst others, Indore, Bhopal, Ahmedabad and Surat) have issued listed Muni Bonds with coupon rates of 7.9% - 9.25% per annum. These instruments have been consistently oversubscribed, indicating strong investor interest.
- This latest move by the regulators appears to be geared towards deepening the debt market for ULBs.

Takeaways

- These notifications have opened a significant avenue for foreign portfolio investors interested in investing in government debt.
- The past few Muni Bond issuances have been popular, but the opportunity for investing in Muni Bonds may not last long since only about 30 ULBs have credit rating of A- or above.
- Muni Bonds have obvious potential; however, their performance is yet to be assessed.

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