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India beckons

The macro-economic concerns notwithstanding, India has emerged as an attractive destination for foreign institutional investors (FIIs) this year. Fli inflows in the first five months of this year have been the highest, when compared to the FII inflows received by the country in the first five months of each of the last 10 years. India has received Rs83,205.10 crore this year as on 31 May 2013, almost double the amount received in the first five months of the previous year (see table).

Ironically, India is witnessing such FII inflows at a time when the US and Japan are pulling out of depressed economies and since the beginning of 2013, net flows in emerging market stock funds have been declining. As on 29 May 2013, the net flows stood at $2.89 billion.

"India's economic problems are solvable, whereas the rest of the developed world has problems, which are mostly not solvable," says Piyush Garg, chief investment officer, ICICI Securities. "India's domestic consumption story is one of the best in the world. Countries like Thailand, Singapore and Malaysia can only absorb a certain amount of money and everyone wants to play the diversification strategy. Central banks across the developed world are injecting liquidity into the system and India is receiving some part of this.

Adding to the factors that have attracted FIIs, "there has been a lot of optimism surrounding the reform measures taken since late last year," says Devendra Joshi, equity strategist, Asia Pacific, HSBC. "To an extent, they marked the end of policy paralysis, the biggest concern of foreign investors. Another reason is that the Korean and Chinese equity markets have their various internal and external problems. India, being another large liquid market, 'benefited from this."

Historically, it has been observed that India receives most of its FII inflows in the second half of the calendar year. In the past ten years, on an average, India has received about 27 per cent of its FII inflows in the first five months while, last year, it received about 33 per cent in the first five months. By this logic, India might be able to surpass its all-time high and receive investments worth more than Rs3 lakh crore by the end of the calendar year.

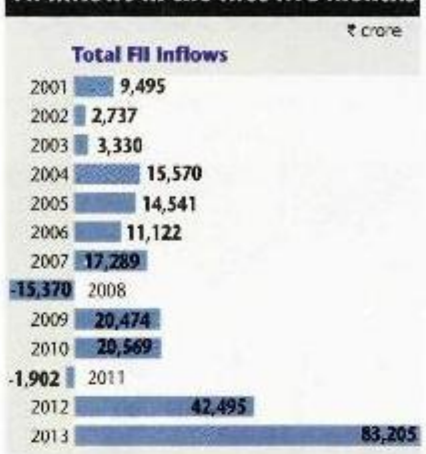
Vulnerable to slowdown

However, according to Joshi, this year, it might not be the case, "given that India is already an overweight country and, compared to its own history as well as other markets in Asia, it is getting increasingly vulnerable to the slowdown. Election-led uncertainty, over-ownership by foreign investors, fading window for reforms and potential downgrades to corporate earnings," might also be among the factors that create a negative impact on FIIs in India.

"Corporate governance issues in India are also a risk," says Garg. "If economic growth in the developed world starts to gather strength, the central banks will start to tighten the liquidity, which will have a negative impact on FII inflows. The largest risk arises from the US, as it is showing relative growth which shows signs of sustenance."

Such a strong inflow of FIIs comes at a time when the Indian investor is selling in the equity markets. As of 31 March 2013, FIIs held 19.7 per cent (an all time high) of the BSE 200 stocks. Unlike an Indian investor who evaluates India's current situation in comparison to its recent history, an FII will also look

FII inflows in the first five months



at India with respect to other emerging markets.

Jyotivardhan Jaipuria, managing director & head, research, Bank of America-Merrill Lynch says, "Viewed from foreign investors' perspective, the margins in India are at an 18-year low, so we might be at the cusp of an earnings upgrade cycle. As global commodity prices are easing, interest rate cuts might happen and the economy could start accelerating. FIIs would like to invest in countries such as India, which would benefit from the fall in commodity prices. Though FII inflows continue to be strong, the issue is whether the supply of paper will be able to absorb it or not and that is important for the secondary market."

"Though FII inflows have been quite strong, they have gone into a few selective stocks and sectors and not across the board," says A.K. Srid-har, director & CIO, IndiaFirst Life Insurance Co, maintaining a negative outlook on the inflow of FIIs in the second half. "Despite the inflows, the rupee has been weakening against the dollar. There is no clarity in terms of earnings growth moving up in the next two or three quarters. Maintaining the present earnings growth, the valuations look a bit stretched; so, anyone who would want to plug in more money would definitely think twice." The depreciating Indian rupee might also prove to be a major cause of concern for the FIIs

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