Economics

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Fluctuating Fortunes: A Review of FII inflows

In August 2013, India was identified and subsequently categorized as one of the 'fragile five' economies by virtue of its

- heavy reliance on foreign
- a widening current Account Deficit (CAD),
- weakening foreign reserves and
- depreciating currency.

In 2014 however, the story changed as foreign investors invested heavily in Indian equities and debt securities in the light of certain positive domestic developments. The net FIIs in equity in 2014 (as of 25th August '14) stand at $12,813 mn ($ 11,582 mn in 2013) and that in debt is $16,672 mn (- $ 5,623 mn).

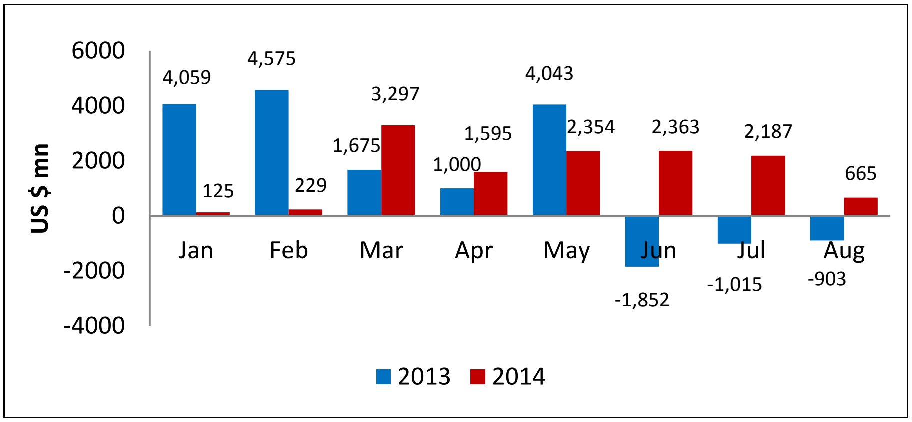
This report briefly analyses the trends in Foreign Institutional Investments (FIIs) inflows in Jan-Aug '14 in equity and debt against the backdrop of the corresponding FII inflows in the previous year and tapering by the Federal Reserve Bank. Stock movements in select emerging economies are also traced for comparison.

FII inflows in Equity

FII inflows into equities have been rather strong in 2014 particularly from March '14 onwards covering tremendous ground from last year when the tapering announcement was first made by the then Chairman of the Federal Reserve, Dr. Ben Bernanke. His comments of a potential commencement of the winding down of the Bank's quantitative easing program triggered a withdrawal of foreign investments from equity and debt in emerging economies. Consequently, FIIs from equity in India depleted drastically between June-August '13 as evidenced in the exhibit below. From a total of $4,043 in May '13, FIIs in equities fell to -$1,852 in June'13.

The exhibit below depicts the FII inflows in 2013 and 2014 between the months of January to August.

Exhibit 1: FII inflows in Equity in Jan-Aug 2013 and 2014 (US $ mn)



Source: SEBI and NSDL

Juxtaposed with the tapering schedule

- The eventual tapering of the quantitative easing came into effect from January 2014 onwards. The total FII inflows in equities stood at $125 mn that month, markedly lower than $4,059 in January ’13.
- Subsequently FII inflows increased to $3,297 mn in March ’14 when the monthly bond buying by the Fed was reduced to $65 bn per month from the initial $85 bn per month.
- FIIs remained strong in April’14 and May ’14 in the lead up to the Lok Sabha elections suggesting that global sentiments pertaining to the new government in India were positive.
- As of August ’14, the Federal Reserve’s stimulus plan stands reduced at $25 bn per month. However, FII inflows in equities stand at $665 crore (as of 25th Aug ’14) painting a stark contrast to the position in August ’13 when FII outflows were to the tune of -$903 mn. This further reiterates the positivity surrounding Indian equities.

Stock index Movement

With the initial comments by Dr. Ben Bernanke pertaining the tapering, five economies were identified as susceptible and were termed as the ‘fragile five’ namely; Turkey, India, Brazil, Indonesia and South Africa. Stock indices in these countries had plummeted as FIIs took the exit route from equities in particular from June ‘13 onwards.

However, share prices have recovered in 2014 after the tapering commenced and Table 1 shows the increase in the stock indices of these countries over 31st December ’13. Countries included are the fragile five economies and three other emerging economies of China, Russia and Argentina.

Table 1: Movement in Stock Indices of select emerging economies (in $ terms)

Country	Index	% change over 31st Dec 2013
Fragile Five		
India	Sensex	23.6
Turkey	BIST	14.2
Brazil	BVSP	12.1
Indonesia	JSX	25.9
South Africa	JSE AS	9.8
Other Emerging Economies		
China	SSEA	3.4
Russia	RTS	-15.4
Argentina	MERV	24.6

Source: Economist

- India has witnessed a significant uptick in stock indices in 2014 relative to most countries. Sensex has been in the news for touching record highs time and again. The index recorded a 23.6% growth relative to its level on 31st December ’13 thereby becoming one of the strongest performers among emerging countries. This can attributed to two forces;
    - Improving economic indicators with slightly moderated inflation, lower CAD and a stable rupee.
    - Increased positive environment surrounding the establishment of a strong new government.
- Indonesia and Argentina also recorded significant growth over December ’13 as they grew by 25.9% and 24.6% respectively. Being in the ‘fragile five’ group these countries have recovered well and are resilient to the ongoing tapering by the Federal Reserve Bank.

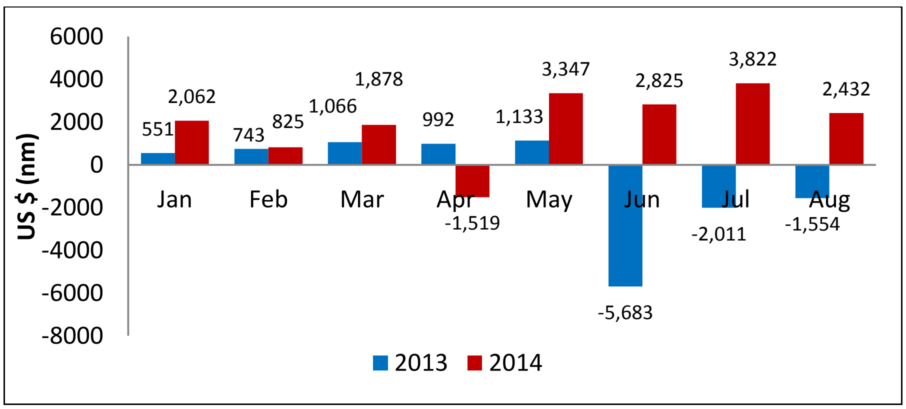
- Countries like Russia, Turkey and South Africa continue to struggle owing to weak domestic fundamentals. Russian stock index has in fact contracted over the period on account of the continuous war like situation with Ukraine. South Africa is engaged in certain labor related issues which have impacted the economy adversely.
- Brazilian stock index grew modestly at 12.1%. However China's Shanghai Stock Exchange registered a growth of merely 3.4% over the period owing to concerns over growth and slowdown in the manufacturing sector.

FII inflows in Debt

FII inflows have been strongly positive in 2014 from January to August with the exception of April '14 when foreign investments in debt contracted by $1,519 mn. Despite the winding down of the quantitative easing, foreign inflows in debt securities have been very high in 2014 relative to 2013 levels.

The exhibit below captures the movement in FII inflows in debt securities in India between January to August in 2013 and 2014.

Exhibit 2: FII inflows in Debt in 2013 and 2014: Jan-Aug (US $ mn)



Source: SEBI and NSDL

- FII inflows in debt increased sharply in May '14 to $3,347 mn -$1,519 in April '14.
- They have been strongly positive from May onwards and vividly contrast from the corresponding figures in the previous year. FII inflows in debt peaked in July '14 to record $3,822 mn.
- As of 25th August 2014, they stand at $2,432 mn.

Outlook for FIIs

Going ahead, while still being in the positive territory, some moderation in the FIIs inflow is expected based on the following factors;

- Quantitative easing by the Federal Reserve will come to an end in the next two-three months and interest rates will then be increased in the country in due course. This could allure investors back to the USA.
- If stable macro-economic indicators persist, FIIs will remain in the positive territory supported by the strong political stability and better expectation of better governance.
- Lastly, upon signs of continued growth struggle in the Euro region, there is a probability that the European Central Bank (ECB) will adopt an unconventional approach 'Federal Reserve type approach' to fuel growth and prevent the region from slipping into deflation. In such an event, FII inflows to India may rise substantially.

Contact:

Madan Sabnavis
Chief Economist
madan.sabnavis@careratings.com
91-022-67543489

Garima Mehta
Associate Economist
garima.mehta@careratings.com
91-022-61443526