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Foreign Portfolio Investments April-October'18

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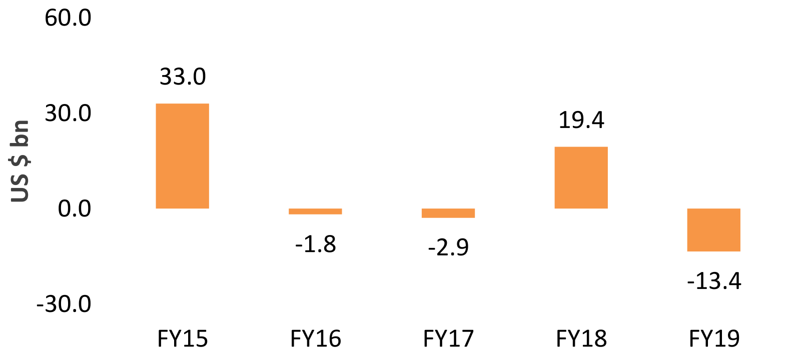
Foreign portfolio investments have emerged as a major source of private capital flow for the Indian Economy and have also been relied upon to manage the balance of payments position. They have also been considered to be one of the driving forces of the stock market. With its increasing importance for the Indian Economy, it thus becomes very crucial to create conducive environment for continuous inflow of foreign capital into the economy.

In this report, we have examined the flows of overall FPIs, the investments in the debt and equity segments, sector-wise and country-wise FPIs. In addition, the FPI utilization limits in debt instruments to assess the investor participation in the same have been looked along with some recent measures undertaken by the RBI and SEBI to boost FPI flows.

Exhibit 1: Net FPI inflows (Apr- Dec'18)



Source: CMIE

The flow of foreign portfolio investments to the Indian economy has witnessed a reversal in the current fiscal year (Apr-Dec'18) after registering an inflow in the comparable period a year ago. A similar trend was observed in the other emerging economies as well.

Net foreign outflows from the Indian economy have been nearly $ 13.4 bn during Apr-Dec'18, in sharp contrast with the net inflow of $ 19.4 bn in the corresponding period last year. The outflows can be attributed to shrinking global pool of investible surplus with the major central banks going in for monetary tightening. In addition, factors including rupee depreciation, rising crude oil prices and widespread uncertainty in the global markets amid US-China trade war have further resulted in investors adopting a cautious stance and reducing their investments in risky assets such as their investments in the emerging economies including India. The fact that the Federal Reserve has increased rates and indicated at further such measures has also made the American market relatively more attractive.

Table 1: Monthly Net FPI Inflows (Apr-Dec'18)

US $ mn	Debt	Equity	Total
Apr-18	-1,785	-983	-2,765
May-18	-2,629	-1,427	-4,063
Jun-18	-1,621	-377	-1,997
Jul-18	105	208	305
Aug-18	355	-278	72
Sep-18	-1,461	-1,314	-2,776
Oct-18	-1,352	-3,753	-5,105
Nov-18	889	868	1,758
Dec-18	828	332	1,159

Source: CMIE

- FPIs have been the net sellers in 5 of the last 9 months with highest amount of outflows witnessed in the month of Oct'18 (to the tune of Rs $ 51 bn). On a monthly basis, the outflows in debt segments have been higher than the equity segment barring the month of Oct'18.
- FPIs have been net sellers in both the debt and equity markets in the ongoing fiscal year so far. The outflows have been the same at $6.7 bn each in both equity and debt markets during Apr-Dec'18.
- It is to be noted that FPIs turned net buyers in the month of Nov'18 and Dec'18 after witnessing two consecutive months of outflows. The increase in inflows can be ascribed to improved investor sentiments following the waivers by US on Iranian oil sanctions, supported by falling crude oil prices and recovery in rupee.

Recent Measures undertaken by Government to stimulate FPI inflows

The RBI and SEBI have undertaken measures in order to boost FPI flows in the economy, details of which are as follows:

- The limit for FPI investment is to be increased by 0.5% each year to 5.5% of the outstanding stock of government securities in FY19 and 6% of the outstanding stock in FY20.
- The RBI decided to discontinue the existing sub-categories under the corporate bond segment
- No fresh allocation to be made to the 'Long-term' sub-category under SDLs. Out of the existing limit of ₹ 13,600 crore for this sub-category then, an amount of ₹ 6,500 crore was transferred to the G-secs category.
- The RBI has revised the allocation ratio of GSec limit over the two sub-categories – 'General' and 'Long-term' at 50:50 in FY19 from the earlier allocation of 25:75.
- It is also decided not to include the coupon re-investment by FPIs in GSecs within the GSec limits.
- The limits were also increased for both GSec and Corporate bond. The limit in GSec- General was revised from the then current limit of Rs 1.91lkh cr to Rs 2.07 lkh cr for Apr- Sep'18 and Rs 2.23 lkh cr for H2FY19. The limit for corporate bonds was set at Rs 2.66 lkh cr for H1FY19 and Rs 2.89 lkh cr for H2FY19. Consequently, the total limit for FPIs in Central government securities, state government securities and corporate bonds was revised to Rs 5.94 lkh cr for H1FY19 and Rs 6.49 lkh cr for H2FY19 from an earlier limit of Rs 5.45 lkh cr.

- The RBI eased investment norms for FPI in debt securities by increasing the FPI cap on investment in government security from 20% to 30% of the outstanding stock of that security.
- The residual maturity requirement minimum 3 year residual maturity for investment in government securities has been done away with and for corporate bonds the residual maturity has been reduced to 1 year from the earlier 3 years.
- Further, the government is to review the removal of exposure limit of 20% of FPI's corporate bond portfolio to a single corporate group and 50% to a single company.
- SEBI also relaxed norms for clubbing of investment limits. From now onwards, clubbing of investment limits for FPIs will be on the basis of common ownership of more than 50% or based on common control. However, in the case of appropriately regulated public retail funds, investment limits will not be clubbed on the basis of common control.
- The RBI in consultation has also proposed a special route called voluntary retention route (VRR) (FPIs will be exempt from regulatory provisions if they commit to retain a minimum percentage of their investment for a particular period) to encourage FPIs willing to make long-term investments in debt.

FPI Investment Limits and Utilization

FPI limits in Corporate Bonds

Table 3: FPI limits and Utilization in Corporate Bonds as on January 9, 2019

Date	Instrument Type	Upper limit (Rs lkh cr)	Investment (Rs lkh cr)	% of limits utilized
January 9 2018	Corporate Bonds	2.44	2.13	91.8
January 9 2019	Corporate Bonds	2.89	2.05	71.1

Source: NSDL

As of January 9, 2019, 71.1% of the total FPI investments limits in corporate bond market were utilized by foreign investors, much lower than 91.8% a year ago indicating that there remains a scope for more inflows in the corporate bond segment.

Sector-wise FPIs (Asset under Custody as on December 31, 2018)

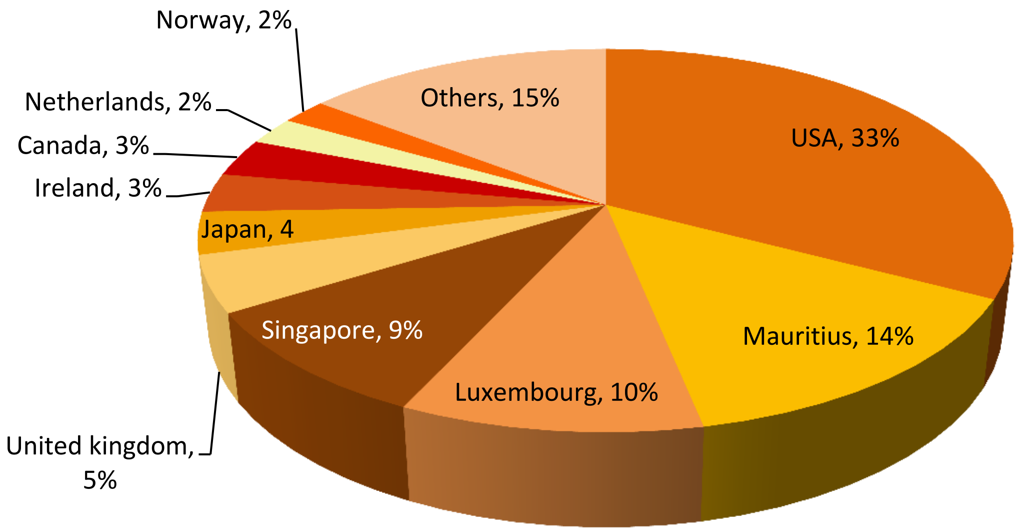
A total of $450 bn has been invested in various sectors as on December 31, 2018, details of which are provided in the Appendix 1.

- Around 87% of the total amount invested in India so far is in equity and the balance is in debt.
- In equity, following sectors have received the largest share in the total FPI equity inflows :
  - Financial services sector (35%)
  - Software services (12%),
  - Oil and Gas (8%),
  - Automobiles (7%).
- Sectors including healthcare services, Coal, Retailing, Hotels, Consumer durables, Hardware technology, realty, media etc. have relatively lower shares.
- The debt segment is dominated by sovereign bonds (around 50% of the total inflows in the debt segment).

Country- wise Asset under Custody

USA has the largest share of around 33% in the total FPIs with Asset under Custody amounting to Rs 10,26,937 crs , followed by Mauritius (Rs 4.4 lkh crs : 14%) , Luxembourg (Rs 3.16 lkh crs : 10%) and Singapore (2.9 lkh crs : 9%). Netherlands and Norway have the lowest share close to 2% with Asset under custody amounting to Rs 74,024crs and Rs 67,653 cr respectively during the period.

Exhibit 2: Share of top 10 countries in total AUC: December 2018



Source: NSDL

CARE Ratings' View

For the remainder of the fiscal, FPI flows would continue to be volatile. It would be influenced by both domestic and global factors.

The equity segment could see inflows fuelled by expectations of improved corporate performance and favorable economic prospects for the domestic economy when compared with other economies. At the same, uncertainty over the general elections, global equity markets performance and global political uncertainties (US-China trade war, Brexit conundrum etc) could impact investor sentiments and pose a risk to flows into the segment.

The inflows into the debt segment could see moderation with the RBI expected to lower its OMO purchases in the coming months and a pause in the interest rate hike cycle on account of benign inflation. In addition, concerns over the government's fiscal position, the risk of resurgence in crude oil prices and monetary policy tightening in developed economies would also weigh on debt inflows.

On a net basis for the financial year as a whole the inflows could tend to be marginally negative compared with the positive inflows of ($ 21.5 bn) in FY18 even though the flows in Q4-FY19 would be positive. (Our earlier view was that they would be marginally positive, which does not look likely given the lower positive net inflows in Nov-Dec.)

Appendix

Appendix 1: Asset under Custody as on December 31, 2018

Table 2: Asset under Custody as on December 31, 2018

US $ bn	Equity	Debt	Total
Financial Services	137	8	146
Software & Services	46	0	46
Oil & Gas	31	0	32
Sovereign	0	30	30
Automobiles & Auto Components	26	0	26
Others	5	18	23
Pharmaceuticals & Biotechnology	17	0	17
Household & Personal Products	16	0	16
Food, Beverages & Tobacco	15	0	15
Capital Goods	15	0	15
Utilities	12	1	13
Construction Materials	8	0	8
Metals & Mining	8	0	8
Telecom Services	7	0	8
Transportation	6	0	6
Textiles, Apparels & Accessories	6	0	6
Consumer Durables	6	0	6
Chemicals & Petrochemicals	5	0	5
Media	4	0	4
Retailing	4	0	4
Realty	3	0	3
Insurance	3	0	3
General Industrials	3	0	3
Healthcare Services	2	0	2
Hotels, Restaurants & Tourism	2	0	2
Coal	1	0	1
Commercial Services & Supplies	1	0	1
Diversified^	1	0	1
Diversified Consumer Services	0	0	0
Forest Materials	0	0	0
Telecommunications Equipment	0	0	0
Healthcare Equipment & Supplies	0	0	0
Hardware Technology & Equipment	0	0	0
Food & Drugs Retailing	0	0	0
Real Estate Investment	0	0	0
Total	**391**	**59**	**450**

Source: NSDL