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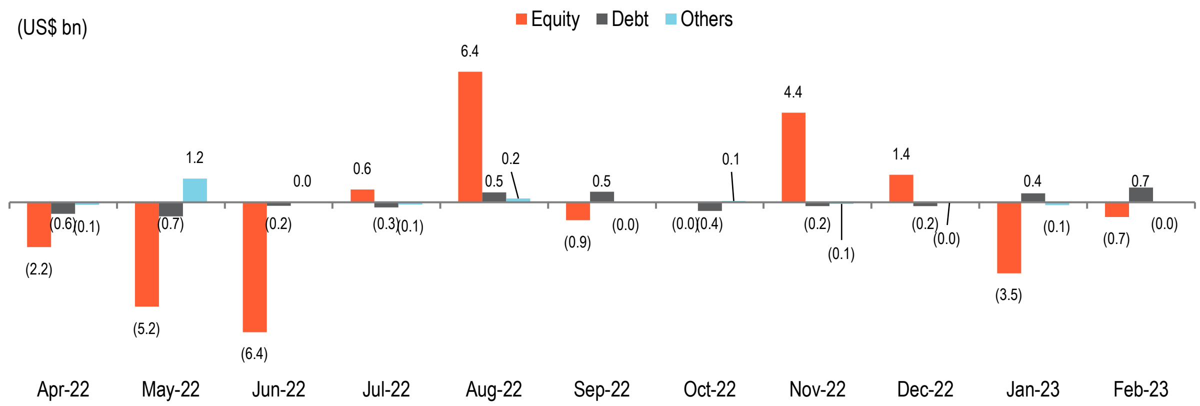
How have FPI performed this year?

FPI flows into India has largely remained negative this year mirroring a trend seen across EM countries. A wide of range factors such as the Russia-Ukraine war, higher global rates, strengthening dollar, China factor as well dimming global growth prospects kept investors risk averse. In India, FPI flows did witness bouts of revival but the momentum has once again derailed amidst a domestic stock market rout, further exacerbated by Fed's unyielding fight against inflation and reopening in China. FPI flows are important to India as these help to supplement the funding requirements caused by a growing current account deficit. With India's CAD expected to widen to ~3% of GDP in FY23, FDI and ECB inflows may not be enough to fund the deficit. FPIs have remained volatile for much of this year with increasing risk and hence they may not contribute positively to our balance of payments.

FPI movement in FYTD23

FPI flows have always been unpredictable and this year too was not an exception. While there was considerable volatility in the movement in FPI flows, overall the year saw total FPI outflows of US$ 5.7bn. This is on top of outflows of US$ 16bn in FY22. The trend in FPI flows this year has largely been negative, with the first three months of FY23 witnessing outflows of US$ 14.3bn. Some of these losses were recovered in Q2FY23 with inflows of US$ 6.9bn and US$ 4.9bn in Q3FY23. However, the situation has quickly reversed since then with Jan'23 witnessing outflows of US$ 3.2bn. It must be noted that the equity flows have dominated the overall trend in FPI flows as these account for the bulk of FPI inflows. FPI movement in debt and debt related instruments has remained largely muted this year.

Figure 1: FPI flows in FYTD23



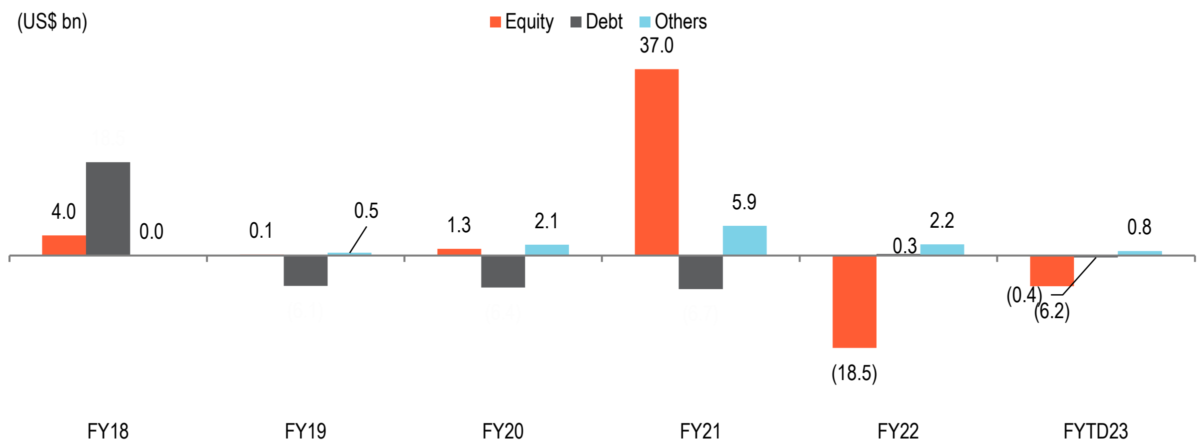
Source: NSDL, Bank of Baroda Research, Data as of 6 Feb 2023 | Note: Others include Debt-VRR and Hybrid

FPI movement over the years

In the last 5 years (FY18 to FY22), total FPI flows have remained negative for 3 years with the exception of FY18 and FY21. Both these years saw sizeable FPI inflows of more than US$ 20bn, which more than offset the outflows seen in the other years. Interestingly, debt inflows of US$ 18.5bn accounted for the bulk of FPI inflows in FY18 (inflows of US$ 22.5bn). However, in FY21, which saw inflows of US$

36.2bn, equity segment saw huge FPI influx of US$ 37bn. It is also interesting to note that in the last 5 years, while equity flows have remained negative only once i.e., in FY22, debt segment has seen outflows in 3 years. In fact, debt outflows predominated the FPI movement in FY19 and FY20.

Figure 2: FPI flows over the years



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<u>What explains the FPI movement in FYTD23?</u>

A number of factors impacted the movement in FPI flows this year, such as:

- Geopolitical tensions in Eastern Europe: Russia-Ukraine crisis and the resulting volatility in the global markets, led to huge outflows from Emerging Markets (EMs) to safer assets
- Interest rates: With global central banks embarking on a rate hike cycle, the relative interest rate differential between countries was an important determinant of FPI flows
- Movement in dollar: Much of 2022 was characterized by dollar strength which also impacted investment decisions of FPIs
- Global recession: Another recurring theme of 2022 was the risk of an impending recession as a result of global monetary policy tightening. This resulted in a risk-off sentiment and also FPI flows
- China: China is an important destination for FPI flows. Growth prospects in China were severely impacted last year amidst rising Covid-19 infections and the government's strict Covid zero policy. This led to FPI flows to alternative sources, such as India. With China announcing removal of all Covid-19 related restrictions in Jan'23, FPI flows to India and other EMs have been impacted. This can to some extent, explain FPI outflows of US$ 3.2bn in Jan'23.

<u>FPI flows and INR</u>

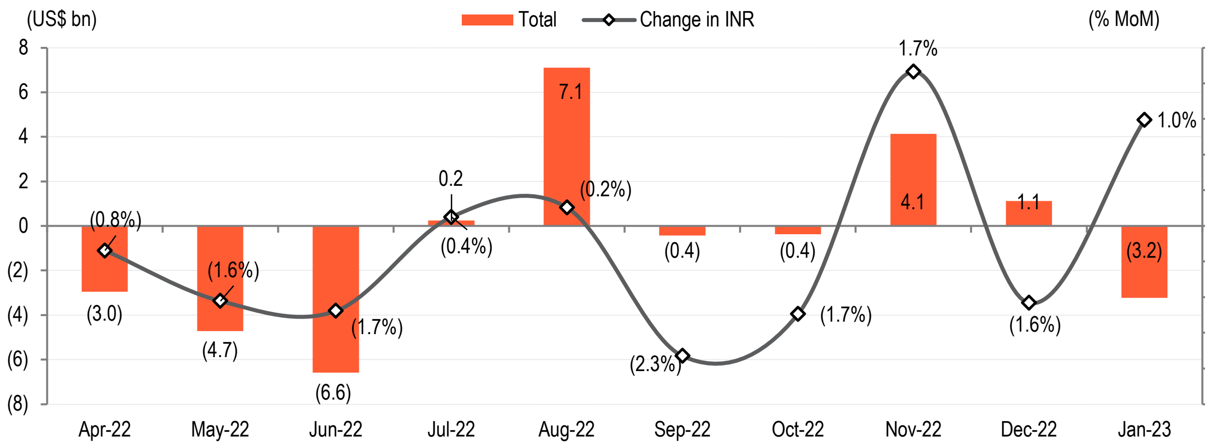
FPI flows have a strong relation with the exchange rate as it is an important component of the balance of payments. Tracking the movement in USD/INR and FPI flows in FYTD23 gives some interesting observations.

- In the last 10 months, FPIs have remained negative in 6 months. Barring Jan'23, INR has depreciated in each of these months.
- Out of the 4 months in which FPI flows were positive, INR still depreciated in 3 of these months

- In response to FPI outflows of US$ 14.3bn in Q1FY23, INR depreciated by 4%
- Between Jul to Aug'22, while FPI flows were positive (US$ 7.3 bn), INR still depreciated, albeit at a slower pace
- In the next 2-months, FPI outflows were relatively subdued at US$ 0.8bn. However, INR depreciated sharply by 4% in response to a strengthening dollar
- Nov'22 saw FPI inflows of US$ 4.1bn. INR appreciated by 1.7%
- In Dec'22, FPI inflows moderated to US$ 1.1bn. INR depreciated by 1.6% in response
- The appreciation in USD/INR during Jan'23 can be explained by a weaker dollar and lower oil prices

It must also be mentioned here that FPI flows alone do not determine the movement in USD/INR. Other factors such as movement in dollar, inflation, oil prices, trade and current account deficits etc also have an important role to play in influencing the movement in exchange rate.

Figure 3: FPI movement and changes in exchange rate



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