9th May 2022

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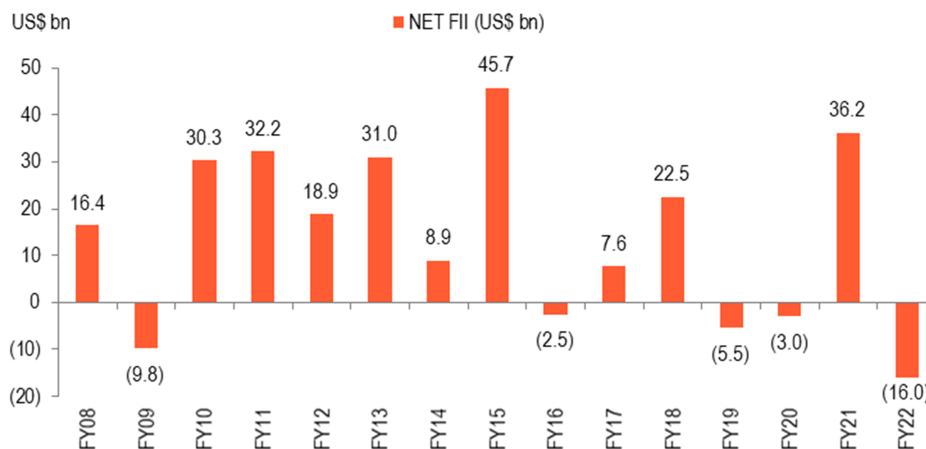
Trends in FPI flows in India

FPIs play an important role in the economy in terms of providing support to the equity and debt market besides adding strength to the foreign capital flows. This study analyzes data on FPIs over a span of 25-years to understand trends. These flows have been analyzed in terms of trends in movement of equity and debt flows, sources of these flows and the sectors preferred by them. India's share in overall flow of FPIs is also looked at after which we conjecture the prospects for FY23.

Emerging markets have continued to remain an attractive destination for international portfolio investment. While the liberalization process began in the country in the early 1990s, FPIs investment began in Sep'92. Portfolio flows in India to begin with have tended to be largely stable. In a span of over 25 years since FY98, India has witnessed portfolio outflows in 7 years only, the remaining have had inflows. The first bout of this outflow was post the Asian Financial crisis; however it was short lived one as the country made a stronger than expected comeback. As of FY22, net FPI flows has dipped to US$ 16 bn with Net equity outflow of US$ 18.5 bn and Debt inflow of US$ 0.3 bn. However, in the last decade, there have been more occurrences of negative new inflows.

Fig 1: Movement of FPI flows over the last 15-years



Source: CEIC, Bank of Baroda Research

Figure 1 above gives the trend in movement of FPIs for the period FY08 to FY22. In 10 of the 15 years, the flows were positive while it was negative in the rest. On 5 of the 10 occasions, the flows were above $ 20 bn in a year, with the highest being achieved in FY15 where they peaked at $ 45.7 bn.

Figure 2 below shows that in this year both equity and debt flows were high with the latter peaking at $ 27.3 bn. This was the time when the government also had more liberal terms for FPI investment in both government and corporate debt. This was probably the golden year because after FY15 there have been erratic movements in both equity and debt. In the last 4 years, debt inflows have been negative or virtually close to nil which is a concern as even though there are more liberal limits for FPIs to invest, they are not being utilized. The focus must be on

the development of the corporate bond market to make them more liquid. Also the high government borrowing programme has militated at the margin at the attractiveness of these bonds.

Fig: 2: Equity and debt flows of FPIs

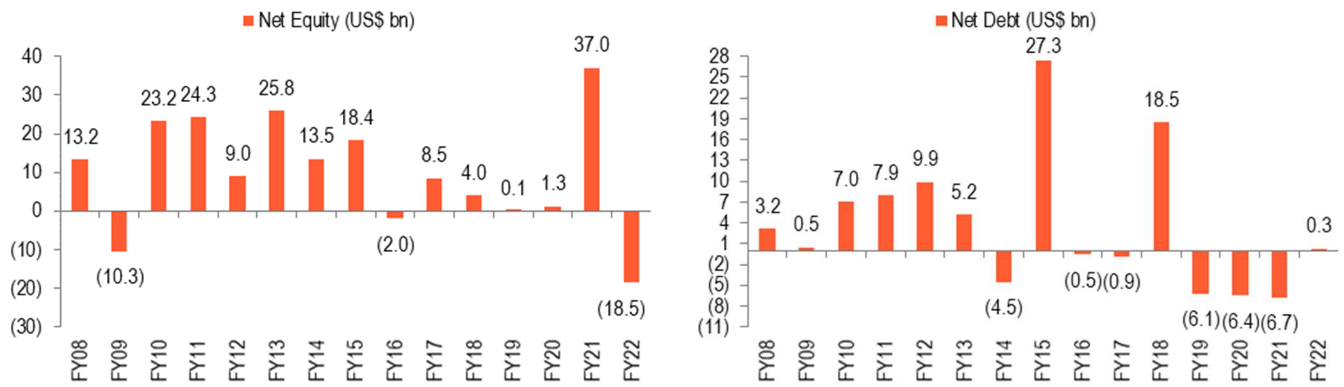
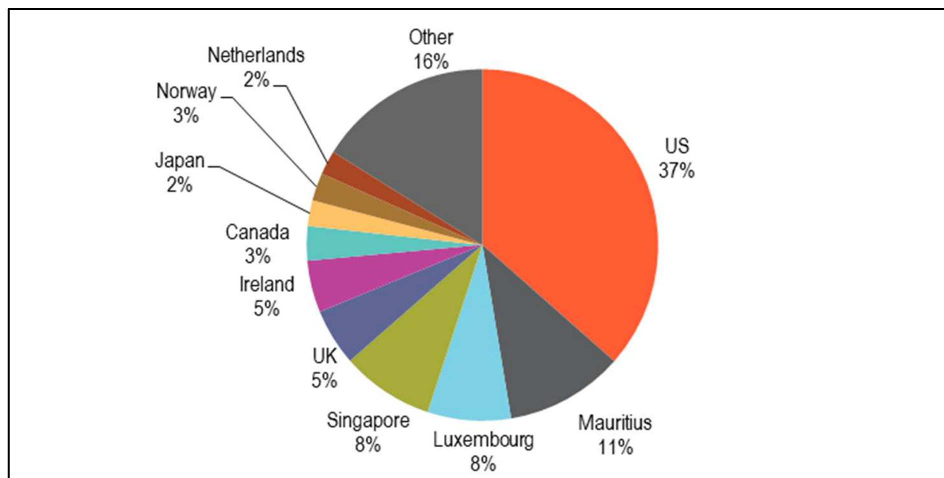


Fig 3. Different Sources of FPIs for Mar'22



Source: CDSL, Bank of Baroda Research

In terms of sources of FPI, USA had the largest share (37%) in Mar'22, followed by Mauritius (11%), Singapore (8%), Luxembourg (8%) and UK (3%). With a large share from the USA it can be intuitively seen that any development on the economy as well as policy can have an impact on the flow of FPIs. A strong US economy goes with a conservative monetary stance which involves high interest rates as is the case today. This would tend to deter funds from moving out as higher returns are earned by them in the domestic market. Also a strong economy indicates good corporate earnings and the USA market becomes attractive. This is one reason as to why we need to look at what is happening in the west to get clues on potential FPI flows.

FPI flows are dependent on both domestic and external factors. Domestic factors will include tracking political stability of the country along with other macro-economic variables. This has been referred to as 'top down' approach. Moreover, rating action, stock market returns along with exchange rate movement also are important determinants. Investors also keenly follow

'bottom-up' approach wherein there is relatively less reliance on macroeconomic fundamentals, and look at the micro foundations. Global factors include interest rate movement, business cycle conditions and global stock market returns.

Notably, the FPI outflows have been fairly volatile in the last few years. FPI flows into equity peaked at $ 37 bn in FY21. They do have a fairly strong relation with the movement in the benchmark indices though the domestic institutional investors (mutual funds) of late have been countering their actions and have also tended to drive the market. When the two are mapped together for most of the periods there is a direct relation. The same can also been noticed with a much higher correlation of 0.5 between absolute FPI Equity flows and returns in Sensex for the last 25-years.

Table1: FPI flows over the years and Sensex Returns

Years	NET Equity FPI flow (US$ bn)	Sensex Returns
FY98	1.5	15.8%
FY99	(0.2)	(3.9%)
FY00	2.4	33.7%
FY01	2.2	(27.9%)
FY02	1.7	(3.7%)
FY03	0.5	(12.1%)
FY04	8.8	83.4%
FY05	9.9	16.1%
FY06	11.0	73.7%
FY07	5.6	15.9%
FY08	13.2	19.7%
FY09	(10.3)	(37.9%)
FY10	23.2	80.5%
FY11	24.3	10.9%
FY12	9.0	(10.5%)
FY13	25.8	8.2%
FY14	13.5	18.8%
FY15	18.4	24.9%
FY16	(2.0)	(9.4%)
FY17	8.5	16.9%
FY18	4.0	11.3%
FY19	0.1	17.3%
FY20	1.3	(23.8%)
FY21	37.0	68.0%
FY22	(18.5)	18.3%

Source: CEIC, Bank of Baroda Research

Table 2: Regression between Sensex and FPI (Equity)

	Coefficients		Correlation
	Constant	FPI (Equity)	
FY98-FY22	4.54 (1.94)	19.12 (2.89)	0.5

Source: CEIC, Bank of Baroda Research Note: Data in parenthesis reflect significance

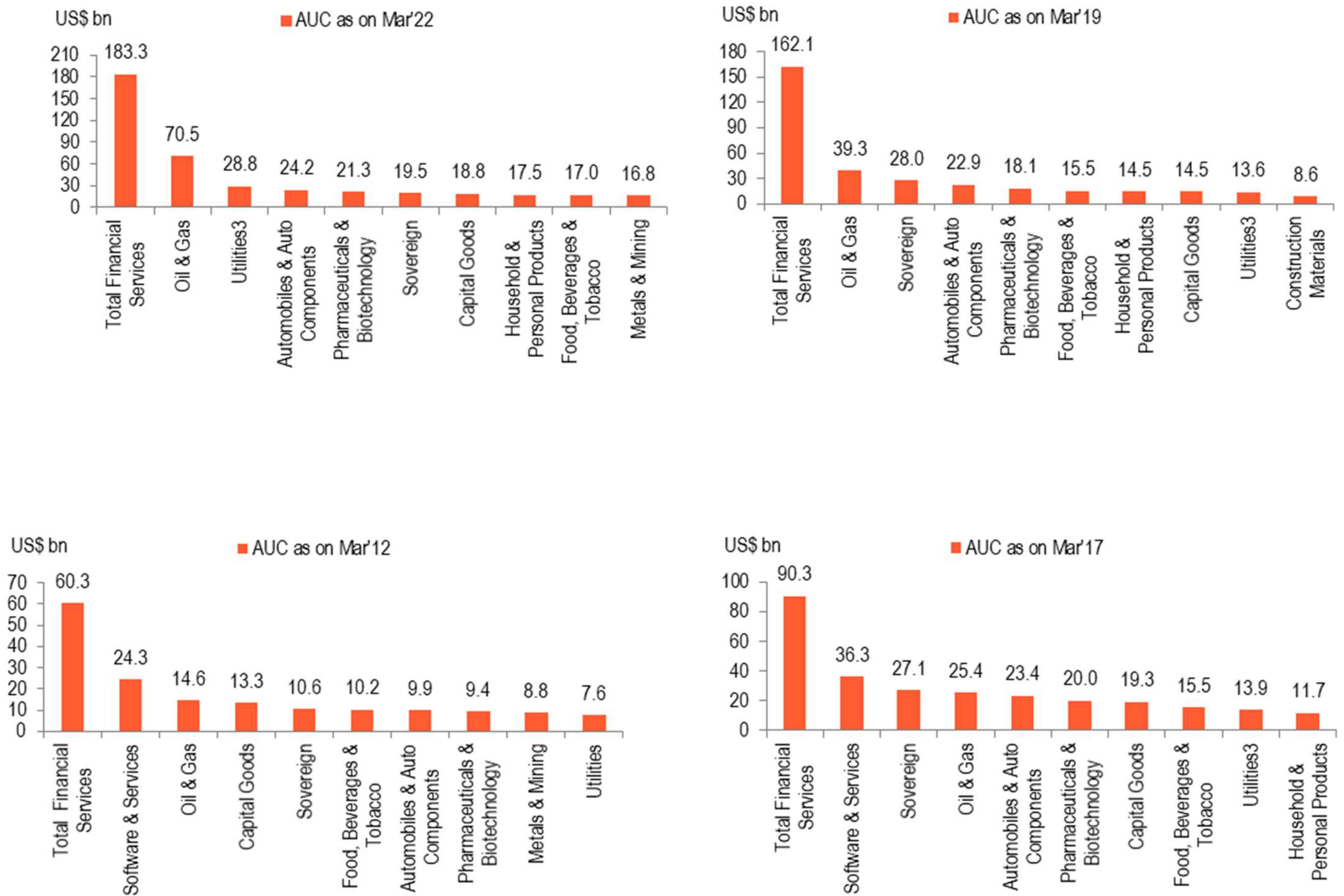
A regression analysis of returns of Sensex on FPI equity flows shows R-square of 0.27 with the coefficient for FPI being significant. Hence while it is not the sole factor driving the market, it is important nonetheless.

Sector wise FPI Flow

Over the years, FPI inflows has been made across different sectors. Financial sector tops the chart over the years as the largest contributor of over US$ 183.3bn in FY22. This was followed

by investments in oil & gas, utilities and auto sector. For FY17 and in FY12, software services was one of the top 2-sectors for FPI contribution, followed by sovereign investments (investment in government bonds). The picture since then has changed with other sectors grabbing a larger pie.

Fig: 4: Sectoral flow over the years

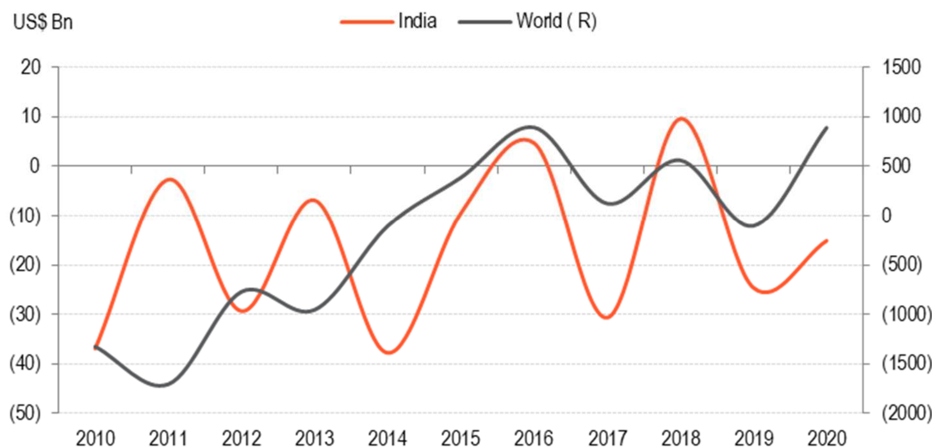


Note: AUC: Assets under Custody; Source: Bank of Baroda Research

Portfolio Investment: India vs World

India's portfolio investment flow has been closely tracking the FPI flows across the World. India has largely followed this as a mirror image. In fact, the QE policies of the west had an unintended consequence of investors using the liquidity to invest in emerging markets and hence most of these countries gained in terms of foreign flows. Against the backdrop of the Russia-Ukraine war and global linkages there has been disruption in all investment flows. Further the rate hike cycle is back on the table globally which poses a significant risk for future FPI inflows to emerging markets including India. This is also being accompanied by a move to roll back on the QE measures with the Fed talking of shrinking its balance sheet. This means that there will be a new series of reallocation of resources by these fund managers.

Fig 5: Portfolio Investment: India Vis a Vis the World (BoP)



Source: World Bank, Bank of Baroda Research Note: India's portfolio investment are based on current US$.

Figure 5 gives the movement of FPIs in India as well as the world based on balance of payments data. These numbers would be different from those presented earlier as the NSDL based data relates to transactions taking place on a daily basis while the balance of payments are net flows when the forex actually enters or leaves the country and gets recorded.

India witnessed an outflow in FY20 with FPI flows around US$(-) 15.1 bn, while world aggregate flow were around US$890.5bn. Interesting, after removing countries with outflows for this specific year, World Bank FPI flows stood at US$ 1,746 bn. Notably in FY18, India had a FPI inflow of around US$ 9.6bn and aggregate world flows stood at US$ 561.3 bn. Again if those countries are removed that witnessed outflows during this period, total world flows rises up to US$ 1,265 bn. With this, Europe Area, Germany, Italy and Japan were the top contributors to the total FPI flows.

What can we expect in FY23?

The present situation where inflation is high and central banks in the west are aggressive in raising rates does not augur well for investments in the fixed income segment. Therefore debt inflows could be shaky this year.

For equity flows to turnaround, there must be strong signals either on corporate earnings or policy reforms given that the days of easy monetary policy are over. Further, the fiscal stimulus in our context has been limited. Therefore, even on the equity side there may not be significant inflows.

The best case scenario will be marginal positive net flows. But for this to work out, the economic numbers that come out must be very positive. In short, FPI flows may not provide too much support to the balance of payments and we may have to rely more on FDI to counter the higher current account deficit (CAD).

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