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What is driving FPI flows?

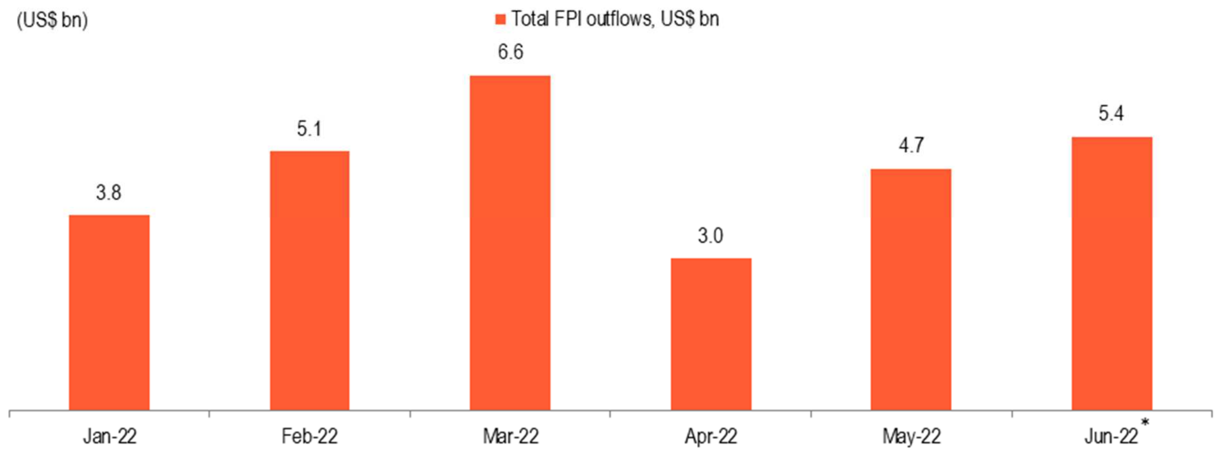
Background

FPI flows into India have seen a sharp decline in recent times. In CYTD22, FPI outflows have totaled US$ 28.5bn compared with inflows of US$ 7.1bn in CY21. Equity segment has seen the maximum outflow. This is consistent with a decline in domestic equity market which has shed about ~10.4% since the start of the year. However, when compared with the global markets, Sensex seems to have been relatively better placed. A global risk-off sentiment amidst increased risks to global growth have contributed to the decline in global equities including India. There are domestic factors at play as well, including high inflation and rising interest rates. Inflows into mutual funds have however remained robust, as investors turn risk-averse. Amidst the current global backdrop, FPIs are likely to remain wary of Emerging Markets (EMs) such as India. We expect FPI outflows of US$ 30-40bn in FY23, assuming that investor sentiment picks up later in FY23. This will put further pressure on India's external position amidst a swelling current account deficit.

FPI flows

India has seen a sharp acceleration in FPI outflows in recent months. In fact, FPIs have been net sellers in the domestic markets since Oct'21. In CYTD22, FPI outflows from India have totaled US$ 28.5bn (upto 22 Jun 2022). This is consistent with other Emerging Markets (EMs), which have seen huge capital outflows in recent times. This has been on the back of a global risk-off sentiment amidst increased expectations of a slowdown in global growth and surging inflation globally. This has prompted central banks across the world to hike rates. Fed has been at the forefront, hiking policy rate to 150-175 bps this year and expectations are that this can go up to 300-350 bps. This has further exacerbated FPI outflows from EMs, including India.

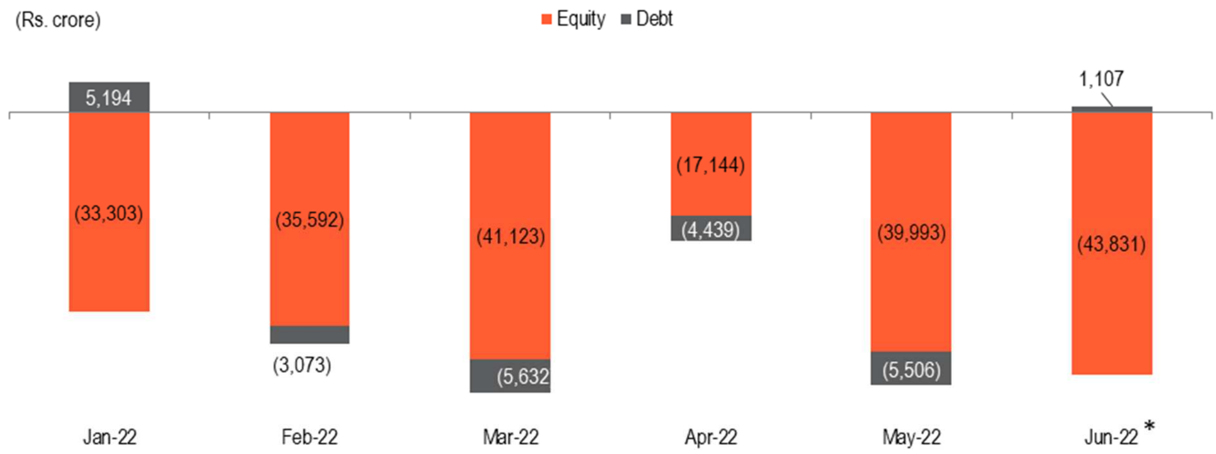
Fig: 1: FPIs have been net seller in the domestic markets in CYTD22



Source: NSDL, Bank of Baroda Research | *Data upto 22 Jun 2022

Even in Rupee terms, FPI outflows from India have surged to Rs. 2.2 lakh crores in CYTD22, concentrated in the equity segment. In fact, equity segment account for about Rs. 2.10 lakh crores or ~97% of total FPI outflow this year. Outflows from the debt segment have been limited.

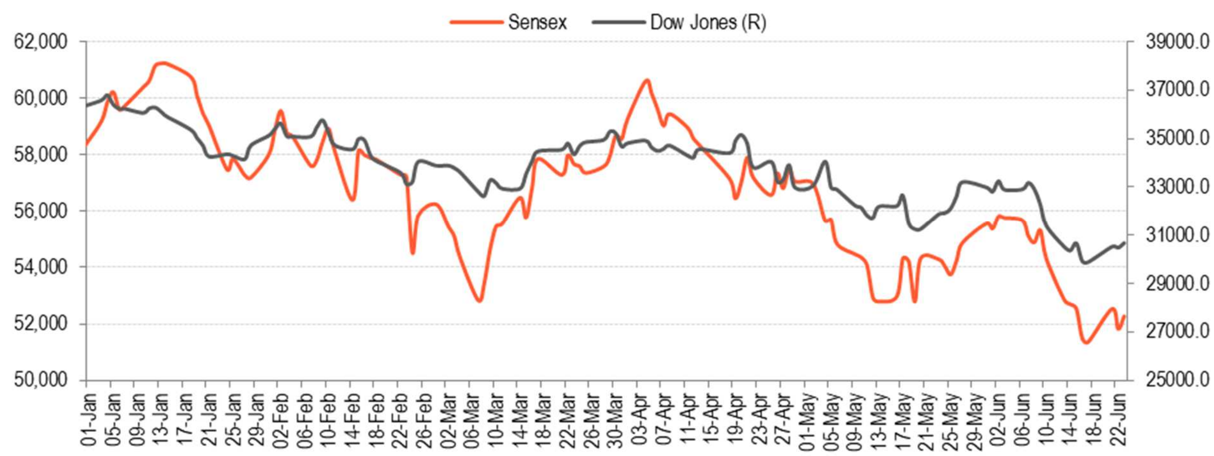
Fig: 2: FPIs outflows concentrated heavily in the equity segment



Source: NSDL, Bank of Baroda Research | *Data upto 22 Jun 2022

The relative performance of Sensex vis-à-vis US stock markets (Dow Jones Industrial Average) has been mapped out in Fig: 3. It can be seen that both the stock markets moved in tandem in CYTD22. In fact, while Dow Jones fell by 16.1% this year, Sensex has performed relatively better and fallen by only 11%. Hence, there is no discernible reason for investors to prefer other markets.

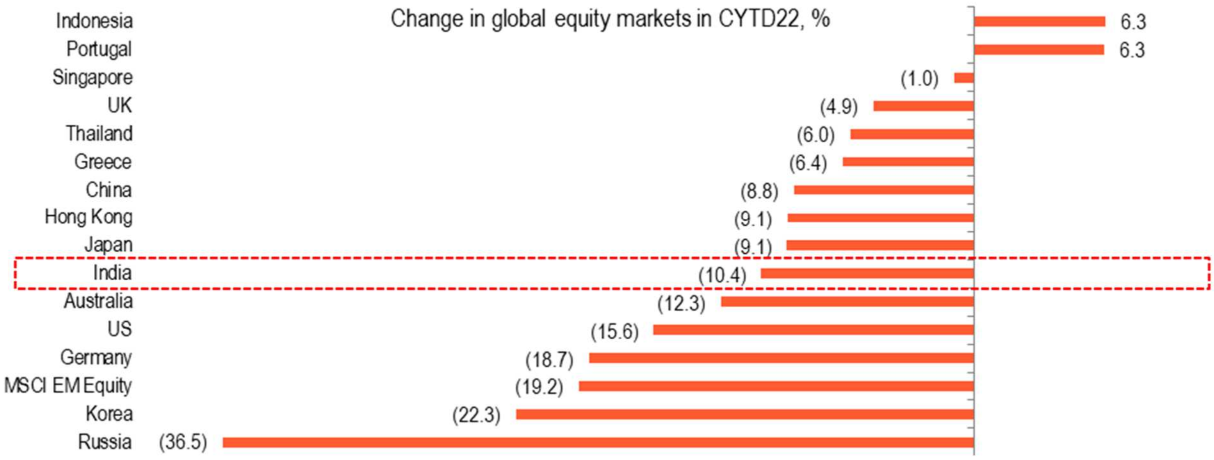
Fig: 3: Equity market performance India versus US



Source: Bloomberg, Bank of Baroda Research | *Data upto 23 Jun 2022

When compared with other global markets, Sensex is relatively better placed than other developed markets (DMs) which have seen a sharp fall in the equity markets. Even for EMs, while the MSCI EM index has fallen by 19.2% in CYTD22, Sensex has fallen by only 10.4% in the same period.

Fig: 4: Equity market performance across the world

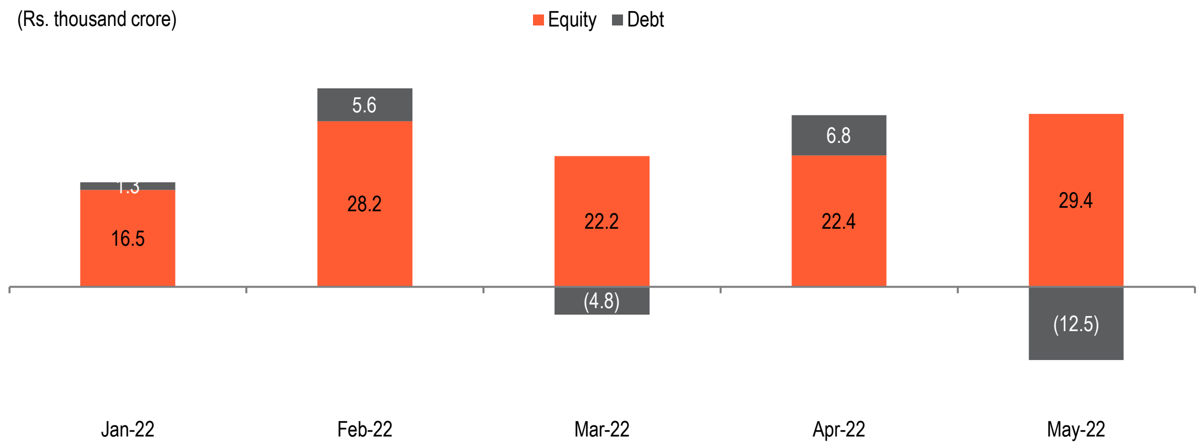


Source: Bloomberg, Bank of Baroda Research | *Data upto 23 Jun 2022

Performance of Mutual funds

It may be a noted that while FPI inflows into equity markets have fallen, inflows into mutual funds, especially under the equity segment have shown an improvement. From Rs. 16.5 thousand crores in Jan'22, equity inflows have risen to Rs. 29.4 thousand crores in May'22. For the year CYTD22, inflows into the equity segment have risen to Rs. 118.7 thousand crores. On the other hand, debt segment has seen net outflows of Rs. 3.6 thousand crores so far this year, with the bulk of the outflows concentrated in May'22.

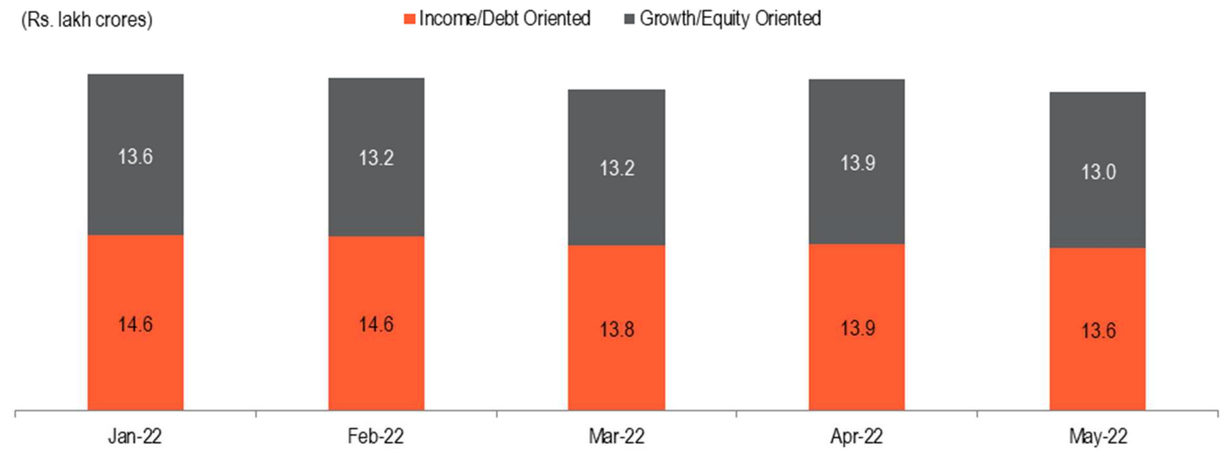
Fig: 4: Inflows into Mutual funds



Source: CEIC, Bank of Baroda Research

Net AUMs under open-ended mutual fund schemes have also seen decline this year. AUMs under equity oriented schemes have fallen from Rs. 13.6 lakh crores in Jan'22 to Rs. 13 lakh crores in May'22. On the other hand, debt oriented schemes have seen a much sharper decline from Rs. 14.6 lakh crores in Jan'22 to Rs. 13.6 lakh crores in May'22 amidst expectations of further rate hikes.

Fig: 5: Net AUMs under mutual funds



Source: CEIC, Bank of Baroda Research

Conclusion:

FPIs have an important role to play in financing India's current account deficit. Latest data from RBI showed that India's current account deficit expanded to US$ 38.7bn (1.2% of GDP) in FY22 from a surplus of US$ 24bn (0.9% of GDP) in FY21 as trade deficit surged. For FY23, trade deficit is likely to expand further amidst a pickup in economic activity as well as higher commodity prices, pushing CAD higher. We estimate CAD at 3% of GDP or ~US$ 100bn.

Capital flows will be important to finance the deficit. However, FPIs have remained net sellers in the domestic market for the past 8-months, which will pull overall capital account surplus lower. At the present run-rate of ~US$ 5bn per month, FPI outflows in FY23 can surge to ~US$ 60bn in FY23, putting further pressure on India's BoP. However, investor sentiment might revive in the later part of the year. In such a case, FPI outflows may be limited to ~US$ 30-40bn in FY23.

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