Expert Zone

Straight from the Specialists

Why FIIs are dumping India

By Kunal Kumar Kundu | APRIL 15, 2013

(Any opinions expressed here are those of the author and not of Thomson Reuters)

The Indian stock market is in a tizzy as foreign institutional investors (FIIs) seem to have pressed the sale button. Securities and Exchange Board of India (SEBI) data shows that while there was a considerable slowdown in FII inflow in March, we are seeing an outflow in April.

While net FII inflow in the equity markets remained above $4 billion for each month between December 2012 and February 2013, the net inflow for March was reduced to $1.68 billion. The trend reversed and during April 3-10, there was a net outflow every day, with cumulative outflow of $269 million during this period.

The outflow in April is small as compared to the over $25 billion inflow during 2012-13, but the trend is unmistakable. The euphoria that was generated after the government announced a series of policy measures (touted as big-ticket reforms) from September 2012 onwards has slowly died down as the magnitude of triple deficit (fiscal deficit, current account deficit and governance deficit) intensified. Hardly any of the announcements bore fruit.

There's still no light at the end of the tunnel for the land acquisition bill. FDI in multi-brand retail is still not a foregone conclusion and may yet face a roadblock when the budget session of parliament reconvenes.

Availability of coal continues to be the biggest challenge for power producers. Foreign investors are still not convinced that India's policy regime is stable enough, especially as the government looks at every which way to fill up their coffers to continue with their social spending spree.

While the Vodafone issue still rankles investors, the income tax department sent a demand notice of 150 billion rupees to Shell India for allegedly underpricing shares it issued to its parent. Logically, since money received from issue of shares is capital in nature and not revenue, it cannot be subject to tax.

Many moons ago, India had a regulator by the name of the Controller of Capital Issues (CCI), which used to decide on what a fair price of a share should be. They are no longer in existence but their spirit has been invoked because the government needs revenue, however dubious the means might be.

Columnist J Mulraj points to a different twist to the tale. When Hero Motocorp set up a wholly owned subsidiary in the Netherlands, and paid a premium for the stock of its subsidiary, the tax department sought to tax the company on the ground that the premium is a 'loan' on which an 'assumed interest income' is to be added to Hero Motocorp's income and taxed.

Meanwhile, key government ally DMK withdrew their support to the coalition government, thereby adding the problem of political uncertainty to an already uncertain economic condition. The recently released Composite Leading Indicators (CLI) by the OECD show that India's CLI has been falling consistently since December 2011. By February, it had touched a low of 96.78.

Clearly, the attractiveness of the Indian markets is diminishing. Even from the stock market valuation perspective, Richard Titherington, CIO and head of global emerging markets at JP Morgan Asset Management, feels that India is more expensive than Russia, China and Brazil. It is no surprise therefore that portfolio investment is slowly moving out of India.

Among the developed countries, Japan is also attracting a lot of inflows as there's a belief that Prime Minister Shinzo Abe's policy might rejuvenate Japanese exports as its currency weakens. As a result, the Nikkei continued to rise even after hitting a five-year high while the yen plunged to fresh lows versus the dollar.

There seems to be consensus among experts that the FII outflow is temporary and will return to India soon as there's enough liquidity in the world market. On the liquidity front, they are indeed right. But inflow returning to India is not a foregone conclusion. As economic weakness continues and policies remain in a mess, liquidity will move to countries that would offer a higher return and hope.

AUTHOR PROFILE

Kunal Kumar Kundu

Kunal Kumar Kundu is an economist, columnist and an independent consultant. He was previously the chief India economist with Roubini Global Economics. His website is http://kunalsthoughts.weebly.com