FPIs' Market Exit

What is the issue?

With the rising inflation and monetary policy tightening in the US, the capital outflows are likely to continue, putting pressure on the Indian currency.

Why is capital flowing out?

- Capital flight is a phenomenon characterized by large outflows of assets/ capital from a country due to political or economic instability, resulting in negative economic consequences to that country.
- Foreign portfolio investors (FPIs), which own around 19.5% of the market capitalisation, have pulled out Rs 42,000 crore in June so far.
- **Reasons for capital flight**
    1. The tightening of monetary policy by the US Fed
    2. Rate hiking by other central banks, including in Britain and the Eurozone
    3. An appreciating dollar
    4. Concerns regarding the possibility of a recession in the US
    5. Rising inflation

Holding of FPIs in companies listed on NSE as on March 31, 2022 show a decrease of 3.36% from December 31, 2021, due to the sustained sell-off since October 2021.

What is the status of FPIs in India?

- Foreign Portfolio Investment (FPI) involves an investor buying foreign financial assets that involves fixed deposits, stocks, and mutual funds.
- FPIs are the largest non-promoter shareholders in the Indian market and their investment decisions have a huge bearing on the stock prices and overall direction of the market.
- The US accounts for a major chunk of FPI investments as of May 2022, followed by Mauritius and Singapore, according to data available from the National Securities Depository Ltd (NSDL).
- Securities and Exchange Board of India (SEBI) operates the FPIs.
- Recently, SEBI has introduced the Foreign Portfolio Investors Regulations, 2019.
- FPIs also need to follow the Income-tax Act, 1961 and Foreign Exchange Management Act, 1999.

How do FPIs operate?

- The intent of investing in foreign markets is to diversify the portfolio and get some handsome return on investments.
- Foreign Portfolio increase the volatility thus leading to increased risk.

- In times of global uncertainty, foreign investors embrace a risk-off trade, meaning they move money from risky assets such as equities and add more of bonds and gold.
- When interest rates rise in the US and other advanced economies, they withdraw money from emerging markets such as India and invest in the bonds in their domestic markets.

How does the capital flight affect the markets and the rupee?

- **Capital market**- The pullout is dampening sentiment in equity and forex markets.
- The impact of FPI selling on markets is visible with increase in volatility and declining equity prices.
- **Forex**- India's foreign exchange reserves have fallen $596.45 billion as on June 10, 2022, mainly due to the dollar appreciation and FPI withdrawals.
- **Depreciation**- The rupee has plunged 7.3% to an all-time low of 78.30/32 against the dollar.
- If the rupee does not strengthen, FPI outflows will continue, which is another negative.
- **Inflation**- Lower rupee against the dollar keeps import bills higher, pushing inflation even higher than it is now.
- **Indians abroad**- Travellers and students studying abroad will have to shell out more rupees to buy dollars from banks.
- **Fuel price**- People are directly impacted by the rupee fall as fuel prices shoot up.
- **DII inflow**- The retail flow and domestic institutional investors (DIIs) inflow is weakening now, and the markets could weaken further if the FPI outflows continue.

References

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