Resilience of Money Market

What is the issue?

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Bond and currency markets have proved quite resilient to the massive foreign portfolio investor (FPI) outflow so far this year.

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Has the outflow affects other sectors?

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- Foreign portfoliooutflows from India in the first nine months of 2018, stood at $13.1 billion, which have been the highest in any year since 1990.
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- Despite the $4.4 billion of their selling in stocks, Indices such as the Nifty50 remain in the green on a year-to-date basis.
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- Bond markets have borne the brunt of FPI withdrawals at $8.7 billion, but the benchmark 10-year gilt has strengthened by just 60 basis points so far this year.
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- Even the rupee's 13 per cent depreciation against the dollar has been far more orderly than the free falls witnessed in 2008 and 2013.
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What are the reasons?

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- There are good reasons why domestic markets have withstood the onslaught of FPI selling better than before.
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- In equities, rising domestic investor participation in mutual funds has allowed them to absorb the selling pressure, especially in blue-chip stocks.
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- Gilt funds, in simpler terms, are mutual funds that allow you to invest in

various government bonds and securities.
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- This makes them extremely less risky than all the other types of investments.
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- Recently, FPI ownership of gilts is limited to less than 5% of the bond market, which ensures lower volatility on account of any massive FPI outflow.
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- Also, continued strength in foreign direct investment (FDI) flows into India, at $22 billion in the first six months of 2018, have proved a blessing for currency markets.
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- It has also partly offsets the pressure from fleeing portfolio flows.
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What are the concerns?

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- The resilient show so far can spiral out of control, which could take a hit in the country's money market.
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- There are visible signs of declining investor enthusiasm for equity funds.
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- With inflows into balanced schemes taking a hit in a falling market, equity fund inflows have declined by one-third in April-September 2018.
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- A carry trade is a strategy in which an investor borrows money at a low interest rate in order to invest in an asset that is likely to provide a higher return.
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- India's bond markets typically attract considerable carry trades, which are threatened by the continued strength in the dollar and the spike in US treasury yields.
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- If rate differentials with the US continue to shrink, the Indian economy may also be singled out for exiting by FPIs owing to its precarious current account, its vulnerability to spiralling oil prices and its looming political risks.
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What should be done?

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- RBI has recently proposed a special route called voluntary retention route (VRR) to encourage FPIs willing to make long-term investments in debt.
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- According to the proposal, FPI will be exempt from regulatory provisions, but will have to voluntarily commit to retain in India a minimum required percentage of their investments for a period of their choice.
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- But the measure is unlikely to work at a time of such high uncertainty about India’s prospects.
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- Instead, the Centre should ensure that healthy inbound flows from long-term oriented FDI investors are sustained.
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- India should also continue to liberalise procedural hurdles that stand in the way of investment approvals.
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- Also, the CBDT and sector-wise regulators must be sensitised against arbitrary interventions in the local operations of multinational firms.
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- They should continue further with its tax rationalisation measures and increasing the tax base along with ensuring private investments, to gain the confidence of the investors.
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Source: Business Line

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