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FOREIGN Institutional Investors (FIIs) are offloading their holdings in India at a scale not seen in years. Regarded as one of the key drivers of the locally listed equities, relentless selling by these investors has raised concerns about the health of the local market and the broader economy.

After selling equity worth ₹1.14 lakh crore through exchanges in October, FIIs have sold another ₹42,000 crores of equity so far in November. Before October, the peak selling by FIIs was seen in March 2020 when the Covid-19 pandemic spooked the global equity market. They sold ₹65,816 crore worth of equity back then. According to market experts, many factors are driving this trend. They, however, are confident that FIIs will return to India, given the nation's long-term growth story remains intact.

Global factors at play

Shivani Nyati, head of wealth at Swastika Investmart, explains that there has been a shift of funds from India to China. The combination of perceived safety and growth opportunities in the US market, along with rising US bond yields and a strengthening dollar index, has influenced investor decisions, she notes.

A recent ICICI Direct report also states that one of the main reasons for the FII exit is the potential for higher returns from the Chinese market. FIIs seem to prefer moving to China as it is trading at less than half of India's valuations. In other words, these foreign investors find investing in Chinese equity markets is less expensive than pumping in money into Indian bourses. In September, the world's second-largest economy introduced a series of stimulus measures to boost its economy. Consequently, China saw FII inflows of \$96 billion in September and the Chinese market benchmark surged more than 20% between September 18 and October 8.

The uncertainty created around the US presidential elections and the outcome also played a major role in the FII exodus. "We believe Trump's plans for lower corporate taxes, higher import tariffs, and deportation of illegal immigrants will result in growth of the US economy, higher inflation, higher interest rates, and a stronger US dollar. This might tempt FIIs to take at least some portion of their money to the US," say analysts at JM Financial. Higher interest rates in developed markets make them more attractive for investments, reducing the appeal of riskier emerging markets like India. US Treasury yields, in particular, have surged, drawing capital away from equities worldwide.

Manish Bhandari, CEO and portfolio manager of Vallum Capital Advisors, says that as



CAPITAL FLIGHT

WHY FOREIGN INVESTORS ARE EXITING INDIA

the chances of Donald Trump winning the election became clearer, his promise to reduce capital gains taxes, incentivise manufacturing activity with tax holidays, and slapping tariffs on countries that are sending goods to the US (like China) gained prominence. "The implication of all these measures is, immediate strength in the US dollar vs the other emerging market currencies. It means depreciation of the rupee. There is a flight of capital to the US markets in anticipation of a manufacturing boom in the US markets," Bhandari adds.

Expensive valuation, poor earnings

Market experts also weighed down on the premium valuation of the Indian market as it leaves little room for investors to make money

The Indian market median price-to-earnings (PE) ratio (starting in 2007) is 21.9. Before the recent fall, the Nifty50 PE was over 24, which makes the Indian market over-valued compared to other emerging economies. As global markets offer more attractive valuations, FIIs are shifting their focus to other markets, stated ICICI Direct.

Further, a weaker-than-expected Q2 FY25 earnings season raised concerns about the growth prospects of Indian companies. India companies saw net profit growth of 3.6% during the September quarter, which was the slowest growth in 17 quarters, driven by sluggish revenue growth and rising interest and depreciation costs.

According to Motilal Oswal Private Wealth (MOPW), earnings growth is expected to moderate to 12-14% compound annual growth rate

POSITIVES

● **Liquidity:** When foreign investors bring in money, it adds liquidity to the market. In other words, the market size becomes bigger making it attractive for investment and trade. Increased liquidity ensures smoother market functioning

● **Growth:** Perhaps the most important rub-off effect of foreign investment in Indian stock markets is that these funds identify and target promising companies, leading to higher demand for their shares. In turn, this drives up stock prices and boosts the overall market performance as the valuation soars. This also kicks in a ripple effect of sorts: the cost of issuing shares goes down, which enhances the equity as it increases the local as well as foreign demand due to improved access to capital. Thus, it encourages other investors and causes higher efficiency in the market by increasing supply, demand, and liquidity

● **Rupee gain:** It is said that increased foreign investment can lead to a stronger rupee. This is because foreign investors need rupees to buy Indian stocks, increasing demand for the currency. A stronger rupee can make imports cheaper, benefiting Indian consumers.

NEGATIVES

● **Volatility:** Foreign investors are known to react to external factors such as geopolitical tensions and economic uncertainties. They don't hesitate to pull out large sums of money by selling their shares in the Indian market, which can trigger sudden drops in stock prices and market volatility. Retail investors may lose money in a volatile market

● **Dependence:** Over-dependence on foreign investment can make the Indian market vulnerable to external factors. If foreign investors lose confidence in Indian markets or find better opportunities in other markets, they just cash out, leaving the Indian markets in doldrums

● **Exchange rate fluctuations:** This is the flip side of the strong local currency due to foreign investment. While a strong rupee is desirable, it can also hurt Indian exports because Indian products become more expensive for foreign buyers, which could dampen demand

ing can drag down indices and trigger bearish sentiment.

Even though the share of foreign investors in NSE-listed companies dropped to 15.98% in October, the lowest in 12 years, they still have a significant influence over the market. The sustained FII selling played a major role in pushing down India's benchmark indices -- the Sensex and Nifty 50 - by 11-12% in less than two months, wiping out gains made earlier in the year. Mid-cap and small-cap stocks, often more vulnerable to FII flows, have faced steeper declines.

Further, the FII outflows have contributed to the weakening of the Indian rupee against the US dollar, putting additional pressure on import-heavy industries and increasing inflationary risks. The rupee slipped to another low of 84.50 against the US dollar in trade this Friday. "Geopolitical tensions between Russia and Ukraine have resurfaced, adding to global risk aversion... This has further fueled FII outflows, continuing the trend of capital flight from Indian markets," says Jateen Trivedi, VP Research Analyst, Commodity and Currency, LKP Securities.

Additionally, retail investors, who have been actively participating in the market over the past few years, have been hit hard by the FII selling. Many are grappling with portfolio losses, and sentiment has taken a hit. The sharp corrections have also impacted mutual funds, especially those heavily exposed to FII-favoured stocks.

Will FIIs come back?

The Street is broadly divided on whether FIIs will start buying in the Indian market in the short term. However, they believe they will return over the medium to long term. JM Financial believes that this is the time to re-evaluate investment opportunities in India as valuations correct and analyst estimates become more realistic, as India is still the best long-term structural growth story.

Rakesh Vyas, co-chief investment officer and portfolio manager at Quest Investment Advisors, says that with the US Federal Reserve likely to pause its rate cuts, and with expectations of a sharp rebound in Indian corporate earnings growth for FY26, along with more attractive valuations for Indian stocks, FIIs are expected to begin reallocating incremental investments into Indian equities from early CY25. This is driven by the expectation that India's GDP and corporate earnings growth will be among the highest in emerging markets.

"Before the start of FII selling, DIIs (domestic institutional investors) held cash reserves exceeding ₹1.8 lakh crore. Over the past two months, the sustained high levels of SIP (systematic investment plan) flows and the cash reserves have helped DIIs absorb much of the ongoing FII selling," Vyas adds.

(CAGR) over FY24-26 with some interim but short-lived slowdown as currently witnessed in 2QFY25. MOPW states that most of the emerging markets have experienced FII outflows during October; for India, these outflows were exacerbated by the ongoing result season that failed to justify valuations.

The other major factors are the ongoing geopolitical tensions in West Asia and the war between Russia and Ukraine. A pick-up in retail inflation in September also hampered sentiments.

Why FIIs are important

FIIs play an important role in emerging markets such as India. They bring in substantial capital flows, driving liquidity, sentiment, and price discovery. When FIIs buy heavily, Indian markets typically rally. Conversely, heavy sell-