Index inclusion, distressed assets could attract more FPIs to debt

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Mumbai, September 25

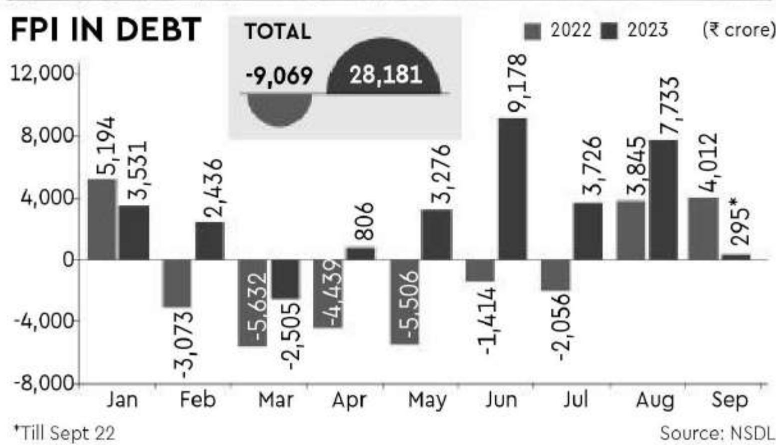
FOREIGN PORTFOLIO INVESTORS (FPIs) are pulling out heavily from the Indian equities, but the momentum is strong in the debt segment.

Data from NSDL show in the calendar year up to September 22, FPIs have invested a net ₹28,476 crore in Indian debt. An interesting aspect is that except March, when FPIs were net sellers to the tune of ₹2,505 crore, they have been net buyers in debt during 2023.

This is a stark contrast to the first nine months of 2022, during which FPIs had withdrawn a net ₹9,069 crore from Indian debt.

Attractive yields and a higher number of distressed assets/special situations are drawing foreign funds to the country, say experts.

"Wholesale financing has become a challenge in India. There are restrictions on banks getting into the high-yield bond space, while NBFCs have found it difficult to refinance existing investments. For FPIs, there is no limit," said Ajay Manglunia, MD and head (investment grade group), JM Financial. He pointed out that those who anticipated the inclusion of Indian bonds in the JP Morgan global index had started investing early. Foreign inflows will only increase from now.



*Till Sept 22 Source: NSDL

What the market believes is that this only spells good news for the segment. Though net flows in September have substantially been less compared with preceding months, they have been in the positive territory. Equities, on the other hand, have witnessed a substantial outflow.

In the 15 trading days of this month so far, FPIs have been net sellers in 11 of them as far as equities go. NSDL data show up to September 22, FPIs had sold to the tune of ₹10,164 crore, in both the primary and secondary markets.

"Since valuations remain high even after the recent pullback and US bond yields are attractive (the US 10-year bond yield is around 4.49%), FIIs are likely to press sales so long as this trend persists. It would be irrational to expect FIIs to aggressively buy when the US 10-year bond yield is around 4.49% and the dollar index is above 105," said VK Vijayakumar, chief investment strategist at Geojit Financial Services.

Others say rising foreign participation is the result of the increasing private credit space in India.

"Crude oil prices, the weak monsoon, and El Nino will surely have their impact on yields. The Indian yield compression is not sustainable for long. However, the RBI has not blindly followed the Fed and decided its policy rates independently," said Venkatakrishnan Srinivasan, founder and managing partner, Rockfort Fincap. Generally, the yield spread ranges from 6-7% under normal circumstances, but in the post-Covid time, it has largely been less than 3%, which explains the heavy flight last year, he added.

As it is unlikely for the Fed to aggressively raise rate now, the spread could increase and FPIs could raise their holdings in India.