THE ECONOMIC TIMES

29 Dec, 2014, 02.56AM IST

India will continue to attract strong FII flows despite strong growth in US; five reasons

NEW DELHI: The US might have grown at its quickest pace in 11 years in the third quarter to 5 per cent, but that will not derail the India story, which is also growing at a similar rate of growth, say experts.

The US growing at 5 per cent is a very attractive growth rate, but that is close to its peak or that of the developed markets, say experts. However, India growing at 5 per cent is close to its bottom growth rate.

No wonder, investors in the US and overseas will still look at India as a more predictable and safe country to invest their funds due to the nature of the growth in India versus the USA, say experts.

However, there could definitely be short phases of volatility with outflows around FED announcements or events such as the US GDP data. But overall experts do not think that a good US economy will lead to outflows.

"If the US GDP was truly growing at a tremendous pace, we should have seen the result over the past 12 months since the annualized GDP figure did not rise. Not only that - consumer spending and retail sales have not significantly increased," says Raghu Kumar, Cofounder, RKSV.

"While unemployment in the US did drop, the US has had to grapple with near 0% interest rates and a stagnant (but slowly falling) inflation. More validation is needed from the US front before FIIs change their tunes, and even then, it will have to grapple with the fact that India's expected rise in GDP is higher than the most optimistic of rises in GDP in the US for 2015," he adds.

Investors are not investing in India to simply diversify their portfolios, but based on its potential. India's economy transformation is not based on the present but also on the future, with a 2 to 3-year horizon easily factored into the picture.

"India's more likely sustainable growth rate is in the range of 7 per cent while for the US it is 3.5 per cent. There have not been long phases of sustained growth at these rates in the last couple of decades," says Dr Vikas V Gupta , Executive Vice President at ArthVeda Fund Management Pvt. Ltd.

"So the flows are likely to become more attracted to the US compared to other markets. However, the US markets are compared first to the other developed markets. So the US will gain more allocation at the cost of Europe and possibly Japan," he adds.

Gupta is of the view that within the emerging market allocation, India will gain flows at the cost of other BRICS, i.e. China, Brazil and Russia, since the Indian economy is the best placed for future growth.

We have collated a list of five factors which make India look more attractive as an investment destination compared to the US:

FII flows likely to hit $25 billion in equities:

Experts do not foresee much change in FII flows for the year 2015 versus what we have witnessed in 2014. While December of 2014 could see the lowest net inflows from FIIs, November 2014 was the third highest.

FIIs simply did not invest in India due to the crisis occurring in Russia, which affected equity markets across the world, India included. DIIs, on the other hand, have pumped in the most into Indian equities during the month of December than any other month. This shows that the economy is in a sound shape, says Kumar of RKSV.

Gupta of ArthVeda Fund Management is of the view that India will continue attracting $25 billion per annum into equities. It could be even larger if we do a few things well and our growth rates start crossing the 7% mark, he adds.

"We think a good US economy signals strong possibilities for triggering growth in the rest of the world. The US growing at 5 per cent means addition of about nearly a trillion dollar of demand per annum - that is comparable to an economy as large as India," adds Gupta.

Indian markets stand out tall in the global scenario:
The US economy growing at 5% implies countries, the economies of which are dependent on exports to the US, will benefit. The Indian economy is not so much export driven and also the US as a destination forms a small part of the export basket. Hence, direct impact on our economy, with the US doing well, will not be large.

"In terms of capital flows, India as a market competes with other emerging/ developing countries than the US (developed market). So it would be difficult for us to imagine people choosing the US over India," says Amit Nigam, Head - Equities at Peerless Mutual Fund Ltd.

"Having said that, in the year 2015, we do not see risk of large capital outflows for Indian because China is still going through a period of slower growth as its workforce is both aging and getting expensive; Russian economy is facing a recessionary threat due to falling crude oil prices and sanctions imposed by the developed nations," he adds.

Apart from the above reasons, Nigam is of the view that some of the other South East Asian economies like Korea, which has a higher dependence on global trade, would be adversely impacted due to lower global growth next year and a deeply depreciated Japanese Yen (Korea's exports have a strong similarity to Japan's exports).

Reform push by Modi government:
The Modi-led government has been putting an effort to kick start a stalling economy. The government is moving ahead with improving the environment of doing business in India. The PM has visited many countries and is putting an effort to attract more FDI into the country.

"These efforts, to our understanding, will have a lag impact on the business environment - investments will be kick started by the public sector and with a lag the private sector would pick up towards the second half of 2015," says Nigam of Peerless Mutual Fund Ltd.

The roll out of more reforms will set in place a virtuous cycle wherein commencement of work on large projects would result in increased hiring/ higher incomes followed by a pick-up in consumer demand and then corporates investing in capacities to meet this demand.

"Consequently our GDP growth, which had slowed down to sub 5%, should pick up going ahead," added Nigam.

We can expect FII and DII flows to remain high as the Indian economy continues to grow. While the US posts a one off quarterly GDP increase, India's growth has been steady, expected, and in line since the start of the year.

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Ease in monetary policy by the RBI:

Most experts are betting that the Reserve Bank of India (RBI) will ease its monetary policy stance in the first half of calendar year 2015. By softening of interest rates (we are already witnessing banks lowering deposit rates) this would translate in improved corporate health - both earnings and balance sheets.

In such an environment, with a stable government at the helm, India stands a great chance to attract a higher share of foreign flows in 2015, says Nigam. India offers a good risk reward profile and will skew the decisions of capital allocators in 2015. "India, in our view, would attract a fair share of money meant to be invested in emerging markets," he added.

Corporate Earnings likely to double:

With the economy is set to bounce back to higher growth levels, earnings growth of India Inc will also accelerate and may even double in the next couple of years, say experts.

"Investors are not investing in India to simply diversify their portfolios. India's economy transformation is not based on the present, but also on the future, with a 2-3 year horizon easily factored into the picture," says Kumar of RKSV.

Kumar is of the view that corporate earnings are expected to double and possibly triple according to domestic and international industry experts, which directly translates to higher valuations of companies.

Once again, these are based on sound fundamentals. Indian stocks have been undervalued and the market is just playing a catch up now, knowing that a reform-based government is in power.