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RBI woos long-term FPI investment with sops

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The Reserve Bank of India in its bimonthly monetary policy measures eased foreign portfolio investors' (FPI) investment in corporate and government securities (G-Sec) and also doubled domestic individuals' foreign investment limit to $250,000. The FPI debt limit in G-Sec remains unchanged at $30 billion.

However, to incentivise long-term investors, it has been decided to enable reinvestment of coupons (interest earned on the bonds) in G-Sec even when the existing limits are fully utilised. This could lead to additional space of approximately $2.4 billion of investments in the G-Sec space.

All future investment by FPIs in the debt market in India will be required to be made with a minimum residual maturity of three years. While G-Sec investment already had this rider, the same will now be applicable also to corporate bonds.

Accordingly, all future investments within the limit for investment in corporate bonds, including the limits vacated when the current investment by an FPI runs off either through sale or redemption, will be required to be made in corporate bonds with a minimum residual maturity of three years.

These RBI measures have come at a time when foreign inflows are rising briskly after European Central Bank's quantitative easing last month, and such steps are being taken by the central bank to tackle the impact of foreign inflows on the domestic market.

VR Iyer, chairperson and managing director, Bank of India said, "Increase in LRS (liberalised remittance scheme) to $250,000 reflects confidence of the regulators in consistency in foreign inflows. Reinvestment of coupon on investments by FIIs has been permitted over and above the ceiling of $30 billion in government securities. With increase in minimum investment period to three years in corporate bonds, there will be stability in investment and the volatility will reduce.

Indranil Pan, chief economist, Kotak Mahindra Bank said, "It was clear… that at all points RBI would maintain a cautious watch on what is happening in the global arena. With this as the background, RBI has now allowed FPIs to put money only in the three-year-plus maturity bucket for corporate bonds and has also not enhanced the limits of G-Sec investment, except for allowing the FPIs to re-invest the coupon earned. This could open up space amounting to $2.5 billion to $2.75 billion in the G-secs for the FPIs."

RBI also has provided more operational flexibility to both FPIs and domestic participants in foreign currency hedging.

"With a view to providing greater flexibility to both FPIs and domestic participants in the exchange traded currency derivatives market domestic entities and FPIs will henceforth be allowed to take foreign currency positions in the USD-INR pair up to $15 million per exchange without having to establish the existence of any underlying exposure," Kotak Institutional Equities said.

RBI also allowed both FPIs and domestic participants to take foreign currency positions in EUR-INR, GBP-INR and JPY-INR pairs, all put together up to $5 million equivalent per exchange, without having to establish the existence of any underlying exposure.

Speaking about LRS for domestic individuals, Vikas Gupta, executive vice-president, Arthveda Fund Management promoted by Diwan Housing Finance said,"The RBI's enhancement of the LRS limit to $250,000 signals that the country is comfortable in terms of foreign exchange reserves. Further, it also signals that we are worried about the rupee being overvalued in the near term due to continuous inflows and would like to let the rupee reach its natural level which could be lower in the long-term. A lower rupee would enhance export competitiveness and also give support to the 'Make in India' programme of the government of India."

"Further, this allows Indian investors to invest significant amounts globally. An allocation by Indian investors to global developed markets, such as, US, UK, Europe and Japan is very critical since a balanced investment portfolio should have exposure to developed economies and capital markets, hard currencies, such as, dollar, pound, euro and yen. The largest 1,000 global companies are mostly listed in these markets. However, a majority of these companies sell products across the globe and not just to these markets," Gupta said.

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