FPIs dump .3-billion bonds in two months; Rs loses 39 paise

Apprehensive the rupee could weaken further, foreign portfolio investors (FPIs) have dumped Indian bonds worth more than $5.3 billion over the past two months. On Friday, the rupee lost 39 paise to fall below the 68 mark against the dollar, closing at 68.01. Dealers say the sales in the equity and debt markets are hurting the currency; sales of stocks by FPIs have been of the order of $2.3 billion between April 3 and June 13.

With the US Federal Reserve raising interest rates by 25 basis points and saying more hikes are on the anvil, the dollar has strengthened. On Friday, the Dollex was trading in the region of 94.86. During the day's trade, the index touched 95.13, a level not seen in at least two months.

The weakness in the Indian currency on Friday was in sync with the fall in a host of other emerging market currencies during the day such as the Indonesian rupiah. Noticeably, the Turkish lira was hovering close to its two-month lows of 4.74 mark against the dollar.

The weakening rupee could prompt foreign investors to offload more bonds, market observers said, since otherwise their portfolios would continue to lose value. Other emerging markets that are vulnerable to rising crude oil prices, have also seen sell-offs in their bond markets. Manish Wadhawan, MD and head of fixed income, global markets at HSBC India, points out there is some general aversion to emerging market bonds at the moment with a sell-off.

The Reserve Bank of India (RBI) recently revised the rules for investments by FPIs in Indian bonds; the central bank allowed a lower residual maturity for some categories of bonds. The auction mechanism was withdrawn and moreover, the caps on aggregate FPI investments in a single security were revised. The central bank revised the cap on aggregate FPI investments in any central government security to 30% of the outstanding stock of that security from 20%.

The new measures were aimed at boosting foreign fund inflows, cooling borrowing costs at a time when yields are on an upward trajectory. The 10-year paper closed at 7.9%. Pradeep Khanna, MD & head of trading at HSBC, explained: "India has had a policy of discouraging frictional debt holdings by FPIs and of encouraging more stable bond investments. This has typically been implemented through restrictions related to residual maturity at the time of purchase by the FPIs."

He even highlighted: "Higher dollar rates, an increased US fiscal deficit and resultant higher dollar issuances have provided some attractive alternatives for investors. Overall, while conditions remain as currently expected, I would not expect a substantial increase in FPI flows into Indian debt this year."