Twitter Thread by Vivek Thebaria

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1. Why are FIIs selling Indian stocks so vigorously?

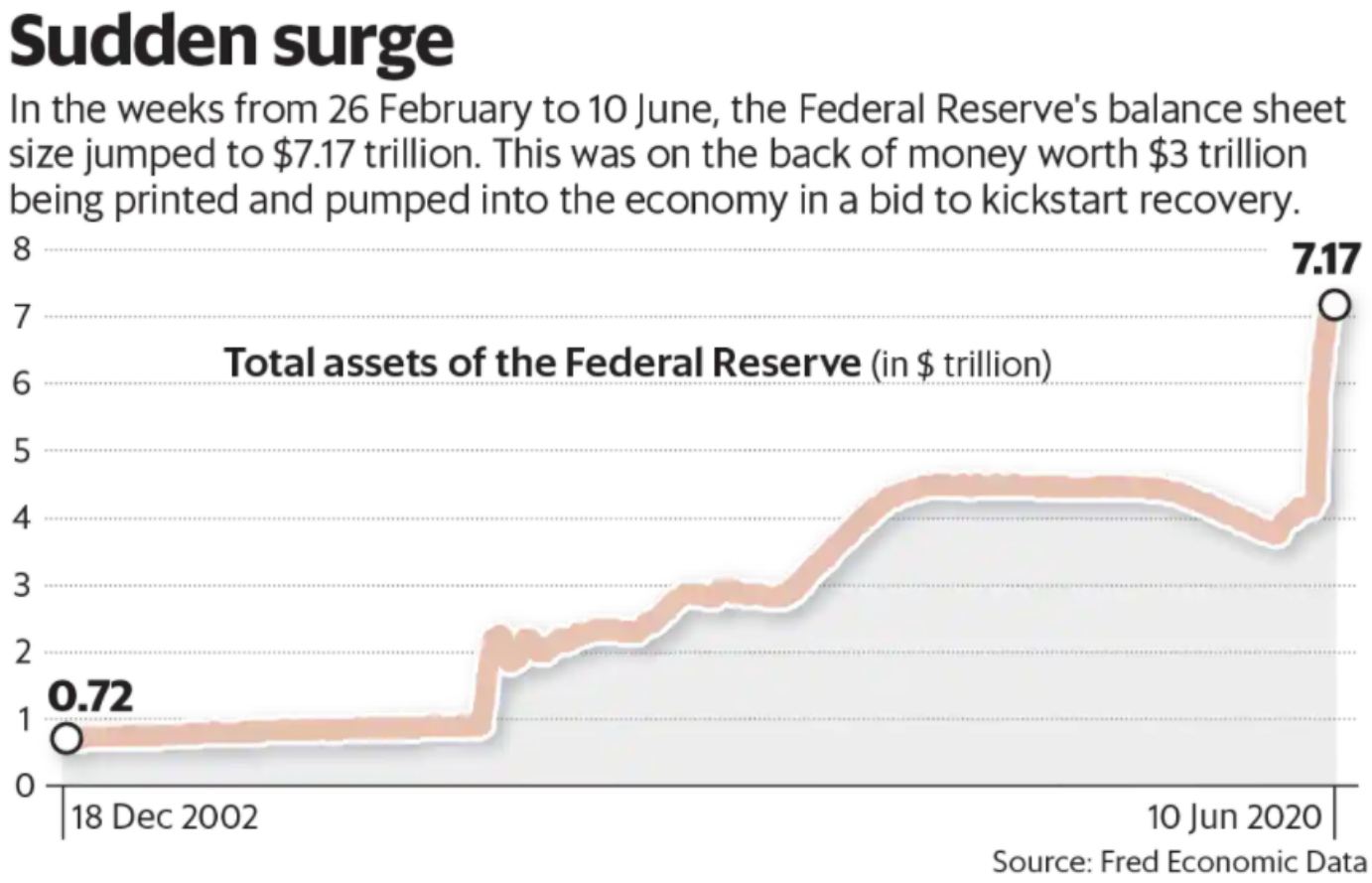
Well, a number of factors. It's actually a domino effect.

And it all begins with the same story…
The day FED decided to go hard on inflation.



2. In layman terms, FED regulates the flow of dollars in the world. For last many years, after the 2008 crisis, they have been printing dollars recklessly to help US Govt fund several economy stabilizing projects by buying US bonds.

3. US 10Y, 30Y bonds are basically a kind of internal debt that the govt raises to run its projects as it has been running into huge deficit for quite sometime.



Source: Fed economic data

4. That, along with near zero interest rates incentivizes banks to lend more to whoever is credit worthy. These credit worthy people use the opportunity to raise dollar denominated debt and convert them into local currencies and invest in emerging markets (among other things).

5. Most EM currencies continue to depreciate against USD as most of them, including India, are net importer of goods and services. That is, they spend more USD than what they earn. So when a foreign investor invests in an EM, it has to factor in this depreciation as well.

6. So, if we put this in a simple formula, it will be something like this:

Net return% = Gross returns from Investment - Interest cost in Home country - 2*Transaction costs - EM currency depreciation

7. Every thing makes sense if the Gross returns from Investment is high enough to take care of all other expenses.

What happens when FED reduces asset purchases and raising interest rates? It basically pulls USD home from all over the world.



8. Institutions look for safer bets as the valuation comfort is not there. A lot of investment avenues go to dump if hurdle rates (Cost of capital) are increased by 1%.
Fed could be raising rates by 2% in next two years.

9. US Govt could be walking a tight rope aka self imposed mild austerity in absence of new dollars.

Another issue that could be accelerating the outflow is Union budget. Well not budget, but the fact that there are 7 elections planned in this year starting with the one in UP.

10. At the backdrop of farmer protest fiasco leading to cancellation of farm laws, budget could be the last chance for the government to show that "PM Cares". (Did you notice what I did there? ■)



11. There could be big and bold 'populistic' measures that government may announce in the budget. Simply more MSP, more subsidy.

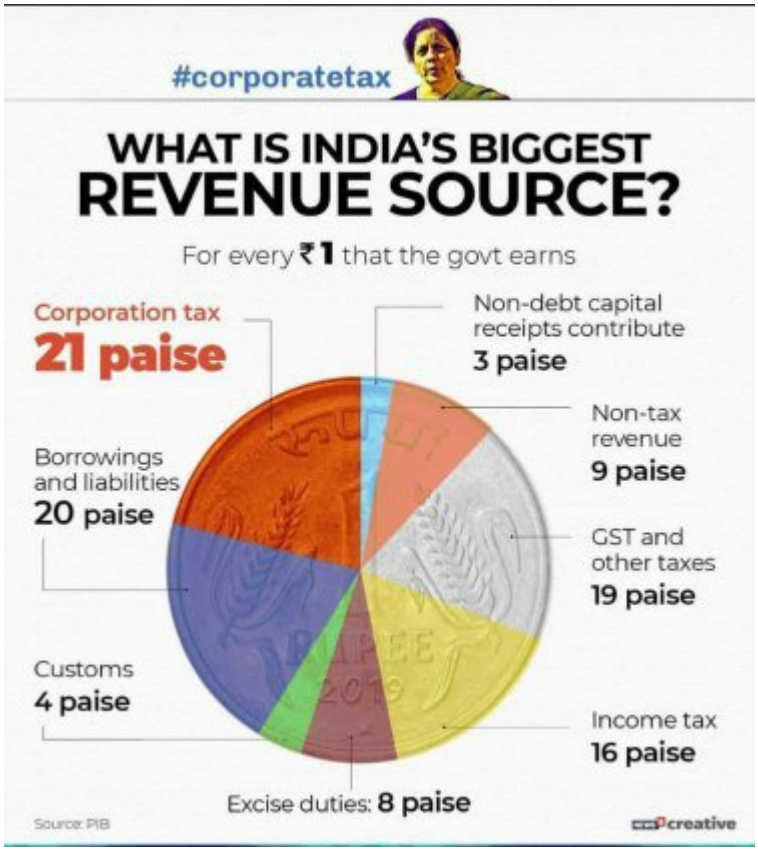
12. They would have preferred the PM to do that personally on TV/stage, but lack of time between budget and imposition of Achaar Sanghita would leave this job in hands of the FM. Obviously she would very clearly acknowledge the vision of the PM while announcing any such scheme.



13. But all populism needs money. And taxes are where they get their money from. So expect some tightening on taxes front. The sops given to industries could be altered. Here, I am not even talking about the personal income tax part.

14. Another source is Borrowing. Expect the borrowing figures to also go up. However, possibly by not much.

Overall impact, the budget could be inflationary leading to pressure on INR.



15. a. As explained earlier, When FIIs convert their currency into INR and then back to their currency to take it home, they pay transaction cost. And the depreciation adds to that cost. That's ok if market is under valued and a good upside is available in near term.

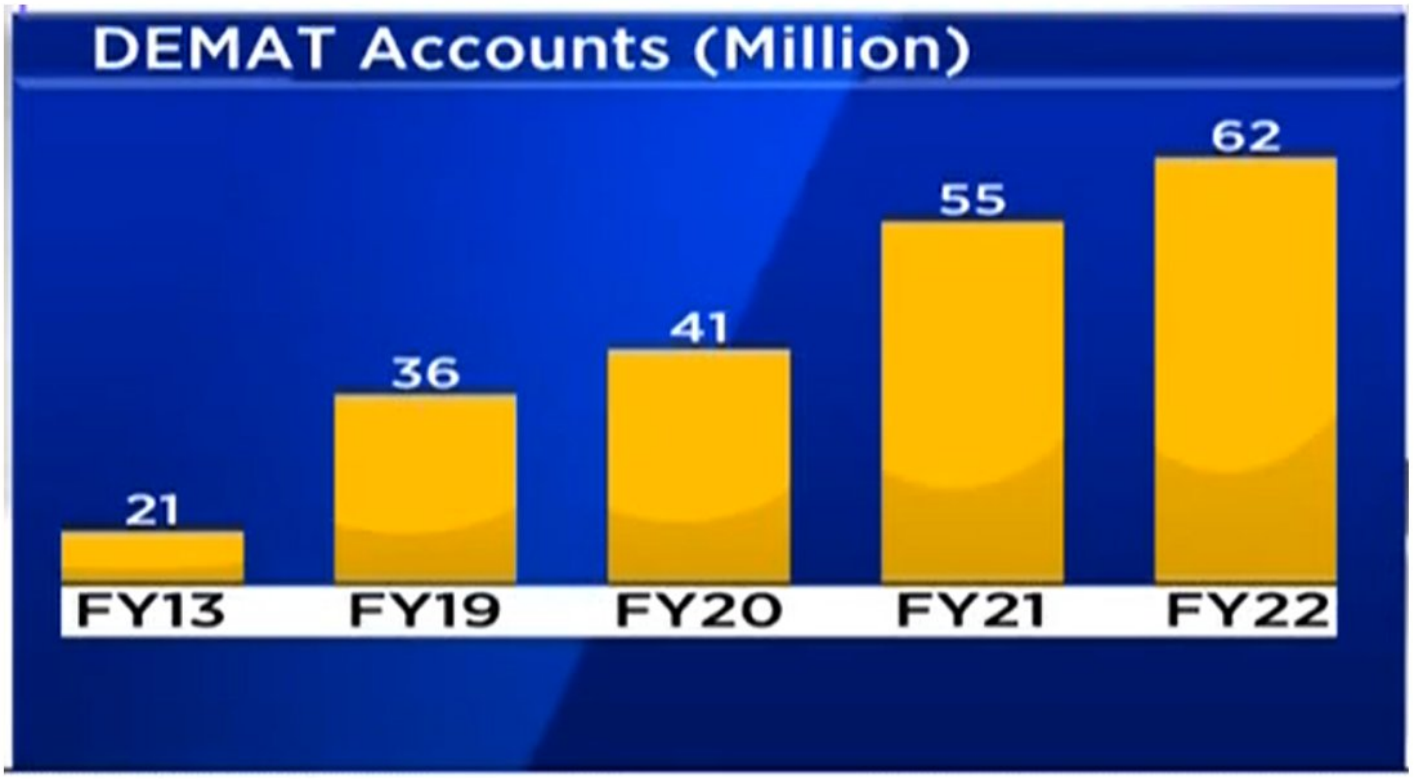
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15. b. If the perceived upside is limited and INR is expected to get double beating, then it's obvious that there will be a race to the exit door. And that creates a vicious cycle.

16. It's the domestic flow which has protected our markets so far. Including the same novice investor who is being ridiculed everytime for enjoying the honeymoon period since the covid crash. India's equity love saga has saved the markets so far.

17. But as inflation rises and FED hikes it's rates, RBI would be forced to hike as well. That would mean banks also raise their deposit rates. Some of these domestic flow gets diverted to debt and gold rather than to equities. There, we cud see deep correction in our markets.

18. Then this novice investors/traders, who have been honeymooning for last 2 years, would know how the market really works. ■



19. Now what can surprise everyone?

Well, if the budget stays business friendly and balance-sheet friendly, then the pressure on INR would be limited and GDP growth projections could be lifted forcing the FIIs to rethink their strategy.

20. More surprises:
FED not walking its talk on monetary tightening and
Our govt not splurging on subsidies what they project in the budget.

But these things will take time and before that markets could be undergoing slow downward grind for next 2-3 months or so.

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Please like if you understand it. Share if you want to look wise to your friends and family.
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