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Investors fleeing China look to India

James Crabtree in Mumbai and Josh Noble in Hong Kong

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Indian Prime Minister, Narendra Modi, centre, arrives for the opening of the parliament's monsoon session

With global emerging markets again under pressure, India might seem an unlikely port in the storm. Promises of far-reaching economic reforms under Prime Minister Narendra Modi are still to be delivered, while hopes of a rapid investment-led recovery under his leadership remain unfulfilled.

But with China's equity market convulsed by a painful sell-off, India finds itself the happy recipient of investment searching for safety in the developing world.

The pre-market email

The benchmark Sensex index has lost more than 2 per cent over the past two days, reflecting investor unease over much larger falls in China. But the index has eked out a 0.6 per cent increase over the past three months. Though not likely to set pulses racing, this makes India the only country in Asia to see markets rise over that period.

Since the Chinese sell-off began on July 15, the Shanghai index has dropped nearly 30 per cent. Indian stocks, meanwhile, are up around 5 per cent.

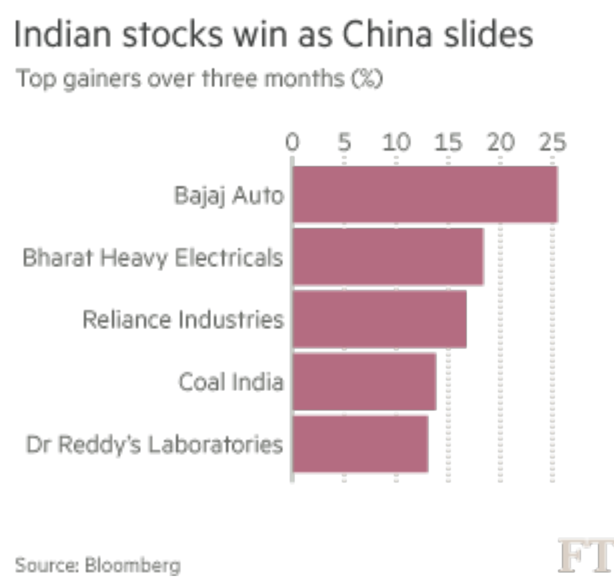
The rupee has also been relatively stable, losing 1.6 per cent against the dollar this year. Among emerging market currencies, only the closely managed renminbi, the rebounding rouble and the Taiwanese dollar have performed better.

Looked at more broadly, Indian equities have witnessed a far milder version of China's ups and downs this year, with markets scaling record highs back in March on heavy inflows from foreign investors hopeful of a robust economic recovery. An unexpected cut in interest rates from the Reserve Bank of India also helped to grease the wheels.

The Sensex then lurched back in the three months to June, as fund managers flocked to China, where stocks had rallied for almost a year. But with Chinese equities tumbling, India has become one of the main winners as investors reallocate in the other direction, argues economist Eswar Prasad of the Brookings Institution.

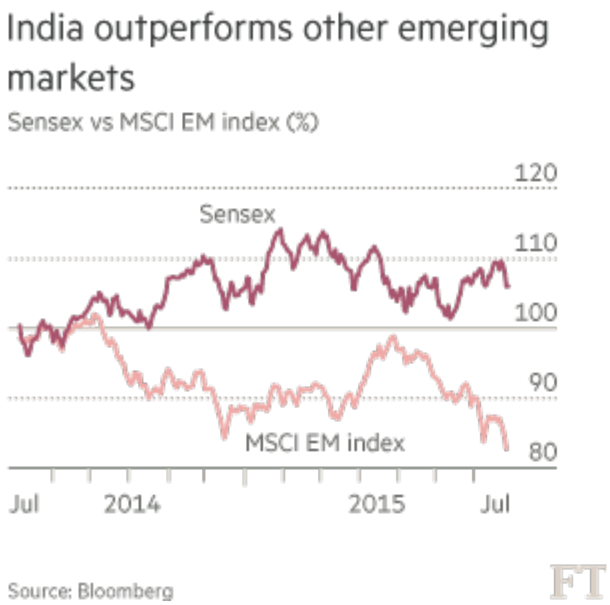
"For money that wants to stay in emerging markets and for which China is now too hot a destination, India seems the best alternative," he says.

Foreign investors have also sunk Rs73bn ($1.1bn) into Indian equities so far this month, in part because of worries over China, reversing outflows over the previous two months. Falls in oil prices have also helped to draw funds back into India's economy, which relies on foreign energy imports.



"There was some reallocation out of India and towards China earlier this summer. That has now stopped, and some of it seems to be coming back," says Rashesh Shah, the founder of Edelweiss, a Mumbai financial services group. "Investors I speak to see China as a lot riskier now."

Mahesh Nandurkar, India strategist at broker CLSA, also credits newly buoyant local investors as much as foreign funds fleeing China for boosting India's market over recent months. "More domestic flows are really supporting the market by pumping in a lot of funds," he says.



Even so, few analysts predict a return to the heady run of record highs that followed Mr Modi's victory in national polls during May 2014, amid signs that India's return to rapid growth is set to be a long and rather uneven process.

Mr Modi's government is struggling to deliver a series of landmark political reforms during a typically rambunctious session of the country's parliament, with doubts in particular over long-awaited measures to improve tax and land allocation policy. There have also been few signs of improvements in corporate profitability during the current first-quarter earnings season.

"We are in a bit a sideways market, so any small thing like China can help it pick up, but basically people are waiting to see if the government can deliver," Mr Shah says.

But after months of first hype and then disappointment, Rahul Chadha, co-chief investment officer at Mirae Asset, believes investors have finally digested the real impact of Mr Modi's election win, and will soon begin to see the fruits of his reform agenda. Almost a quarter of his fund is invested in India, compared with a MSCI emerging markets benchmark level of just 8 per cent.

"We're going to see Modi's steps and policies in the coming quarters," he says. "What we'll see over the next six to nine months is good policymaking."

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