Japan’s Surging Appetite for Indian Stocks, Scene of Swelling Risk Too

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Now Asia’s Second Largest Target for Japanese Investment Trusts

Japanese securities investment in India is on the rise. The September 10 morning edition of the Nihon Keizai Shimbun economic daily reported on the results of a survey conducted by the Investment Trusts Association of Japan, which found that as of the end of this July the net asset balance of foreign-currency-denominated investment trusts targeting newly emerging countries and regions was up 20% compared to the end of July 2004, thereby surpassing the one trillion yen mark. Of this total, the balance for India had reached a scale of 440 billion yen (including products set up overseas but sold in Japan), making that country Asia’s second largest target market for Japanese investment trusts after Hong Kong.

Japan’s first India stock investment trusts were set up in September of 2004 by Marusan Securities, Shinko Securities and other brokerages. Nomura Securities and other major securities houses soon followed up with a steady stream of investment trusts that either specialized in Indian stocks or incorporated those issues into the portfolios. Because it is impossible for individual investors to directly acquire Indian stocks, almost all investment in Indian stocks from Japan is channeled through the investment

Indian Stocks Surge Above Other Indexes
trust mode. According to the official statistics on external securities investment, of the cumulative total for the period of January through July, investment in Hong Kong and China stocks, markets that have lead the way up to now, shifted to a broad-based net influx (a surplus in the disposal by residents of securities issued by non-residents). In term of momentum, therefore, the lead role for Asian directed stock investment has shifted to India.

***Boom-Driven Foreign Capital Influx Spurs Strong Share Prices***

Japan is not the only source of the growing investment in India’s surging stock market. Channeled through foreign institutional investors (FII) sanctioned by the Securities and Exchange Board of India, some 450 billion rupees (approx. $10 billion) flowed into the Indian securities market in both fiscal 2003 and fiscal 2004, respectively (17 times the capital that entered the market in FY2002), with 95% or more of that money earmarked for the stock market. The cumulative net purchase value for FII since FY1992, the year that the Indian securities market was opened up to these overseas investors, reached 1.5 trillion rupees at the end of March 2005. A net buying spree on a par with that recorded last year has continued from April and on as well.

The Sensex Index on the Bombay Stock Exchange (BSE), India’s leading stock price index, temporarily climbed to the 8,500-point level in late September, a gain of over 50% compared to a year previous. Behind this jump can be found the robust state of the Indian economy, which continued to chart solid growth in the 7% vicinity. It can also be said, however, that the inflow from overseas of large amounts of capital onto the Indian stock market, which at the end of this May remained below 33 trillion rupees even for the combined total of the BSE and the National Stock Exchange (NSE; with the roughly the same market value as the BSE), has also been a factor that spurred the rise in stock prices.

***Sharp Influx of Foreign Capital Over the Past Two Plus Years***
Importance of Contributing to Stable Development for Asian Markets

Expanded securities investment will lead to the diversification of the fund raising in the country targeted for investment. While this expanding investment in securities will not contribute to increasing productivity simply by pushing up stock prices, the issuing of new shares, bonds and other financial instruments renders it easier for companies to raise capital, with that underpinning growth in the securities market of the target country. Conversely, a “torrential” influx of capital into Asian countries where the scale of the securities markets (stocks and bonds alike) is small and the markets are not developed can prompt market confusion, running the risk of shaking the very foundation of the macro economy. This recalls events in the wake of the Asian financial crisis of 1997-98, in which Japanese banks made major cuts in their financing to Asia. As it turned out, Malaysia and other countries were sharply impacted by these moves, with their recoveries from the crisis delayed.

In contrast, the recent surge in investment in Indian stocks can be viewed as a shift in the investment attitude of the Japanese, who despite harboring the world’s highest level of financial assets have traditionally been reticent to put their money into assets carrying risk. Now, despite understanding the potential of suffering a certain degree of loss, the Japanese appear to be investing in overseas stock, not to mention expanding away from the bias so long displayed for stocks of the industrialized countries of the West to put their money into Asian stocks. With the lack of maturity seen in Asian securities markets one of the factors for shunning investment there in the past, another major dynamic has been the continued trend over the years for Japanese investor interest to focus on the U.S. and Europe, with scant attention paid to Asia.

In the interest of also supporting the cultivation of Asian securities markets, therefore, the securities companies, banks and other vendors of investment trusts must go one step beyond simply selling those products on the strength of their high earnings. It is important that they also supply investors with information, including the knowledge and awareness of risk, in moving as an industry to contribute to the stable development of the Asian markets.