Indian Economy · GS - III

Persistent foreign portfolio outflows highlight the vulnerability of emerging-market capital flows to global risk perceptions. Discuss the implications for India and policy responses. (150 words)

EXAM YEAR	PAPER	SUBJECT
Daily Practice 05/10/2026	GS - III	Indian Economy

MARKS	WORD LIMIT
10	~150 words

Answer Hint

- **FPI volatility; exchange rate; current account; liquidity; equity markets; domestic savings; macro stability; external debt; reserves.**
- **Avoid treating FPI outflow as inherently negative; distinguish short-term volatility from long-term fundamentals.**

Model Answer

Foreign portfolio investment (FPI) provides liquidity and capital to Indian financial markets, but it is inherently sensitive to global interest rates, risk appetite, geopolitical uncertainty and relative asset valuations. Large outflows can therefore transmit external shocks into the domestic economy.

FPI withdrawals may put pressure on the rupee, increase market volatility and raise the cost of external financing. They can also affect corporate investment sentiment. However, moderate outflows are not necessarily a sign of economic weakness because portfolio investors frequently rebalance globally. India’s large domestic savings base, strong institutional investors and relatively deep capital markets provide important buffers.

Policy responses should focus on macroeconomic stability rather than attempts to prevent normal market movements. Adequate foreign-exchange reserves, prudent external borrowing, credible monetary policy and sustainable fiscal management can reduce vulnerability. Developing domestic institutional investors and

deepening bond markets can lessen dependence on volatile foreign capital. Stable and predictable taxation and regulation can improve investor confidence.

Thus, the objective should not be to eliminate FPI volatility but to ensure that India’s financial system can absorb external shocks without compromising growth, exchange-rate stability or financial stability.

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