# Indian Economy · GS - III

**The return of foreign portfolio investment to Indian equity markets does not necessarily indicate broad-based investor confidence in the economy. Analyse the factors influencing FPI flows and examine their implications for India's macroeconomic stability.**

| EXAM YEAR | PAPER | SUBJECT |
|---|---|---|
| DAILY PRACTICE 20/11/2026 | GS - III | Indian Economy |

| MARKS | WORD LIMIT |
|---|---|
| 15 | ~250 words |

## Answer Hint

**Portfolio capital, global interest rates, currency movements, crude oil prices, valuation, sectoral concentration, capital market liquidity, exchange-rate volatility, external vulnerability, regulatory stability.**

## Model Answer

### Introduction

Foreign Portfolio Investment (FPI) provides an important source of capital and liquidity to Indian financial markets. However, FPI flows are sensitive to global financial conditions and domestic market expectations. Their concentration in selected sectors may not reflect broad-based confidence across the economy.

### Factors Influencing FPI Flows

1. **Global monetary conditions:** Higher interest rates in advanced economies can divert capital away from emerging markets.
2. **Currency movements:** Expectations of rupee depreciation can reduce foreign investors' returns.

3. **Crude oil prices:** Lower oil prices can improve India's current account position and inflation outlook, supporting investor sentiment.
4. **Market valuations:** Attractive valuations encourage investment, while high valuations may trigger selective buying.
5. **Sectoral fundamentals:** Earnings visibility, corporate governance and growth prospects influence allocation towards particular sectors.

**Implications for Macroeconomic Stability**

- **Positive effects:** FPI inflows deepen capital markets, improve liquidity and support equity financing.
- **External vulnerability:** Sudden reversals can exert pressure on the rupee and foreign exchange reserves.
- **Market concentration:** Heavy investment in a few sectors can create uneven valuation increases and volatility.
- **Monetary management:** Large capital movements can complicate exchange-rate and liquidity management.

**Way Forward**

India should strengthen domestic institutional investment, deepen bond markets, maintain macroeconomic stability, improve corporate governance and sustain predictable regulatory policies. A stronger domestic savings-investment ecosystem can reduce excessive dependence on volatile foreign capital.

**Conclusion**

FPI inflows are an important indicator of financial-market sentiment, but their quality, stability and sectoral distribution matter as much as their volume. India's long-term resilience requires stronger domestic investment alongside sustained foreign participation.