Indian Economy · GS - III

Analyse the factors influencing foreign portfolio investment flows into India. How can India reduce its vulnerability to sudden reversals in foreign capital flows?

EXAM YEAR	PAPER	SUBJECT
DAILY PRACTICE 21/11/2026	GS - III	Indian Economy

MARKS	WORD LIMIT
15	~250 words

Answer Hint

Global interest rates, US dollar movement, domestic growth, corporate earnings, geopolitical stability, exchange rate, FPI volatility, foreign exchange reserves, domestic institutional investors, capital market regulation, macroeconomic stability.

Model Answer

Introduction

Foreign Portfolio Investment (FPI) plays an important role in India's capital markets by providing liquidity, supporting investment and influencing market valuations. However, its volatility can expose the economy to external financial shocks.

Factors Influencing FPI Flows

1. **Global monetary conditions:** Higher interest rates in advanced economies can attract capital away from emerging markets.
2. **Dollar movement:** A stronger dollar can increase currency-related risks and reduce the attractiveness of Indian assets.
3. **Domestic economic fundamentals:** Growth prospects, corporate earnings, inflation and fiscal stability influence investor confidence.

4. **Geopolitical developments:** Regional tensions and global uncertainty can trigger capital outflows or renewed investment.
5. **Market valuations:** Relative valuations and expected returns across emerging economies influence investment decisions.
6. **Exchange rate expectations:** Anticipated rupee depreciation can reduce foreign investors' returns.

Measures to Reduce Vulnerability

- Strengthen macroeconomic fundamentals through stable inflation, sustainable public debt and consistent growth.
- Deepen domestic institutional investment through mutual funds, insurance and pension funds.
- Maintain adequate foreign exchange reserves to manage external volatility.
- Improve market transparency, regulatory predictability and corporate governance.
- Diversify exports and attract stable long-term FDI alongside portfolio investment.

Conclusion

FPI inflows reflect investor confidence but cannot substitute for domestic savings and productive investment. A resilient financial system requires strong fundamentals, diversified capital sources and effective regulation.

BECOME IAS
AI POWERED UPSC PREP