FPI surge into Indian equities

Mains: *GS-III – Economy*

Why in news?

After two years of outflows driven by geopolitical tensions, the AI boom, and valuation concerns, foreign portfolio investors (FPIs) have reversed course, investing a record Rs. 89,856 crore in Indian markets so far in November.

What is Foreign Portfolio Investment & Investor?

- **Foreign portfolio investment (FPI)** – It is the entry of funds into an economy through passive holdings of financial assets—such as stocks, bonds, and cash equivalents—without active management or direct control over the issuing business (typically holding under 10% equity).

  Passive ownership *– Investors buy securities purely for financial returns (dividends, interest, or capital appreciation) without participating in daily business operations.*

- **Regulator** – Foreign portfolio investments are regulated by the Securities and Exchange Board of India (SEBI).
- **Foreign Portfolio Investor (FPI)** – A non-resident individual or institutional entity that invests in financial assets—such as stocks, bonds, mutual funds, and exchange-traded funds (ETFs)—in another country without taking active management or control of the underlying business.
- FPIs act as a more liquid, short-to-medium-term flow ("hot money") traded easily on secondary markets, compared to the long-term, less liquid commitment of FDI.
- **Investment limit** – Under Indian regulations, an individual FPI (or investor group) is generally capped at holding less than 10% of the total paid-up equity capital of an Indian company.
- If an investment crosses the 10% threshold, it is typically reclassified as Foreign Direct Investment (FDI).
- **Eligible Instruments** – SEBI-registered FPIs can invest in listed equities, government securities, corporate bonds, mutual fund units, and Real Estate Investment Trusts (REITs).

FPI vs. FDI

Foreign Portfolio Investment (FPI) – Involves paper assets (stocks, bonds), < 10% stake, passive involvement, and high liquidity.

Foreign Direct Investment (FDI) – Involves physical or business assets, ≥ 10% or controlling stake, active management, and long-term commitment.

Why are FPIs returning?

- **Global AI & Tech stocks** – The recent slowdown in AI stocks and concerns about their growth prospects have brought investors seeking a safer bet back to India.
- The boom in global AI and tech stocks over the last two years prompted investors to move too heavily into tech-heavy countries like the U.S., South Korea, and Taiwan.
- **Strong macroeconomic fundamentals** – India's macroeconomic conditions also remained resilient even against the backdrop of heightened geopolitical uncertainty.
- The quarterly performance of India Inc for July-September also saw
    - Strong earnings growth;
    - Crude oil prices eased,
    - Nifty 50 trimmed year-to-date losses and reclaimed the 25,000 mark, and
    - The rupee stabilised, recovering sharply from its record-low levels against the dollar.

Is this a behavioural shift?

- **Inflows may be temporary** – Although FPIs have invested in Indian markets for two consecutive months, analysts caution that this does not yet signal a permanent change in investor behaviour.
- **Tactical Reallocation of Funds** – Much of the recent inflow appears to be part of a tactical and rotational allocation of funds, which could be reallocated elsewhere in the wake of any external triggers, including further development in AI and tech stocks, etc.
- **Unwinding of previous positions** – According to market experts, the sudden surge in inflows is likely due to investors reversing earlier investment positions rather than making long-term commitments to India.
- **Strong fundamentals needed for sustained flows** – A lasting return of FPIs will depend on continued strong corporate earnings, stable crude oil prices, and an easing of geopolitical tensions, particularly in the Middle East.
- **Long-term investments yet to take over** – Analysts believe that if these favourable conditions persist, temporary or "rotation" flows could gradually be replaced by long-term investment allocations to India.

Where is the money going?

- **Concentrated in large-cap stocks** – Most market participants suggest that the foreign fund inflow has largely gone into large-cap companies, also known as blue-chip stocks.
- Large-cap companies are generally seen as less volatile and more stable, compared to mid- and small-cap stocks.

- **Preference for established sectors** – Index heavyweights such as financial services, IT, automobiles and telecom have witnessed gains even while broader markets remained flat or down in recent weeks.
- **Gains in key market indices** – Nifty IT, Nifty Banks and Nifty Auto rose as high as over 1.5% last week, before domestic investors stepped up for profit booking.

Where do domestic investors stand?

- **Domestic investors turn net sellers** – While foreign investors turned net buyers this month, domestic investors have turned net sellers, largely stepping up for profit booking.
- Domestic investors have offloaded Rs. 52,607 crore from the Indian equity market so far this month.
- **Strategy ahead** – Going forward, domestic institutions are expected to turn selective, booking profits in overheated pockets while deploying cash into reasonably valued stocks.
- Steady domestic participation is likely to cushion market corrections and limit downside volatility.

Will an interest rate hike by the U.S. Fed affect sentiment?

- **Potential impact** – The U.S. Federal Reserve has turned hawkish lately due to persistent and elevated inflation.
- **Strong possibility of higher U.S. rates** – The Federal Open Market Committee (FOMC) held the Fed Funds Target range unchanged at 3.75-4.00% last month, with two officials calling for a rate hike by 25 basis points.
- **Pressure on the Rupee** – Higher U.S. interest rates typically strengthen the U.S. dollar, which can put downward pressure on the Indian rupee and increase currency-related risks for foreign investors.
- **Risk of reversal in foreign flows** – A large share of the recent FPI inflows is considered tactical or short-term.
- If global borrowing costs rise, some of these funds could quickly move out of India and return to developed markets.
- **Key risk to watch** – A surge in crude oil prices, rupee depreciation, persistent global and domestic inflation, and interest rate differentials all remain key monitorables that could trigger a reallocation of these funds.

Will FPI flows continue?

- **Inflow likely to continue** – Analysts expect the momentum in foreign fund inflows is likely to sustain through the rest of FY27.
- However, they flag global macroeconomic conditions, which could impact the current pace of flows.
- **Corporate earnings will be crucial** – Sustained FPI participation will require continued growth in corporate earnings.
- Any slowdown in earnings growth or downward revisions could limit further valuation expansion and moderate FPI participation.
- **Crude price concern** – The impact of elevated crude prices over the past few months

is also expected to weigh on corporate earnings in Q3 (October-December) and Q4 (January-March).

Reference

The Hindu | What's behind the record Rs. 89,856-crore FPI surge into Indian equities?

