

The Declining Investor Sentiment Towards India: Growth vs Capital Outflows

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- India has been the **world's fastest-growing major economy**, averaging 8.2% GDP growth between 2021 and 2024 — higher than Vietnam, China, and other major economies. The momentum continued in 2025 with growth of 7.4% and 7.8% in the first two quarters.
- Yet, this impressive performance has **not translated into steady foreign portfolio investment (FPI) inflows**.
- Except for 2023-24, when FPIs invested \$25.3 billion, all other recent years saw net outflows — \$18.5 billion in 2021-22, \$5.1 billion in 2022-23, \$14.6 billion in 2024-25, and \$2.9 billion in 2025-26 (till September).
- This disconnect highlights persistent investor caution despite robust growth.

Role of Foreign capital in India's growth

- Foreign capital, which includes Foreign Direct Investment (FDI) and Foreign Portfolio Investment (FPI), has played a significant role in India's economic growth, especially since the economic liberalization of 1991.
- It provides financial resources that the domestic economy may lack, acting as a crucial driver of development.
- Foreign capital supplements domestic savings, finances investment needs, and bridges the gap in capital-scarce sectors.
- Foreign Direct Investment (FDI) has modernised industries, brought in advanced technologies, boosted infrastructure, and created employment opportunities. It has also integrated India into global supply chains and enhanced competitiveness.
- FPI has deepened capital markets and provided liquidity, though with volatility risks.
- Beyond finance, foreign capital strengthens innovation, supports services like IT and e-commerce, and improves balance of payments by financing current account deficits.

The Foreign Capital Paradox in India

- Despite India's robust GDP growth of 7.8% in early 2025, overseas capital inflows have remained weak.
- **Net capital flows** fell to \$18.3 billion in 2024-25, the lowest since the global financial crisis of 2008-09, and inflows in April-June 2025 were over 40% lower than the same period last year.
 - Net capital flows into India includes foreign investment, commercial borrowings, external assistance and non-resident Indian deposits.
- **Balance of payments** (BoP) data show net foreign investment plunging from a peak of \$80.1 billion in 2020-21 to just \$4.5 billion in 2024-25, with minimal FDI (\$959 million) and modest FPI inflows (\$3.6 billion, largely in debt).
 - BoP records all financial transactions between a country and the rest of the world over a period.
 - It tracks money inflows and outflows from trade in goods and services, investments, and loans involving individuals, companies, and governments.
- **Equity markets**, however, saw heavy sell-offs.
- Meanwhile, **external commercial borrowings** rose to \$15.8 billion in 2024-25, reversing the outflows of previous years.
- The disconnect between high growth and low foreign capital underscores investor caution about India's economic prospects.

Why Capital Flows to India Have Declined

- **Impact of Past Investments**
 - Much of the FDI that entered India during the last decade, peaking in 2020-21, came from private equity (PE) and venture capital (VC) in sectors like retail, e-commerce, financial services, green energy, healthcare, and real estate.
 - These investors are now exiting to monetise mature positions, leading to reduced net inflows.
- **Investor Exits and Monetisation**
 - According to industry experts, PE/VC exits were valued at \$24 billion in 2022, \$29 billion in 2023, and \$33 billion in 2024.

- Nearly 59% of exits in 2024 were through public markets, supported by India's strong stock valuations.
- **Foreign Portfolio Investor (FPI) Behaviour**
 - FPIs too have been selling off, but their exits have been offset by bullish domestic investors who sustain attractive market valuations, enabling profitable exits for both FPIs and PE/VC firms.

Balance of Payments Challenges for India

- **India's merchandise trade deficit** surged to \$287.2 billion in 2024-25, more than triple the 2007-08 level.
- These deficits have so far been offset by strong surpluses in services exports and remittances, keeping current account deficits under \$50 billion in most years and financed through steady capital inflows that boosted forex reserves.
- However, risks are rising. U.S. President Trump's 50% tariffs threaten Indian exports to a \$86.5 billion market, while capital inflows remain uncertain, driven more by investor confidence in corporate earnings and valuations than headline GDP growth.
- Recent capital outflows and tariff concerns pushed the rupee to a record low of 88.37 per dollar.
- In response, the current government has cut GST rates to stimulate consumption and earnings and announced a task force for next-generation reforms to improve ease of doing business.

Source: IE

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