

An exploratory study on measures followed by the central bank of India (RBI) in attracting FDI and FPI due to current geopolitical tensions (2026)

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ABSTRACT

Monetary policy in an economy uses instruments like repo rate, reverse repo rate to manage an economy's external sector and inflation targets. Amidst geopolitical tensions, specifically since February 2026, India has faced heavy outflows of Foreign Direct Investment (FDI) and Foreign Portfolio Investment (FPI) as investors started selling. This has impacted the economy's balance of payment, exchange reserves, exchange rate and domestic inflation rate. All of these combined with weak domestic corporate earnings and competitive worldwide investment opportunities have worsened India's macroeconomic indicators.

To address this issue, the economy, along with traditional policy measures, has introduced the new FCNR(B) scheme (June 2026) to try and stem the outflow of FDI and FPI. This paper attempts to highlight the policy measures that contributed in making India a favourable environment for foreign investment specifically in FY2023-2024, and how policy factors adopted by the RBI can reverse the trend that India has been witnessing in terms of its flight of FIIs since 2026. This paper will study a critical analysis on policy measures followed by the RBI in addressing the current impact of geopolitical tensions.

Keywords: Foreign Direct Investment (FDI), Foreign Portfolio Investment (FPI), monetary policy, Reserve Bank of India (RBI), liquidity, interest rates, Foreign Currency Non-Resident Bank Deposit {FCNR(B)}

1. Introduction

Monetary policy plays an important role in shaping a country's investment climate by influencing macroeconomic stability, inflation, liquidity, and investor confidence. A stable monetary policy framework helps maintain low and predictable inflation, creating a favourable environment for both Foreign Direct Investment (FDI) and Foreign Portfolio Investment (FPI). While FDI is generally attracted by long-term economic stability, sound institutions, and policy credibility, FPI

is highly sensitive to changes in interest rates, exchange rates, inflation, and overall market conditions. Through measures such as liquidity management, inflation targeting, and exchange rate stability, central banks can influence capital flows into the economy. [1, 4] Since 2016, the Reserve Bank of India (RBI) has been implementing India's monetary policy to maintain price stability while supporting economic growth. To achieve these objectives, the RBI conducts a Monetary Policy Review every two months. This review assesses current economic conditions, including inflation, growth, liquidity conditions, and global economic developments, letting the RBI choose appropriate monetary policy measures. Prior to this, the objective of the RBI policy continued to change depending on the major problems that the Indian economy was facing. The policies were changing rapidly, given the time-lag for the effects of the policy to set in; the economy was not in a position to feel the impact of the monetary measures. In September 2013, the then governor Raghuram Rajan initiated a monetary policy study group under Urjit Patel to streamline monetary policy measures, introducing flexible inflation targeting and establishing the Monetary Policy Committee (MPC). This led to reforms in India's monetary policy, including enhanced transparency, policy credibility, improved monetary transmission and better financial market stability. [9, 16]

The RBI uses several monetary policy instruments to influence the economy. These include the repo rate, at which banks borrow funds from the RBI; the reverse repo rate, at which banks deposit surplus funds with the RBI; the Cash Reserve Ratio (CRR), which specifies the percentage of deposits banks must keep with the RBI; and the Statutory Liquidity Ratio (SLR), which requires banks to maintain a certain proportion of liquid assets. By adjusting these rates and ratios, the RBI regulates money supply, controls inflation, ensures financial stability, attempts to adjust the balance of payments and promotes sustainable economic development in the country. [10]

India's external sector has long benefited from remittance inflows, expanding exports, and consistent foreign capital investment. However, 2026 has witnessed an adverse change in this trend, raising concerns about the country's external stability. Foreign Portfolio Investors have withdrawn more than USD\$21.01 billion during the year, reflecting weakening investor sentiment and increased global uncertainty. Simultaneously, rising crude oil prices due to the ongoing West Asian conflict are likely to widen India's Current Account Deficit (CAD) to nearly 2% of GDP, putting even greater pressure on the economy. Moreover, according to the United Nations Conference on Trade and Development (UNCTAD), global FDI increased by 14% to reach USD\$1.6 trillion in 2025, but investment flows to developing countries declined by 2%. This trend highlights the growing fragmentation of international capital markets and the impact of geopolitical tensions on investment decisions, especially those specific to developing nations.

In this challenging global environment, India must focus on strengthening investor confidence. [6]

This paper discusses how the RBI manages its monetary policy in attempts to manage FDI and FPI in light of recent geopolitical tensions that have triggered significant capital outflows, increased volatility in foreign investment, weakened the Indian rupee, and placed pressure on the country's balance of payments.

2. Literature review/background:

Investment is essential for an economy because it drives economic growth by increasing productive capacity, creating employment, and raising incomes. It also encourages innovation and entrepreneurship by supporting the development of new technologies and industries, enhancing long-term competitiveness. A stable economic environment and favourable financial conditions further strengthen business confidence, encouraging firms to expand operations and undertake long-term investments, thereby fostering sustainable and resilient economic growth. [5]

In a developing economy like India, foreign investment mainly takes two forms: Foreign Direct Investment (FDI) and Foreign Portfolio Investment (FPI). [17, 18]

FDI in India involves foreign investors acquiring a significant ownership stake (typically 10% or more) in an Indian company with a long-term objective. It often includes participation in management and helps build business capacity in sectors such as manufacturing, infrastructure, technology, healthcare, and services. FDI is typically considered a more stable source of capital than FPI because investors are less likely to withdraw during periods of economic uncertainty. [17, 18]

FPI, on the other hand, involves foreign investment in financial assets such as shares, bonds, government securities, and mutual funds without gaining control over the company. Investors enter a country through the stock market, and these funds usually hold less than 10% ownership and focus on earning returns through stock market performance. As a result, FPI is more liquid and can move in and out of the economy more quickly in response to changes in global financial conditions. [17]

FPI takes several forms, all of which involve foreign investors providing capital through financial markets rather than taking ownership or control of businesses. One common type is Foreign Institutional Investment (FII), where overseas institutions such as banks, pension funds, insurance companies, mutual funds, and hedge funds invest in domestic stock markets to earn financial returns. Another form is Foreign Currency Convertible Bonds (FCCBs), which are

bonds issued by companies in foreign markets to raise capital in foreign currency, offering investors interest payments and the option to convert the bonds into company shares. A third type is Global Depository Receipts (GDRs) and American Depository Receipts (ADRs), which enable foreign investors to buy and trade shares of companies listed in other countries, with GDRs traded internationally and ADRs listed on U.S. stock exchanges. Together, these forms of FPI provide companies with access to international capital while allowing investors to benefit from liquidity and potential capital gains. [21]

Foreign investment is important for India because it provides capital needed to support economic growth, create jobs, and improve productivity. FDI helps finance businesses, infrastructure, and new technologies, while also bringing in international expertise and management skills. This increases the competitiveness of Indian industries and strengthens economic development in the long-run. [19]

As for studies on the RBI specifically, the economic liberalization reforms introduced in 1991 significantly transformed India's monetary policy environment. As the Indian economy became increasingly integrated with global financial markets, the RBI assumed additional responsibilities related to managing capital inflows, exchange rate volatility, and financial sector stability. [10]

The global economy is undergoing significant structural change, driven by evolving trade policies, higher tariffs, and an increased emphasis on national security, technological sovereignty, and economic resilience. For India, these developments have important implications for its external sector—including trade, foreign investment, capital flows, and external debt—which plays a central role in driving economic growth and integrating India into the global economy. Although this shifting international landscape presents new challenges, it also creates strategic opportunities for India to attract investment, expand trade, and strengthen its position within global value chains. [20]

Economic uncertainty is a leading cause of a reduction in investment, more specifically FDI and FPI. This is a recurring theme in studies that revolve around the use of monetary policy to combat economic slumps due to global tensions, including studies on monetary policy to address issues caused by the COVID-19 pandemic. [3, 15]

Masengesho, Dada, and Ogboi (2025) investigated the relationship between monetary policy and FDI inflows in selected East African countries. The findings indicate that monetary policy significantly influences FDI inflows through measures including interest rates, exchange rates and inflation. The effects vary across different potential measures. Exchange rate volatility and excessive growth in the broad money supply were found to have a negative impact on FDI, implying that macroeconomic instability and uncertainty discourage foreign investment.

Moreover, the paper puts emphasis on the importance of *institutional quality* when it comes foreign investment, and effective monetary policy should be complemented by institutional reforms to maximise FDI inflows. [7]

According to many sources, it is important to note that in high-income countries, the relationship between central bank interest rates and FDI inflows is positive. FDI inflows in lower and middle-income economies are dependent on the interest rates that the monetary policy decides in high income countries. When there is a substantial difference between the two interest rates, FDI flows to those economies with the highest interest rates. Mostly, the high-income countries function on low interest rates, whereas in the case of lower and middle-income countries, the interest rates are much higher. This becomes attractive for FDI to enter developing economies. The FDIs are willing to take risks in lower-income countries which offer high interest rates as they earn both in terms of exchange rate, as well as interest earnings. [1]

3. Research gap and methodology

The research gap that this paper would attempt to fill is the impact of geopolitical tensions on the investment opportunities available in developing economies like India. The domestic Indian investment is inadequate for the growth of GDP that the economy has envisaged. The shortfall is made up by foreign investment. Geopolitical tensions have disrupted this source. How does the domestic monetary policy address this problem? What are the measures that the RBI can take to attract investment without disturbing inflation levels in the economy?

The methodology adopted would be both quantitative and qualitative. All data would be secondary data from authentic sources. The explanation of the quantitative analysis would be substantiated by qualitative conclusions.

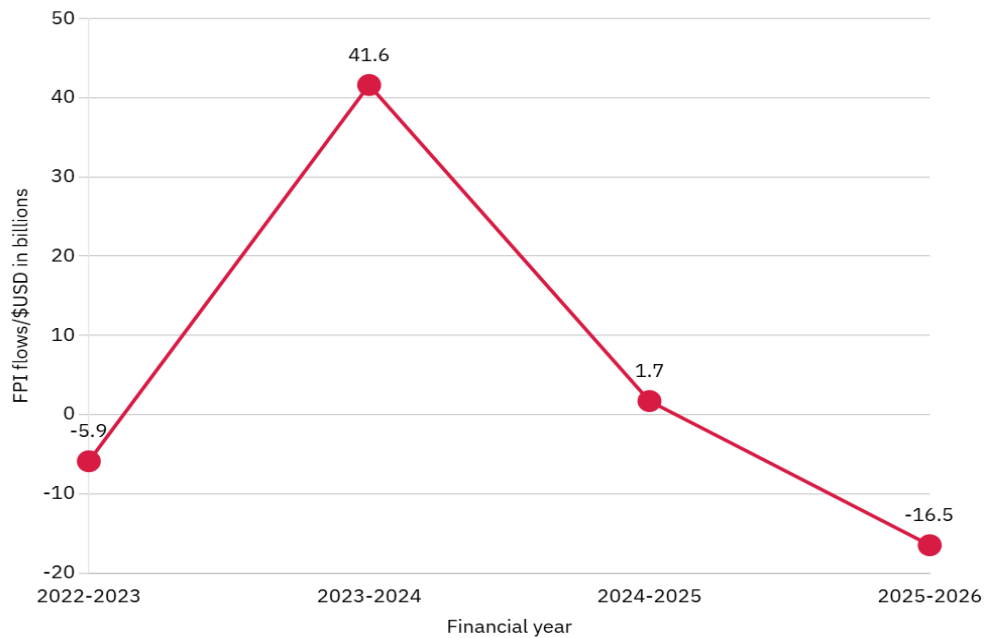
4. Analysis

Table 1: Comparison of impact of FPI flows on NSE index and BSE index

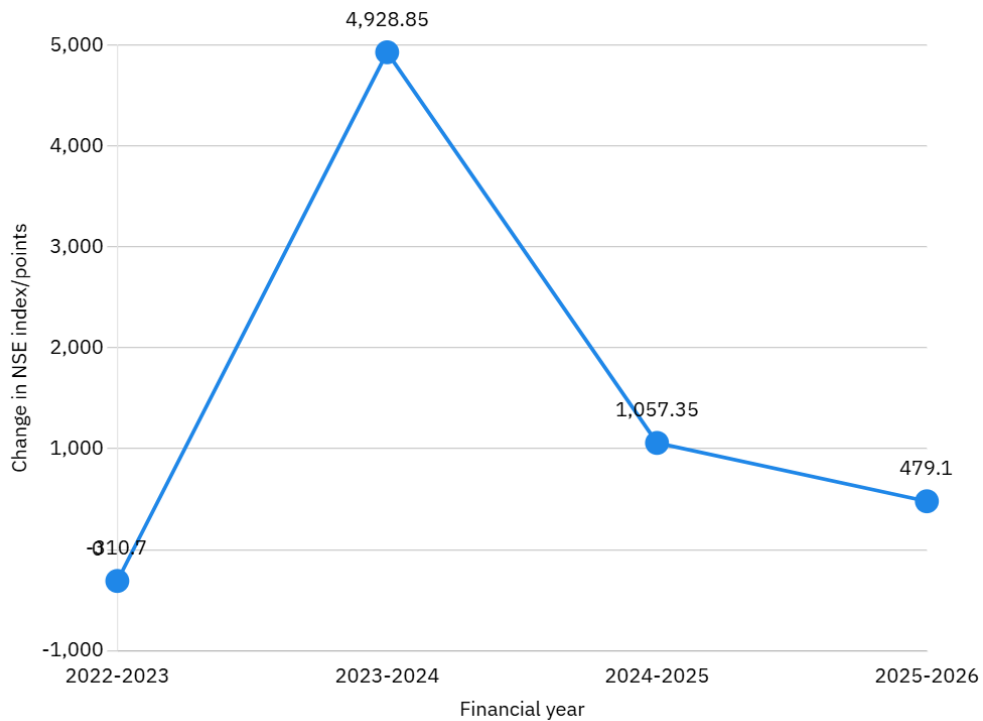
Financial year	FPI flows/USD\$	Change in NSE index/points	Change in BSE index/points
2022-2023	– 5.9 billion	–310.70	–285.17
2023-2024	+ 41.6 billion	+4,928.85	+14,659.83
2024-2025	+ 1.7 billion	+1,057.35	+3,400.37
2025-2026	– 16.5 billion	+479.10	–4,076.96

Sources : <https://www.niftyindices.com/reports/historical-data>,

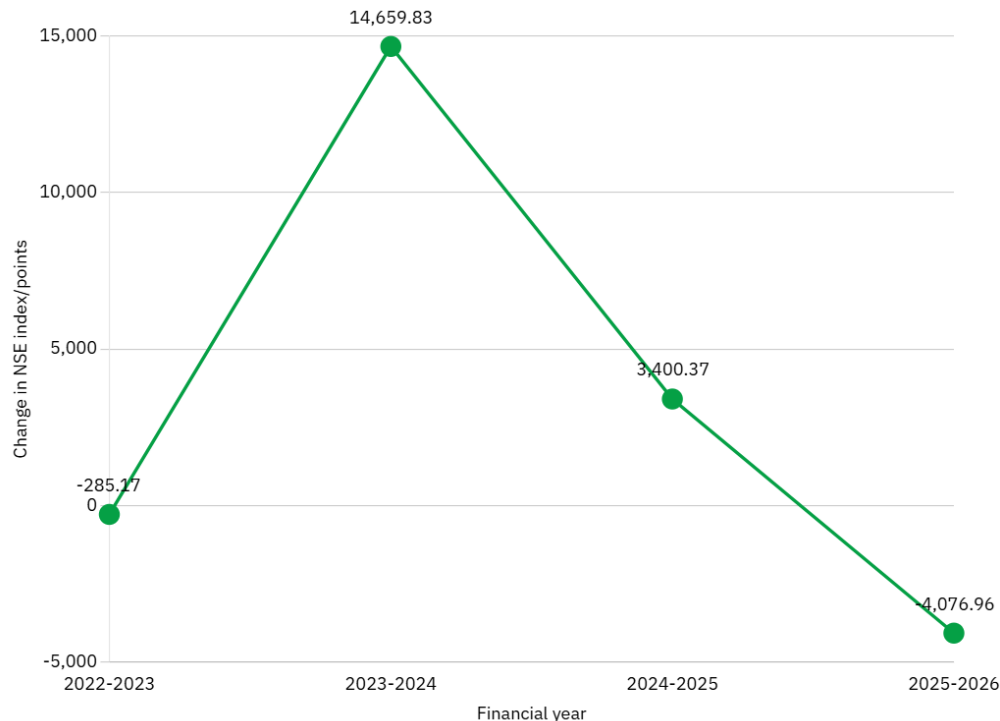
Graph 1.1: FPI flows in USD \$billion (FY2022-2026)



Graph 1.2: Change in NSE index (FY2022-2026)



Graph 1.3: Change in BSE index (FY2022-2026)



There are 5 major reasons for the surge of FPI, as well as the strong performance of the Nifty 50 and the BSE Sensex in FY2023-2024, which are:

4.1 Strong Indian economic growth

India's real GDP grew by about 7.1% in FY2023-2024, an impressive growth rate according to global standards. A high economic growth rate typically leaves a strong, positive impression on both domestic and foreign investors' confidence, making India's economy a favourable environment for investment. This growth rate helped in attracting FPIs and FDIs in India, leading to greater demand for Indian stocks that increased the robustness of Nifty 50 and the BSE Sensex. India, during this time, became a preferred country for investment compared to other global economies. [8,11]

4.2 Corporate earnings

Several major Indian companies gained from domestic demand, better operating conditions, and growth specific to their sectors. Greater profitability tends to raise investors' anticipations for upcoming dividends and cash flows, enhancing the appeal of equities. Strong profits, especially from major corporations in the Nifty 50 and BSE Sensex, led to enhanced valuations and greater

investor trust. Growing confidence in the fact that Indian firms could maintain and increase earnings also motivated foreign portfolio investors to boost their investment in Indian stocks. [12]

4.3 Foreign investor participation

Following significant FPI outflows in FY 2022–23, foreign investors returned strongly to Indian equities, resulting in net FPI inflows of around USD\$41.6 billion during FY2024 as reported by the RBI. This renewed participation reflected India's economic expansion, improving corporate earnings, and appealing investment opportunities. Heightened international interest in Indian stocks led to enhanced market liquidity and reinforced equity valuations. Due to significant foreign investments potentially raising demand for listed securities, FPI involvement was a key element linked to the considerable rise of the Nifty 50 and BSE Sensex throughout the financial year. [13]

4.4 Domestic liquidity

Participation by domestic investors helped absorb periods of foreign selling and reduced the Indian market's dependence on international capital flows, a necessary change following the economic crises caused by COVID. Regular investments through systematic investment plans and mutual funds further strengthened domestic equity demand. This relatively stable domestic investment base helped maintain market confidence during periods of global uncertainty. [14]

4.5 Sectoral performance

The robust performance of several key economic sectors contributed greatly to the rise of India's major stock-market indices during FY 2023–24. Banking and financial services, automobiles, capital goods, power, telecommunications, information technology and oil and gas were among the sectors that attracted considerable investor interest. Strong performance in these sectors was supported by domestic demand, infrastructure spending, improving corporate profitability and expectations of continued economic expansion. Since many large companies from these sectors have substantial weights in the Nifty 50 and Sensex, their gains had a significant influence on overall index performance. [22]

The stock market in India has declined from its peak that was witnessed in September 2024. The reasons for this are:

4.6 FPI outflows

The withdrawal of FPI contributed to the dip in the Indian stock market after its September 2024 peak. Foreign investors began reducing their exposure to Indian equities amid concerns

regarding relatively high valuations, subdued corporate earnings and more attractive investment opportunities in competing markets. Sustained FPI selling increased downward pressure on major market indices, including the Nifty 50 and BSE Sensex. The Reserve Bank of India identified FPI outflows as one of the factors contributing to the market correction between October 2024 and February 2025. However, the relationship between FPI flows and market performance is not necessarily unidirectional, as declining market expectations can themselves encourage foreign investors to withdraw capital. Thus, FPI outflows both reflected and intensified negative market sentiment. [24, 25]

4.7 Weak domestic corporate earnings

Slower-than-expected corporate earnings growth was another significant factor behind the decline in Indian equity markets following the September 2024 peak. The strong market performance observed during the preceding period had resulted in elevated valuations and, consequently, created high expectations regarding future corporate profitability. When earnings growth subsequently moderated, these valuations became difficult to justify. Investors eventually reassessed the earnings potential of listed companies, resulting in downward pressure on equity prices. [23]

4.8 Global uncertainty

Heightened global economic and geopolitical uncertainty led to changes in expectations regarding global interest rates, fluctuations in bond yields, geopolitical tensions and concerns regarding international economic growth increased risk aversion among investors. During periods of heightened uncertainty, international investors typically reassess their exposure to emerging-market assets, including Indian equities. This can result in capital reallocation towards relatively safer or more attractively valued markets. Consequently, global developments affected Indian markets through both investor sentiment and foreign capital flows. Although India's domestic economic fundamentals remained relatively resilient, external shocks contributed significantly to increased volatility and downward pressure on equity valuations. [23, 26]

5. Actions taken by the RBI during the Global financial crisis of 2008-2009, 2022, till 2025

During the global financial crisis in 2008-2009, India experienced a sharp reversal in portfolio flows. Net FII outflows reached about USD\$11.9 billion by January 2009, accompanied by rupee depreciation and falling equity markets. First, the RBI responded by using foreign-exchange reserves and selling dollars to reduce disorderly currency-market conditions. It also provided additional dollar liquidity to banks through *swap* arrangements and eased restrictions on external commercial borrowing (ECB). On the domestic side, the RBI cut the repo rate, while the government introduced fiscal stimulus in order to support domestic demand. India did not

particularly make attempts at preventing portfolio investors from exiting. Instead, it sought to absorb the external shock while keeping domestic credit and financial markets functioning. *The RBI described its objectives as maintaining rupee liquidity, augmenting foreign-exchange liquidity and ensuring continued credit delivery.* [27]

In 2022, the situation was different because the source of pressure was aggressive monetary tightening in more advanced economies. India experienced substantial FPI outflows as investors moved toward higher-yielding dollar assets. Rather than defending a particular exchange-rate level, the RBI chose to smooth rupee volatility, achieved by using foreign-exchange reserves to supply dollars to the market. The RBI explicitly stated that reserves were being used to curb exchange-rate volatility. At the same time, India's relatively strong FDI performance helped offset some portfolio-flow weakness. Net FDI remained robust at USD\$13.6 billion in Q1 2022–23, even as FPI outflows remained. The policy therefore relied on India's broader external buffers, rather than trying to prevent portfolio investors from leaving. [28]

Between 2020 and 2025, India's response to declining FPI flows increasingly came from within its own capital markets as well. The COVID-19 pandemic accelerated retail participation, digital trading and mutual-fund investment, while systematic investment plans (SIPs) created a relatively steady source of domestic equity demand. At the institutional level, DIIs became increasingly important to outweigh foreign selling. This was particularly evident in 2025, when FPIs recorded their largest-ever annual outflow of approximately USD\$16.96 billion, yet the Nifty 50 gained around 10.4% and the Sensex around 8–10%. DII inflows of approximately USD\$81.5 billion, alongside sustained retail SIP contributions, helped absorb the impact of foreign selling and limit its impact on market prices and volatility. [26]

6. Current measures that the RBI has undertaken on June 8th 2026

In 2026, the Indian market witnessed a widespread withdrawal of FIIs and FPIs. This was primarily due to the geopolitical crisis that had emerged in the world (the US-Iran conflict). This led to a sustained decline in the stock market and the depreciation of the rupee. To stem this, the government decided to encourage dollar flows in the country through FCNR(B) {foreign currency non-resident deposit with banks}. The banks involved are all commercial banks. Principle features are that:

- Deposits are maintained in designated foreign currencies, allowing depositors to avoid direct exposure to movements in the exchange rate.
- FCNR(B) deposits are held in foreign currency, making them an important channel for non-residents to place foreign savings with Indian banks.

- Banks determine rates within the RBI-prescribed ceilings. The ceiling is linked to the relevant currency's reference rate/swap rate, with distinct limits for 1–3 years and 3–5 years.
- Banks may offer either fixed-rate or floating-rate for these deposits, subject to the applicable RBI ceilings. If it is a floating rate, the banks are allowed a six-month reset period.
- FCNR(B) deposits have a minimum maturity of one year and cannot exceed five years. Banks cannot accept deposits for more than five years, and recurring deposits are not permitted.
- RBI rules provide a framework governing premature withdrawal and the interest/penalty will be applicable if a depositor withdraws before maturity. [30]

As a response to intense foreign selling and decline in FPIs, India decided to use the above channel with the intention of mobilising foreign-currency inflows amidst rising global financial tensions. This was announced on 5th June 2026. The RBI allowed banks to exchange the foreign currency they received through this new FCNR(B) deposit at a fixed rate. It also introduced support for certain foreign loans taken by Indian companies and banks. These measures were designed to encourage banks to raise additional foreign-currency resources while providing them with predictable access to rupee liquidity through the swap arrangement. Subsequently, the government described the initiative as part of a broader effort to improve foreign-exchange liquidity, strengthen the banking system's access to foreign currency and support external-sector resilience. The 2026 initiative is significant because it used an existing deposit channel but provided an additional incentive through the RBI's swap mechanism, making it a targeted response to changing global financial conditions. This was formally implemented on June 8th, 2026. [31]

While this particular scheme was originally supposed to run from 8th June to 30th September 2026, the RBI preponed the deadline to 31st August 2026 due to its massive success in bringing in far more foreign-currency inflows than anticipated. By 13th August, banks had already mobilised about USD\$52.3 billion through FCNR(B) deposits. The huge inflow meant that the original target had effectively been achieved well ahead of schedule. Moreover, economists estimated that hedging the FCNR(B) deposits could cost the RBI around 15% of the amount raised over the relevant period. With such large amounts of money coming in, continuing the concessional facility could become expensive at the time of maturity of these deposits. [32, 29]

The total inflow of deposits from the FCNR(B) scheme from June 8th-August 31st was ~USD\$127.2 billion. [33]

The 2026 expansion of FCNR(B) deposits could be viewed as being a burden on India's financial sector in the future but it strengthened Indian banks' foreign-currency liquidity and funding capacity. It also generated an unprecedented scale of inflows that resulted in excess domestic liquidity and left banks with additional foreign-exchange and potential maturity-management risks. [32, 29]

7. Limitations of the study

The primary limitation is that only secondary data was used throughout the analysis. Though the sources were authentic, an ideal scenario would have been to add interviews of various financial experts and RBI officials but this was not possible due to paucity of time and money. Moreover, the exact result of FCNR(B) scheme of 2026 would be envisaged only after the maturity period has been completed.

8. Conclusion

This study shows that monetary policy is necessary to manage foreign investment and maintain economic stability in India during all times but additional measures need to be adopted by the central bank to address issues that may have arisen due to global uncertainty. The analysis of FPI flows and stock-market performance also shows that large foreign inflows can support the Nifty 50 and Sensex, while sudden outflows can increase pressure on financial markets and the Indian rupee.

The experience of India during earlier periods of financial stress, including the global financial crisis of 2008–09 and the FPI outflows of 2022, demonstrates that the RBI has generally focused on reducing excessive volatility rather than completely preventing foreign investors from withdrawing their money. The increasing role of domestic institutional investors and retail investment has also helped India absorb the negative impact of foreign investment outflows and reduce its dependence on foreign portfolio capital. This suggests that a strong domestic financial market is an essential part of India's ability to withstand external shocks, but it also means that the central bank has to be in a proactive mode in addressing geopolitical tensions. To counter the external impact of the current US-Iran conflict, which resulted in a huge outflow of foreign investment along with depreciation of the rupee, the central bank decided to adopt the FCNR(B) 2026 scheme to target the above problem. By encouraging non-residents to bring foreign currency into Indian banks and providing banks with access to predictable rupee liquidity, the measure helped strengthen foreign-exchange liquidity at a time when the rupee and Indian

financial markets were under great pressure. The scheme attracted exceptionally large inflows, reaching approximately USD\$127.2 billion between June 8 and August 31, 2026.

However, the success of the scheme also highlights an important trade-off. Large foreign-currency inflows can strengthen the banking system in the short term, but they also create future obligations and risks when these deposits mature in the future. Therefore, the FCNR(B) scheme should not be viewed simply as a solution to capital outflows, but as a temporary measure that involves both benefits and costs.

Overall, the findings suggest that India needs a balanced monetary-policy approach that protects financial stability without creating excessive risks for the future. The RBI's response should not only focus on attracting foreign capital during periods of crisis, but also on their strengthening their already growing domestic investment sector, maintaining price stability, and building investor confidence. The effectiveness of the 2026 FCNR(B) expansion can be truly judged only after the deposits reach maturity, which is also a key limitation of this study. Thus, while such monetary policy measures can reduce the immediate effects of geopolitical and financial shocks, India's long-term resilience will depend on maintaining strong domestic economic fundamentals, bilateral trade and a stable, credible financial system.

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