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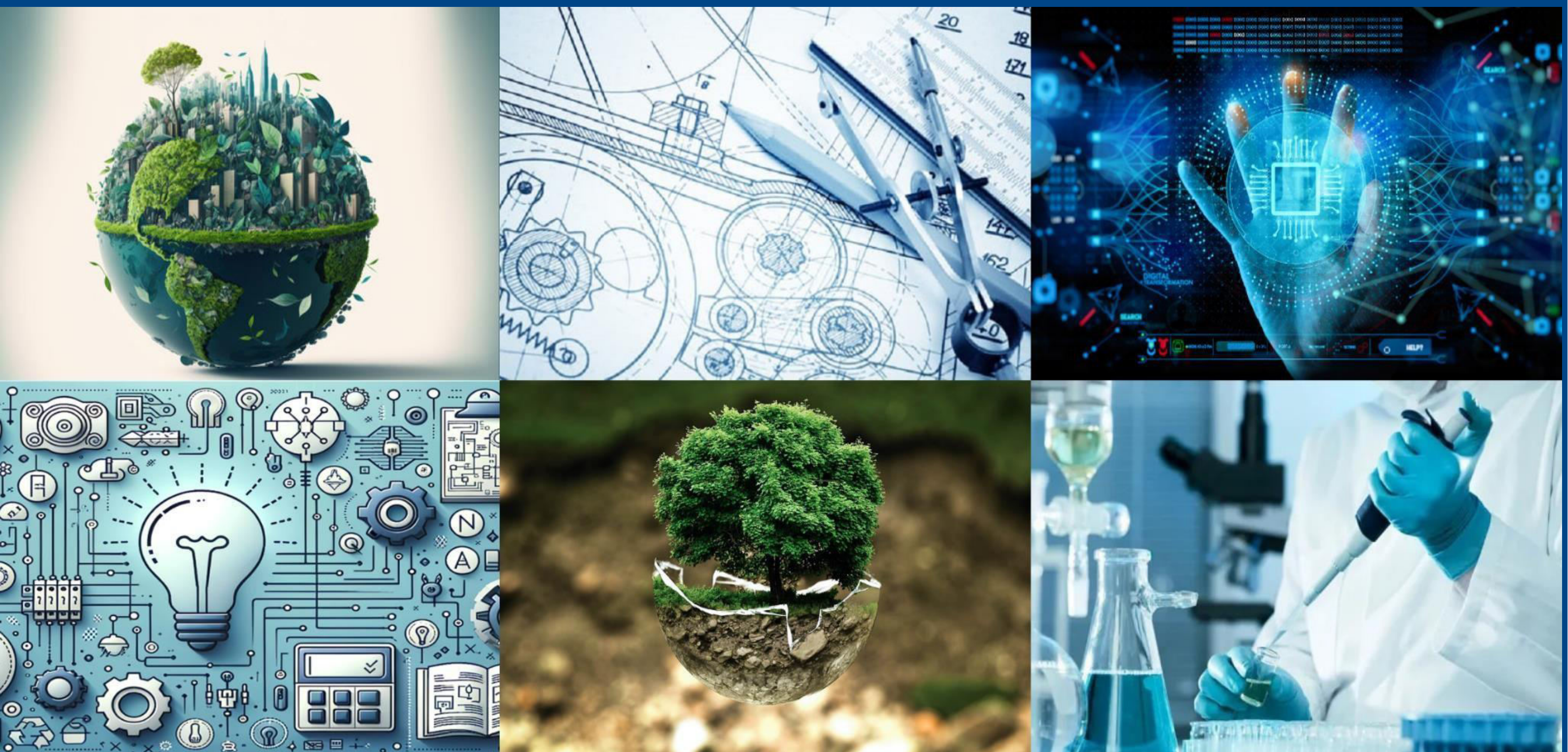

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Foreign Investment in Indian Government Bonds: A Study on Investor Behaviour and Returns

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ABSTRACT: India's government bond market is gaining the attention of foreign investors, thanks to the country's strong economic momentum and growing global interest in emerging markets. This study looks at how foreign investments moved in and out of the market from January to September 2025 and why.

Even though inflation stayed low and stable, investment flows were still quite volatile, often reacting to global events like oil price changes and currency shifts. The findings show that while India offers a solid investment environment, it remains closely tied to global ups and downs. This insight can help investors and policymakers make smarter, more resilient decisions going forward.

KEYWORDS: Foreign Portfolio Investment (FPI), Government Bond Yields, Inflation, Crude Oil Prices, Exchange Rate, India, Emerging Markets, Investor Behavior, Financial Stability, Market Volatility, Global Economic Trends

I. INTRODUCTION

Foreign investment in Indian government bonds has become an important dimension of India's integration with global financial markets. As one of the world's fastest-growing economies, India offers investors a unique mix of relatively high yields and a steadily liberalizing regulatory framework. While government bonds are traditionally considered low-risk instruments, the decision-making process for foreign investors is far more complex. Beyond yield considerations, factors such as currency fluctuations, sovereign credit ratings, fiscal policies, and global economic movements shape how international investors perceive and engage with Indian bonds.

Over the past decade, India has taken deliberate steps to attract more foreign participation in its sovereign debt market. Reforms like the Fully Accessible Route and the gradual easing of investment limits for foreign portfolio investors reflect this intent. Yet, challenges remain in the form of regulatory constraints, policy uncertainty, and market infrastructure that is still evolving. For foreign investors, these conditions create a distinct environment compared to other emerging and developed bond markets.

At the same time, investor behaviour in this space cannot be understood purely through economic fundamentals. Global uncertainty, policy signals from central banks, and shifts in market confidence play just as much of a role in shaping investment flows. Understanding how foreign investors balance risk and return, adapt to policy changes, and respond to international developments is therefore essential. This study seeks to fill that gap by exploring not only the trends and outcomes of foreign investment in Indian government bonds but also the underlying behaviour and strategies that drive such participation.

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II. REVIEW OF LITERATURE

Akram, T., & Das, A. (2019). *The long-run determinants of Indian government bond yields*. Asian Development Review, 36(1), 168–205.
This paper explores what drives Indian government bond yields over the long term, focusing on the role of short-term interest rates and fiscal indicators. It finds that short-term rates are the primary influence on long-term bond yields in India. Interestingly, government debt levels do not have a significant long-run impact on bond yields, offering useful insights for policymakers.

Mishra, R. K., Mahapatra, M. S., & Geeta, P. (2020). *Municipal bonds as an investment option among Indian investors*. South Asian Journal of Management, 27(2).
This study examines how Indian investors perceive municipal bonds as a tool for local infrastructure financing. Using survey data and PLS-SEM analysis, it finds that investor perception plays a key role in investment decisions. The paper highlights the potential of municipal bonds as a viable and innovative funding option for urban development.

Faniband, M., & Faniband, T. (2021). *Government bonds and stock market: Volatility spillover effect*. *Indian Journal of Research in Capital Markets, 8*(1–2), 61–71.
This study explored whether price movements in Indian government bonds and the stock market influence each other. Using 15 years of weekly data, it found no meaningful spillover or causal relationship between the two. The research reassures investors that bond and stock market volatilities in India mostly move independently.

Faniband, M. (2021). *Indian government bonds sensitivity to macroeconomic and non-macroeconomic factors: A quantile regression approach*. *Afro-Asian Journal of Finance and Accounting, 11*(5), 772–786.
This paper explores how different factors like GDP, inflation, interest rates, and policy uncertainty influence Indian government bond returns. Using data from 2010 to 2018, the study finds that economic growth and inflation generally support bond performance, while rising interest rates and uncertainty have a negative effect. These insights help investors understand how bonds behave under different market conditions, especially during times of economic stress.

Panigrahi, A., Sisodia, M., & Vachhani, K. (2022). *Impact of global and domestic economic variables on 10-year Indian government bond yield: An empirical study*. IUP Journal of Applied Finance, 28(2), 5–23.
This study examines how global factors like oil price shocks and US bond yields, alongside domestic monetary policy and inflation, affect the 10-year Indian government bond yield. Using advanced econometric models on data from 2001 to 2021, it finds monetary policy and inflation have significant long-term impacts. Global shocks also influence bond yields, with US bond movements closely linked to Indian yields over extended periods.

Azad, S., Devi, S. L. T., & Mishra, A. K. (2024). *Investing in our planet: Examining retail investors' preference for green bond investment*. Business Strategy and the Environment, 33(6), 5151–5173.
This study explores what influences Indian retail investors to choose green bonds, finding that personal attitudes and perceived control matter more than external factors like government policies. Investors value green bonds that perform well financially and environmentally, with issuer ratings and willingness to pay premiums shaping their views. The findings offer valuable insights for growing the green bond market and encouraging sustainable investments.

Suswaram, S., Satpathy, J., & Laza, S. (2024). *Behavioral finance in emerging markets: Towards an investor sentiment index for India and Argentine sovereign bonds*. SSRN. https://doi.org/10.2139/ssrn.5344005
This paper explores how investor sentiment, shaped by emotions and cognitive biases, impacts market behavior in emerging economies like India and Argentina. It highlights the role of AI tools like NLP and machine learning in analyzing sentiment to predict market movements. The authors propose developing an Investor Sentiment Index to help manage volatility in sovereign bond markets.

Sehgal, S., & Singh, J. (2025). *Impact of global and domestic factors on Indian government bond yields*. Asia-Pacific Financial Markets, 32(2), 465–488.
This study analyzes the long- and short-term effects of various global and domestic factors on Indian government bond yields across different maturities (5, 7, and 10 years) from 1999 to 2021. Key long-run drivers include interest rates, economic uncertainty, and oil prices, while short-run factors also involve inflation and government debt. The findings provide important insights for policymakers and investors to manage risks and optimize portfolio decisions.

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Research Gap

While there's a lot of research on foreign institutional investment in Indian stock markets and the factors influencing government bond yields, there isn't much focus on how foreign investors behave specifically when it comes to investing in Indian government bonds. Most studies look at broad economic factors like inflation and interest rates or focus on equity markets, but they don't dig into things like:

- What foreign investors actually trade and make decisions in the Indian government bond market.
- How foreign investors' returns and risks compare to domestic investors in these bonds.
- How government rules and limits on foreign investment in rupee-denominated bonds affect investor behaviour and the overall market.
- The role of investor emotions and sentiment especially using new tools like AI to analyse these feelings in influencing foreign investment in government bonds.
- What global events, like changes in oil prices or U.S. bond yields, impact foreign investment flows in Indian government bonds.
- Also, although some research looks at green bonds and retail investors, there's very little understanding of how foreign investors view newer options like green government bonds in India.

Exploring these areas could give us better insights into what drives foreign investors in the Indian government bond market and help policymakers create smarter strategies to attract and manage foreign investment effectively.

OBJECTIVES:

- To examine the key economic and policy factors influencing foreign investment in Indian government bonds.
- To analyse the investment behaviour and trading patterns of foreign investors in the Indian government bond market.
- To assess the impact of foreign investment on the returns and stability of the Indian government bond market.

III. RESEARCH METHODOLOGY

1. Research Approach: This study will mainly use numbers and data to understand how foreign investors behave in the Indian government bond market and how their investments affect bond returns. It will look both at the patterns in the data and the connections between investment and market performance.

2. Data Collection: We will use existing data from trusted sources like the Reserve Bank of India, SEBI, and other financial databases. This data will include information about how much foreign investors are putting into government bonds, bond prices and yields, and important economic factors like inflation and interest rates over the past 10 to 15 years.

3. What We Will Study: Our focus will be on Indian government bonds, covering both short-term and long-term bonds, and how foreign investments in these bonds have changed over time.

4. How We Will Analyse the Data:

- First, we will look at simple statistics to understand the general trends and behaviour of foreign investors.
- Then, we will use more detailed methods like regression analysis to explore what factors influence foreign investment and how these investments impact bond yields and returns.
- We may also study how the bond market reacted to key policy changes that affected foreign investors.

5. Tools for Analysis: We will use Microsoft excel to help analyse the data and create clear charts and graphs.

6. Limitations: Since the study depends on existing data, there might be some gaps or limits in the detail available. Also, global economic events outside our control may affect the bond market in ways we cannot fully measure.

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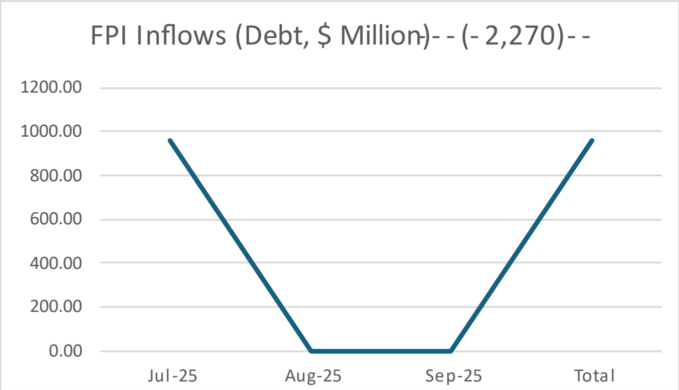
IV. DATA ANALYSIS

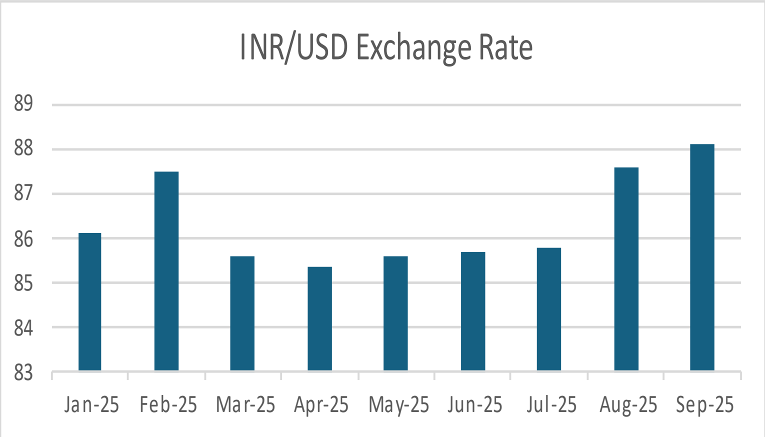
1.1 ECONOMIC INDICATORS 2025 (INDIA)

Month-Year	FPI Inflows (Debt, $ Million)	INR/USD Exchange Rate	CPI Inflation Rate (% YoY)	Brent Crude Oil Price ($/bbl)	10-Year Govt. Bond Yield (%)
Jan-25	-	86.12	-	75.74	-
Feb-25	-	87.49	-	71.53	-
Mar-25	-	85.6	-	71.87	6.7
Apr-25	(- 2,270)	85.34	-	59.55	6.33
May-25	-	85.59	-	61.46	-
Jun-25	-	85.68	2.10%	66.3	-
Jul-25	959.00	85.8	1.61%	70.36	6.35
Aug-25	-	87.61	2.07%	64.36	6.62
Sep-25	(-119.43)	88.11	-	64.28	6.48
AVERAGE	**-$443.95**	**86.2**	**1.93%**	**$67.14**	**6.44%**
MEDIAN	**-$119.43**	**85.8**	**2.07%**	**$66.30**	**6.48%**
MAXIMUM	**$959**	**88.11**	**2.10%**	**$75.74**	**6.70%**
MINIMUM	**-$2,270**	**85.34**	**1.61%**	**$59.55**	**6.33%**

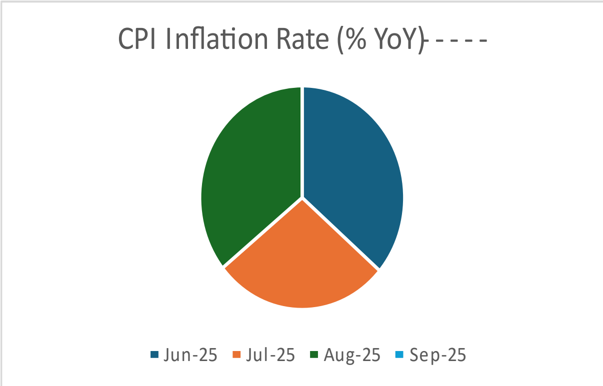
1.1 FPI INFLOWS



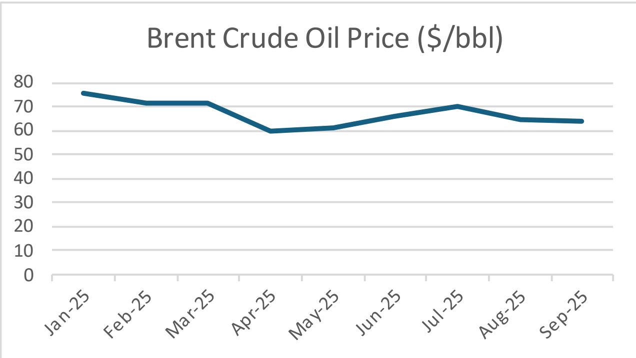
1.2 INR/USD EXCHANGE RATE



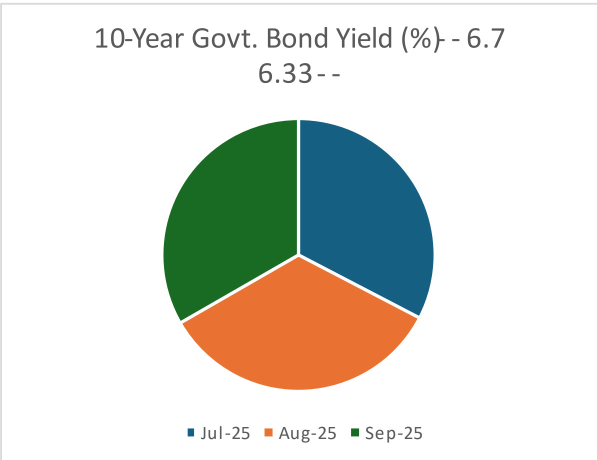
1.3 CPI INFLATION RATE



1.4 BRENT CRUDE OIL PRICE



1.5 GOVERNMENT BOND YIELD



V. FINDINGS

1. Foreign Investment Flows Remain Highly Volatile

Over the year, foreign portfolio investments (FPI) in Indian government bonds have been inconsistent, showing sharp swings. April saw a major outflow of $2.27 billion, followed by a modest recovery in July, and another decline in

September. Interestingly, this movement in FPI closely mirrors the pattern of the 10-year bond yield, which dropped sharply to 6.33% in April, only to rise again by August.

2. Inflation Has Been Comfortably Low and Stable

Perhaps the most reassuring trend is the consistently low inflation rate, which stayed around 2% for most of the observed months. This indicates that price levels are well under control, and the Reserve Bank of India (RBI) is doing a good job maintaining monetary stability.

3. Macro Relationships That Stand Out

- Bond Yields and Crude Oil Prices: There seems to be a link between oil prices and bond yields. In April, when oil prices fell to around $59.55 per barrel, bond yields also dropped. This is expected lower oil prices mean lower import bills, less inflationary pressure, and potentially lower interest rates, which translate into falling bond yields.
- FPI Outflows and Currency Depreciation: The months that saw foreign investors pulling out (April and September) also witnessed a weakening rupee, with the exchange rate moving from ₹85.34 per USD in April to ₹88.11 in September. This pattern suggests that capital flight leads to rupee depreciation, which can further deter investors creating a cycle of volatility.

What This Means for Policymakers & Investors

- For policymakers: The link between FPI movement and currency pressure calls for more stable and predictable policy frameworks. Transparent and investor-friendly reforms may help cushion against sudden outflows.
- For investors: Periods of low inflation and falling yields could be good opportunities to lock in longer-term bond investments. However, given the volatility in FPI flows and oil prices, it's important to stay alert to global developments that could shift market sentiment quickly.

VI. SUGGESTIONS

1. Improve Policy Clarity to Reassure Foreign Investors

One of the key things we noticed from the data is how foreign investment in Indian government bonds tends to swing up and down often reacting to uncertainty. When foreign investors are unsure about where the economy or policy is headed, they pull out quickly. This creates volatility in both bond yields and the rupee.

What can be one?

The government and RBI should continue working on clear, transparent communication about policy changes, borrowing plans, and interest rates. This kind of clarity builds trust especially with long-term investors.

2. Help Foreign Investors Manage Currency Risk

The data clearly shows a pattern when foreign portfolio investors (FPIs) pull out, the rupee tends to weaken. This suggests they're sensitive to currency risk. If the rupee loses value after they've invested, their returns take a hit.

What can be done?

India can offer more cost-effective ways for foreign investors to hedge their currency exposure. If they know their money is protected from sharp rupee swings, they're more likely to stay invested especially in long-term government bonds.

3. Keep an Eye on Crude Oil Prices and Inflation Trends

Another trend we saw is the connection between oil prices, inflation, and bond yields. When oil prices dropped, bond yields fell too probably because lower oil prices ease inflation, which in turn makes bonds more attractive.

What can be done?

Both policymakers and investors should treat oil prices and inflation as important signals. Including global commodity and inflation data in bond market outlooks can help everyone make better decisions.

4. Encourage More Domestic Investment in Bonds

If we rely too heavily on foreign investors, the bond market becomes more vulnerable to sudden changes in global sentiment. Encouraging large Indian institutions like pension funds and insurance companies to invest more in government bonds can provide a much-needed cushion.

What can be done?
Offering small incentives like tax breaks or risk-based benefits could encourage more domestic participation in the bond market, making it stronger and less prone to FPI-driven shocks.

5. Build a Public Dashboard for Better Market Transparency
Right now, getting all the relevant data (yields, inflation, oil prices, FPI flows, etc.) requires checking different sources. A centralized dashboard showing real-time economic indicators would help investors especially retail and smaller institutions make more informed decisions.

What can be done?
A partnership between RBI, SEBI, and market data providers could make this a reality. A real-time dashboard would be a simple but powerful tool to increase transparency and investor confidence.

VII. CONCLUSION

This study set out to understand what drives foreign investment in Indian government bonds and how this investment is influenced by domestic and global economic factors. The analysis reveals that while interest rates and inflation are important, foreign investors are also highly responsive to broader signals such as currency movements and shifts in global oil prices.

In particular, significant FPI outflows during April and September 2025 coincided with depreciation of the Indian Rupee and changes in investor sentiment. At the same time, a consistent and low inflation rate offered some level of stability, making the bond market more attractive for investors who value real returns.

These findings suggest that foreign investors are cautious and reactive, often shifting their positions based on short-term market signals. While this is expected in globally connected markets, it also highlights the need for India to strengthen its domestic investor base to reduce reliance on foreign capital. A strong and active domestic bond market can provide a buffer during times of global volatility.

To support a more stable investment environment, it is essential that Indian policymakers focus on maintaining macroeconomic stability, improving transparency, and encouraging predictable economic policies. Strengthening communication with investors and offering tools for better risk management can also improve confidence in the Indian bond market.

In summary, while India's bond market has shown resilience and potential, there is still work to be done to make it more robust, less reactive to external shocks, and more attractive to long-term investors.

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