

India Insights

Strong buffers and broader opportunities

October 2026

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Market spotlight: From external pressure to stronger buffers

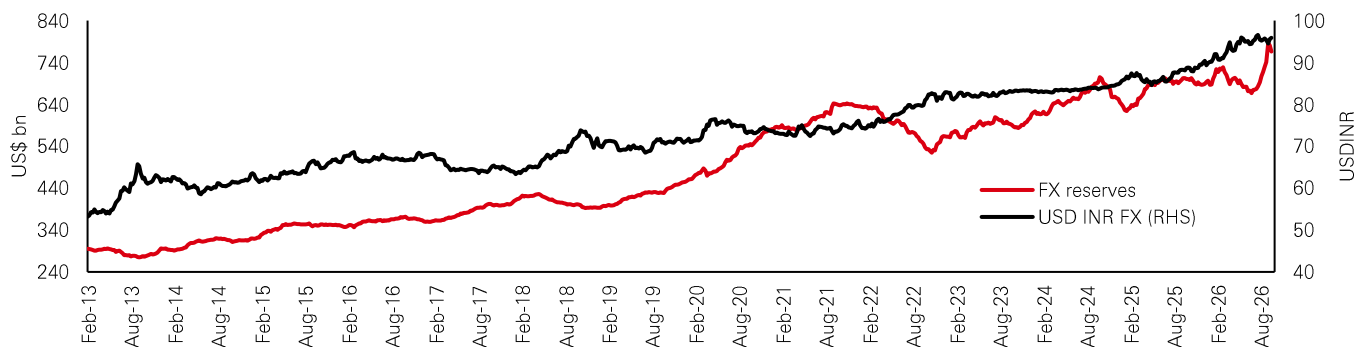
India's economy has faced a number of external threats, ranging from higher oil prices to tighter global financial conditions. However, it has absorbed these shocks much better than expected, supported by stronger foreign currency inflows and a more stable current account, while policy measures have strengthened the buffer against further volatility.

To illustrate India's resilience, real GDP expanded 7.8% year-on-year in the three months to June 2026, ahead of the 7.4% market expectation and the RBI's 7.0% forecast. Investment was particularly strong, with gross fixed capital formation rising around 12%, while net exports also made a meaningful contribution. This points to a broader growth mix rather than one dependent on consumption alone.

A second source of resilience has come from foreign currency funding. Measures introduced by RBI on 8 June improved the economics of Foreign Currency Non-Resident (Bank), or FCNR(B), deposits for non-resident Indians, including through attractive hedged returns. This prompted an unusually strong response with around US\$133 billion flowing through FCNR(B) deposits by end-August, taking total FCNR(B), external commercial borrowings (ECBs) and other foreign currency borrowing to US\$143.5 billion.

Those inflows have helped rebuild foreign exchange reserves to US\$780 billion by mid-September, from US\$671.6 billion around the June policy announcement window. That does not necessarily imply sustained rupee appreciation, as elevated oil prices and global rates remain significant headwinds. Instead, the larger reserve buffer reduces the risk that renewed external pressure turns into a disorderly currency adjustment.

India's FX reserves versus the USD/INR spot rate



Source: Bloomberg, Reserve Bank of India, HSBC Asset Management, September 2026.

The improvement is also broader than reserve accumulation alone. India's resilient services exports and remittances continue to offset part of the goods deficit, giving the current account a more stable foundation. The policy challenge is therefore changing. Earlier in the year, attention centred on external vulnerability. Now, resilient growth and stronger capital inflows are creating a different set of questions around domestic liquidity and inflation. That transition carries directly into markets. For equities, stronger fundamentals are beginning to show through in earnings and foreign flows. While for fixed income, these inflows strengthened India's external position but created substantial surplus liquidity for the RBI to absorb.

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India equities

Fundamentals are beginning to catch up

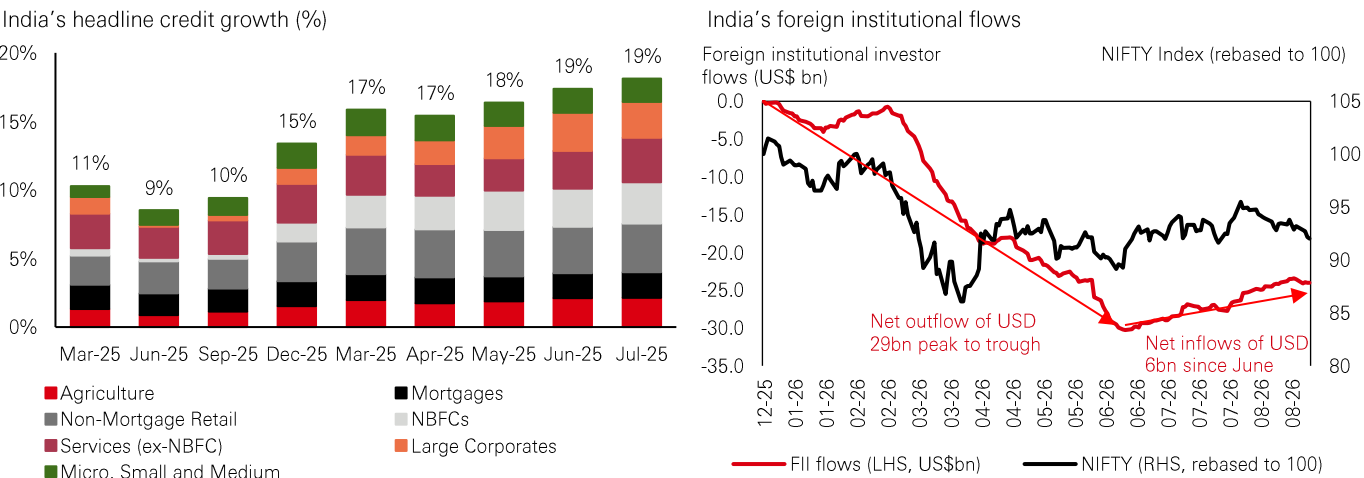
The stronger macro foundation is increasingly visible in Indian equities. The first half of 2026 was difficult as global investors favoured AI-heavy markets, while higher energy prices and rupee weakness added to the pressure. More recently, however, market leadership has started to broaden, allowing India's more domestically driven earnings story to come back into focus.

Corporate results provide the clearest evidence of that improvement. Revenue growth among NIFTY companies in the latest reporting season was the strongest in ten quarters, while earnings growth of around 19% came in meaningfully ahead of expectations. The recovery is also becoming broader across sectors rather than being driven by one narrow area of the market.

Domestic conditions remain supportive. Headline credit growth has reached around 19%, a two year high, while auto sales and other high frequency indicators remain firm. That strength feeds directly to company revenues and earnings as financials benefit from stronger activity and loan demand, while consumer discretionary and real estate are more exposed to improving domestic spending. Continued investment also supports industrial and infrastructure businesses.



India's equity story is shifting from recovery to a broader, domestically driven growth cycle

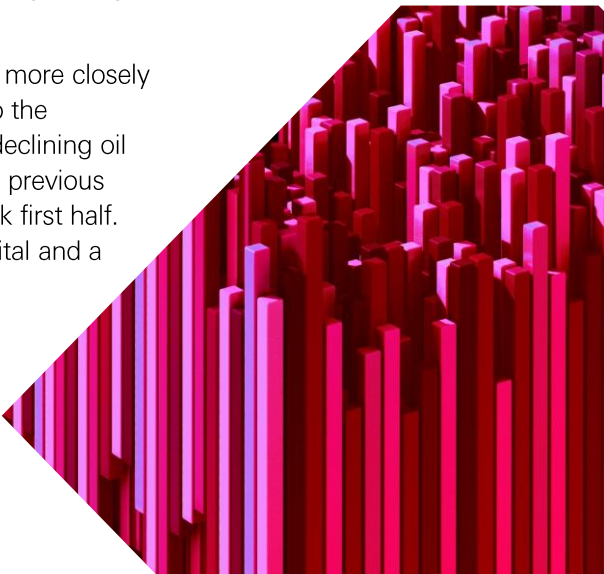


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Source: RBI, CEIC, Goldman Sachs Research. September 2026. Note: NBFC stands for non-banking financial companies.

Foreign flows are beginning to respond as well. After around US\$29 billion of peak-to-trough outflows during the first half of the year, foreign institutional investors have bought more than US\$6 billion of Indian equities since mid-June. India also remains relatively under-owned across many active global portfolios, leaving room for further participation if risk appetite stabilises.

This gives India a different role within emerging markets. Its earnings are more closely linked to domestic consumption, investment and financial activity than to the semiconductor led AI capex cycle that dominates part of North Asia. Its declining oil intensity also makes the economy less sensitive to energy shocks than in previous cycles. The equity story is therefore moving beyond recovery from a weak first half. The next test is whether stronger domestic activity, returning foreign capital and a broader earnings cycle can reinforce one another.

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India fixed income

Managing abundance rather than scarcity

Foreign currency inflows have strengthened India’s external position, but converting those dollars into rupees has also injected substantial liquidity into the banking system. The surplus reached a record INR11.6 trillion in early September and, despite RBI’s absorption measures, tax payments and FX intervention bringing the surplus down to around INR7.4 trillion, liquidity remains exceptionally high.

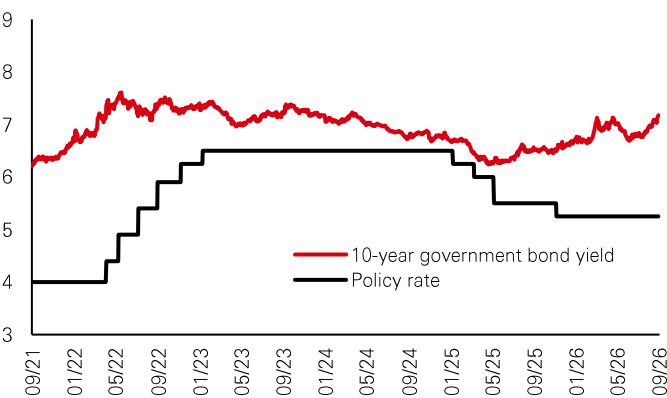
The RBI has responded by broadening its absorption operations beyond shorter term reverse repos. These measures include open market bond sales and sell/buy foreign exchange swaps, where RBI temporarily absorbs rupees in exchange for foreign currency and reverses the transaction at a later date. The aim is to manage excess cash in the banking system without relying solely on changes in the policy rate.

Inflation is making that liquidity management more important. Headline CPI accelerated to 4.8% year-on-year in August, from 4.4% in July, while core inflation reached around 4.2%. Price pressures are also appearing across a wider range of categories.

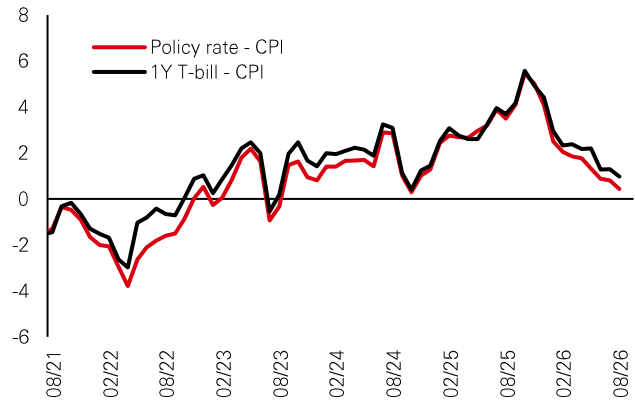
Oil remains the main external risk. Sensitivity analysis suggests that a 10% increase in oil prices could add roughly 0.3 percentage points to CPI. An extended energy shock could therefore complicate liquidity management even while underlying domestic growth remains healthy.

Strong growth and abundant liquidity do not automatically translate into aggressive tightening, but the policy balance has shifted. Earlier in the year, contained inflation gave the RBI greater room to support activity. The focus now is on withdrawing sufficient surplus liquidity to prevent easier financial conditions from reinforcing broader price pressures.

10-year government bond yields versus policy rate



Real rates are positive

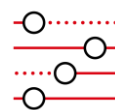


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Source: HSBC Asset Management, Bloomberg, RBI. Data as of September 2026.

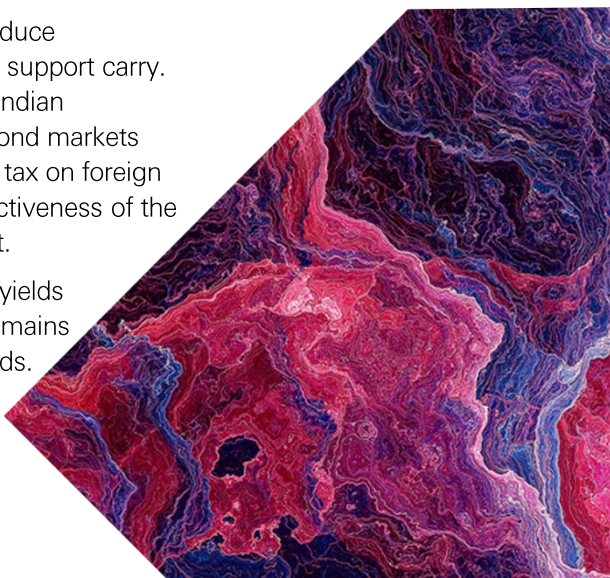
For bond investors, stronger reserves and a healthier external position reduce vulnerability to global shocks, while attractive nominal yields continue to support carry. Real rates also remain positive, strengthening the income argument for Indian government bonds. Their historically low correlation with major global bond markets adds an additional source of diversification. Furthermore, the removal of tax on foreign investment in Indian government bonds has improved the after-tax attractiveness of the market for offshore investors, adding another potential source of support.

At the same time, liquidity withdrawal, firmer inflation and higher global yields make the duration case less straightforward. The preference therefore remains for carry with selective duration, rather than relying on a broad fall in yields.

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India offers bond investors carry and diversification, while selective duration remains preferable



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