

India equity: a diversification route beyond the crowded AI theme

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India equities: potential for a turnaround as market leadership broadens

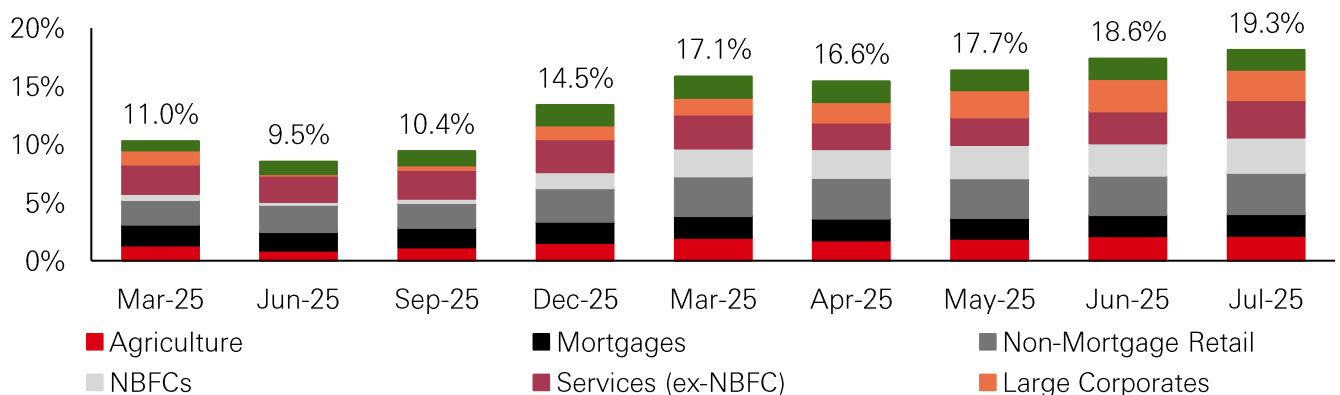
Indian equities had a difficult first half of 2026. Foreign participation was muted, reflecting the perception that India isn't a direct beneficiary of the "AI trade". At the same time, energy costs rose sharply and the Indian rupee weakened. Together, these factors drove one of the weakest half-year performances in recent memory—comparable in scale to the sell-offs seen during the 2008 Global Financial Crisis and the initial Covid-19 shock.

In the third quarter of 2026, however, the market narrative has started to shift. The sharp swings in AI-exposed assets that dominated the first half of the year are increasingly giving way to broader market leadership, as investors rotate away from a narrow group of AI winners and diversify their exposure. Against that backdrop, **Indian equities have quietly begun to outperform.** Earnings momentum is improving, macro and high-frequency indicators are firming, and foreign inflows are showing early signs of turning.

The main takeaway is that growth has remained more resilient than many expected, underpinned by policy support, sustained strong credit growth, and a structurally lower oil intensity than in previous cycles (Fig.1 & 2). Meanwhile, earnings momentum is picking up again, with both revenues and profits surprising to the upside. Positioning and flows are also becoming more constructive: inflows are turning while India remains under-owned relative to its index weight, creating scope for meaningful marginal inflows if broader risk sentiment stabilises. Finally, a steadier INR reduces the hurdle rate for global investors by limiting currency drag on USD-based returns.

Fig 1: India's headline credit growth reaches a two-year high, led by NBFCs

Headline credit growth



NBFC stands for non-banking financial companies. Source: RBI, CEIC, Goldman Sachs Research, data as of July 2026

Source: HSBC Asset Management, August 2026.

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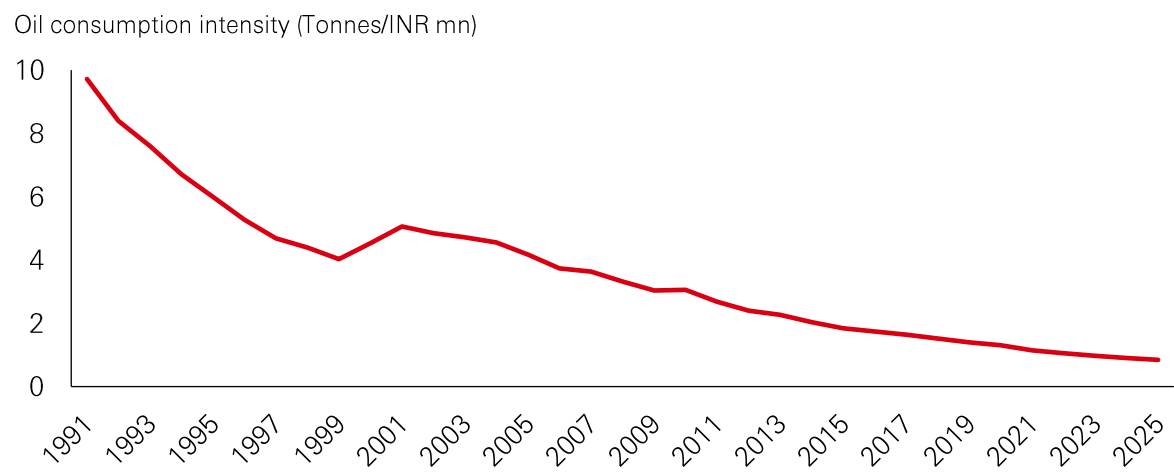
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Solid fundamentals despite the Middle East conflict

Growth resilience: reforms and policy support are showing through. Despite the energy price shock that followed the Middle East conflict in 1Q 2026, India’s GDP growth in 2Q 2026 printed at 7.8% year-on-year, materially above expectations, with broad-based contributions from investment, exports and consumption. That outcome reinforces the view that India’s growth engine is proving relatively resilient, helped by a mix of near-term policy support and longer-running reform dividends that are increasingly visible in macro outcomes.

A key structural differentiator is India’s steadily declining oil intensity over the past three decades. Energy efficiency gains, greater electrification and a gradual shift towards less energy-intensive growth have reduced the economy’s sensitivity to oil price spikes, lowering the probability that an external energy shock translates into a prolonged domestic slowdown. In practical terms, this means the hurdle for an oil-driven growth scare is higher than it used to be, and periods of volatility may be more likely to create short-lived dislocations than lasting damage—particularly if reforms continue to lift productivity and policy remains oriented towards sustaining investment and domestic demand.

Fig 2: India’s oil consumption intensity has declined over time



Source: CEIC, Goldman Sachs Research, data as of December 2025

Fiscal policy has also been supportive. Income tax cuts and GST rate rationalisation implemented through 2025 were designed to raise household disposable incomes and strengthen consumption. These measures were complemented by fuel excise duty reductions and limited pass-through of higher energy prices, helping to cushion consumers. Demand has been further reinforced by robust government and public-sector capex, alongside bank credit growth of around 19%—a two-year high—which is providing a meaningful tailwind to domestic activity.

Impact from monetary policy easing in 2025 is now showing up in the credit channel, with headline credit growth reaching a two-year high (Fig. 1). In addition to cutting rates by a cumulative 125bp in 2025, the Reserve Bank of India (RBI) introduced a broad set of regulatory relaxations aimed at lowering funding costs and easing banks’ capital constraints. Together, these measures are supporting credit creation and real economic activity. Importantly, inflation also appears contained despite higher commodity prices: headline inflation was 4.4% in July—within the RBI’s target range—while core inflation remains moderate, giving policymakers room to prioritise growth without reopening inflation concerns.

Earnings are increasingly reflecting this macro improvement. NIFTY companies revenue growth in the latest reporting season (2Q 2026) was the strongest in 10 quarters while earnings growth of ~19% came in meaningfully above expectations. High-frequency indicators, including credit demand and auto sales, continue to point to sustained momentum, reinforcing the case that the recovery is broadening rather than narrowing.

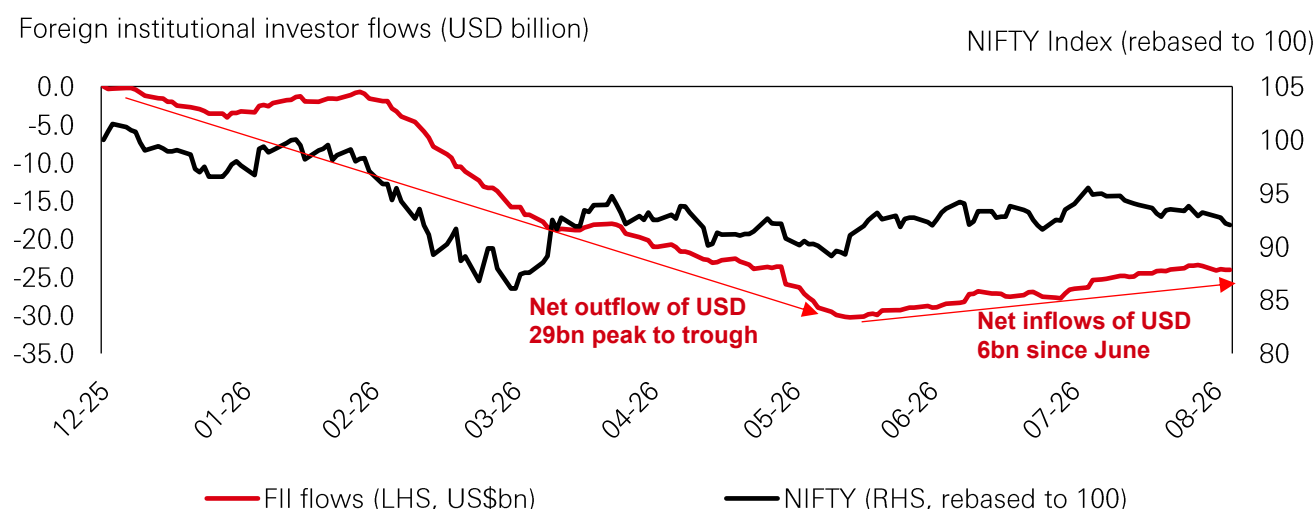
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Foreign flows starting to turn

Flows are turning from de-risking to reallocation. With much of the recent AI-related de-risking already absorbed, investor attention is gradually shifting beyond a narrow set of US-led themes. India remains under-owned across many active global funds, so if broader risk sentiment stabilises, even modest reallocations could translate into meaningful marginal inflows—supporting market liquidity and, potentially, relative performance. Early evidence is emerging: foreign institutional investors (FIIs) have turned net buyers since mid-June, with more than USD 6 billion of net inflows, compared with ~USD 29 billion peak-to-trough net outflows in 1H 2026. In addition, Foreign Currency Non-Resident Bank (FCNR (B)) inflows have surprised to the upside, materially boosting FX reserves, reducing external vulnerability and supporting the banking system's capacity to fund ongoing credit growth. A steadier rupee is also meaningful for global allocators, as it reduces currency drag on USD-based returns and lowers the hurdle rate for overseas investors—broadening participation beyond index heavyweights.

Under-owned EM opportunity: diversification with improving fundamentals. Geopolitics and US Fed policy remain key swing factors, but in an environment where volatility in AI-exposed sectors and markets remains elevated, Indian equities are looking more attractive for investors seeking diversification and long-term compounding. The mix is supportive: improving macro tailwinds and fundamentals provide an anchor, while strong domestic equity flows and inflecting foreign inflows add incremental support. In our view, the macro impulse remains constructive for positioning in Indian financials, real estate and consumer discretionary, where improving activity, credit dynamics and demand trends are likely to be most visible.

Fig 3: Foreign institutional inflows have started to return since mid-June



Contributing author



Beth Wong

Senior Investment Specialist, Asian equities

Source: HSBC Asset Management, as of September 2026.

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