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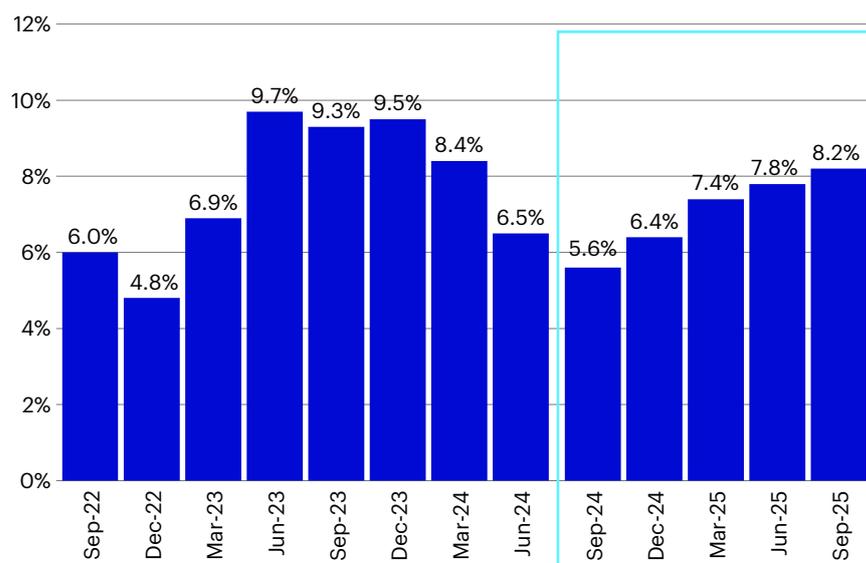
Key takeaways

- India’s macro fundamentals remain resilient, with steady GDP growth rate and supportive Reserve Bank of India (RBI) monetary policy following five rate cuts.
- Trade breakthroughs, including the India-US deal cutting tariffs to 18% and new agreements with the EU and UK, restore competitiveness and expand export markets.
- Valuations have corrected recently and earnings growth is expected at 16%, positioning banking, telecoms, and data centers as preferred sectors for 2026.

Backdrop: A Difficult 2025

Indian equities had a disappointing 2025. Foreign investors withdrew nearly US \$17 billion¹, reflecting concerns about tariffs, relative positioning, and earnings growth. Yet the macroeconomic picture remained resilient. GDP growth held steady at around 6.5%² in FY25, defying fears of an export slowdown.

Figure 1 - India’s quarterly GDP growth



Source: CEIC, UBS, data as of December 2025.

1. India races to reform financial sector as foreigners pull \$17 billion, Reuters, October 2025
2. India’s FY25 economic growth hits four-year low of 6.5%, Q4 GDP hits one-year high, The Economic Times, May 2025

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The real surprise was disinflation. CPI inflation reached a low of 0.71% in November from 4.26% in January, a level not seen in decades.³ Nominal growth tracked real growth closely as the deflator shrank. With inflation so weak, the Reserve Bank of India cut interest rates five times, moving from tight liquidity conditions to an accommodative stance and easing regulatory forbearance to encourage lending.

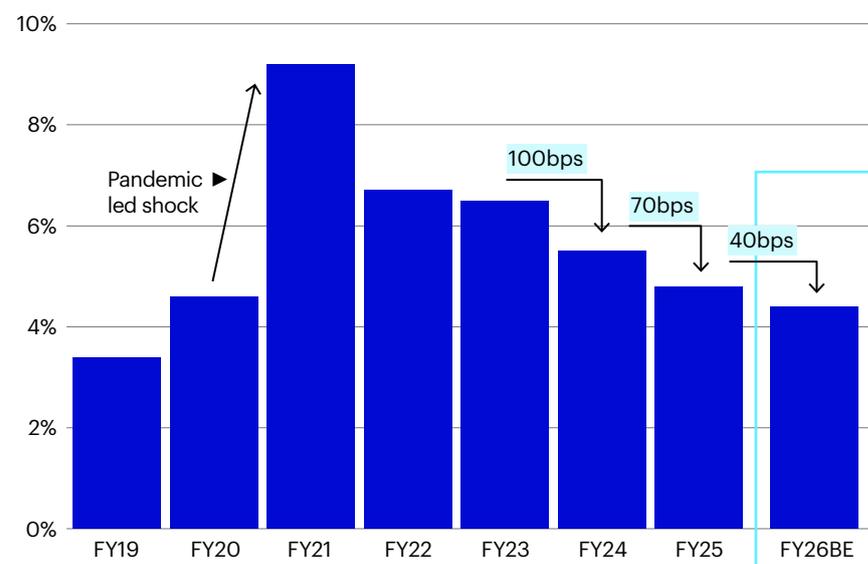
Policy response: Reviving growth momentum

Government policy has focused on boosting manufacturing through capital expenditure in recent years, which grew at around a 15% CAGR between 2021 and 2024.⁴ Last year, however, the government moderated capex growth to a medium-term CAGR of close to 8 to 10%⁵ and introduced meaningful consumption incentives. Direct tax cuts and GST rationalization were announced, with the September 2025 GST reforms marking a significant step.

The effects of these measures are beginning to show. Monthly automotive sales have improved, while banking demand is rising as households and businesses take on more loans. Rural demand has also been targeted through specific schemes, reflecting the government's recognition that rural consumption needs reinforcement.

The Union Budget of 2026 will reinforce this two-phase strategy. After focusing on tax-led consumption last year, the government returned to capex and reform this year. Fiscal consolidation remains intact, with the deficit at 4.3% of GDP compared to 4.4% previously,⁶ and a clear glide path toward reducing debt-to-GDP to about 50% by FY31.⁷ The current debt-to-GDP ratio of 56.1% is expected to fall by 40 basis points next year, underscoring India's commitment to fiscal discipline.⁸

Figure 2 – Fiscal drag to ease (as % of GDP)



Source: Budget documents, RBI, UBS, data as of February 1, 2026.

The budget also emphasized manufacturing incentives across power, renewables, defence, aerospace, semiconductors, EMS (electronics manufacturing services), and pharmaceuticals (particularly contract development and manufacturing organizations, CDMOs). A landmark policy for data centers—a 22-year tax holiday until 2047⁹ underscores India's ambition to capture global investment flows in digital infrastructure.

3. 2025: A Defining Year for India's Growth, India's Goldilocks Moment: High Growth, Low Inflation, December 2025

4. Capex slowdown masks strong pockets in power, defence, and data centres: Jefferies, CNBC, September 2025

5. Ibid

6. Union budget 2026-27 - balancing fiscal discipline with fostering structural growth, UBS Global Research, February 2026

7. Ecoview: What to Expect from Budget F2027, Morgan Stanley Research, January 2026

8. Ibid

9. India Unveils 20-Year Tax Break to Woo Global Data Centers, Bloomberg, February 2026

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Trade breakthroughs: Tariff relief and market access

Tariff-related uncertainty was one of the biggest headwinds in 2025. The US had imposed punitive tariffs of 26%, later raised to 50%, linked to India’s purchase of Russian crude.¹⁰ This was among the highest globally and weighed heavily on exports.

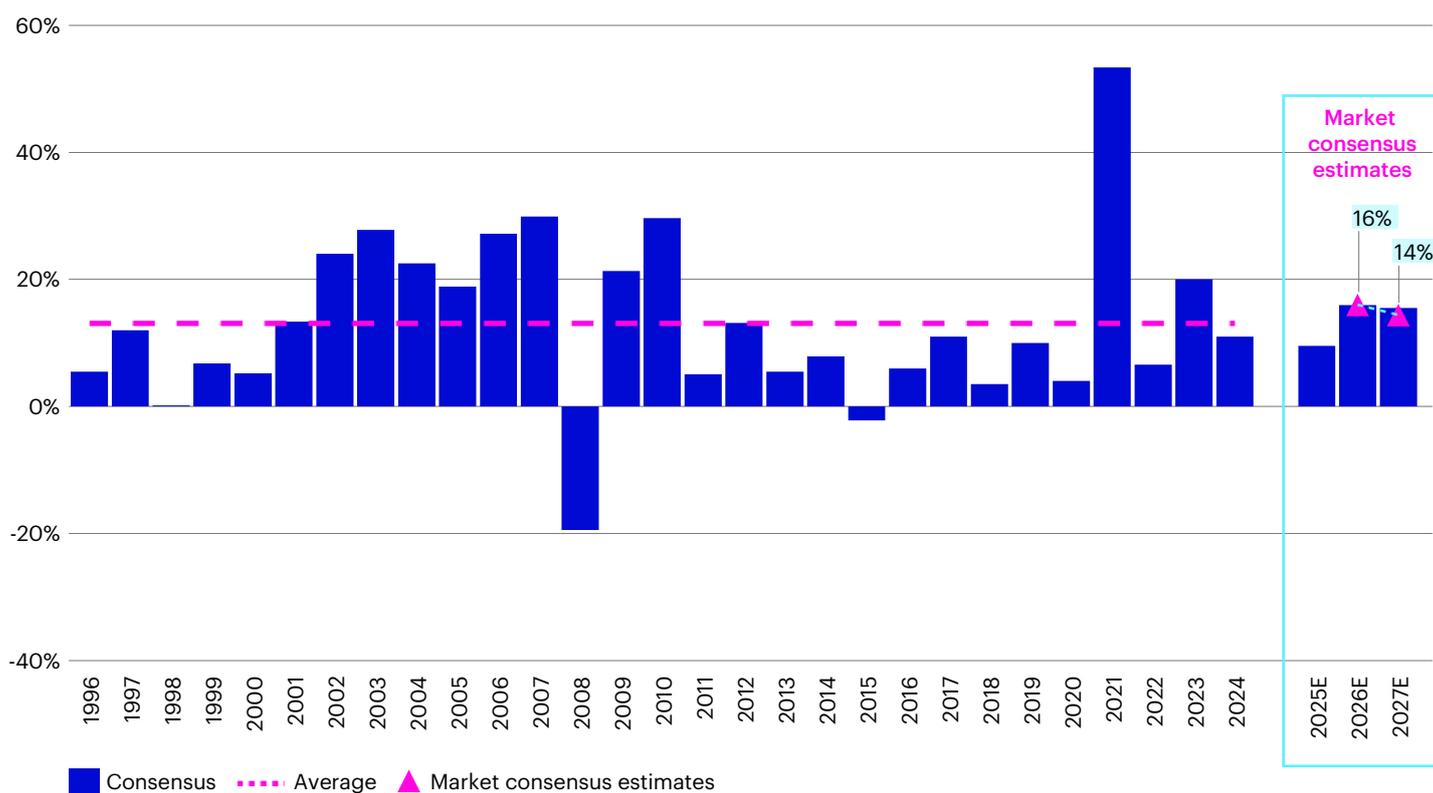
In early 2026, however, the India-US trade deal was announced, reducing tariffs to 18% and removing the punitive surcharge entirely.¹¹ This positions India favorably compared to peers such as Vietnam and Malaysia, where U.S. tariffs remain higher. Indian exporters in textiles, leather goods, gems, and other sectors stand to benefit directly.

India also signed agreements with New Zealand, Oman, the UK, and the EU. The EU deal, expected to be ratified in early 2027, could be transformative across multiple industries. These agreements expand India’s market access and provide a structural tailwind for exports over the next decade.

Outlook for 2026

Valuations have corrected recently. With earnings growth expected to normalize at 16% in 2026 and limited risk of downgrades, Indian equities appear attractively positioned for a rebound. This combination of low valuations and improving earnings visibility provides a supportive backdrop for investors.

Figure 3 – MSCI India EPS growth (% YoY)



Source: FactSet, I/B/E/S, MSCI, Goldman Sachs Global Investment Research, data as of February 6, 2026.

10. US tariffs on India reset to 15% after Supreme Court ruling, Economic Times, February 2026

11. India-US trade deal slashes tariffs; seen lifting exports, market sentiment, Reuters, February 2026

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Sector picks and pans

The banking and financial sector is poised to benefit from RBI's easing stance, stronger loan growth, and reasonable valuations. Consumption discretionary sectors such as autos, hospitality, and weddings are seeing momentum from tax-driven spending. Manufacturing and industrials—including renewables, autos, railways, defence, pharma (CDMO), semiconductors, and EMS—are supported by government incentives and robust demand. Telecom and data centers stand out as structural growth stories, with tariff hikes and digital infrastructure demand providing strong tailwinds.

On the other hand, IT services face tepid growth due to weak US client demand, while global cyclicals such as energy, utilities, and metals remain subdued amid benign crude prices. Generics in pharma also face challenges, though domestic hospitals and CDMO opportunities show selective potential.

Potential headwinds

Geopolitical uncertainty remains a significant risk, particularly in an evolving global trade and security environment. Bond market pressures have emerged, with higher gross borrowing figures pushing 10-year yields up slightly. Inflation is expected to rise modestly this year, and while borrowing costs may increase, they are unlikely to pose a major threat to corporate margins. Currency dynamics will remain critical, but overall external balances appear manageable.

Conclusion

After a disappointing 2025, Indian equities enter 2026 with a more constructive outlook. Government reforms, trade breakthroughs, and attractive valuations set the stage for recovery. While IT and global cyclicals remain areas of caution, domestic sectors—banking, consumption, manufacturing, and telecoms—are positioned to lead growth. With earnings expected to expand by and policy tailwinds in place, we believe India's equity markets are well placed to regain momentum in 2026.

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Investment risks

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