2026 Midyear Investment Outlook – India Equities

July 2026

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Key takeaways

— India equities faced volatility in the first half of 2026, but stabilizing global sentiment and lower oil prices are improving the outlook.

— A resilient macro backdrop, supportive policy measures and strong domestic investor participation continue to underpin India's long-term growth story.

— Improved valuations, earnings recovery and structural opportunities in areas such as digitalization, consumption, manufacturing and data centers may create more attractive opportunities for long-term investors.

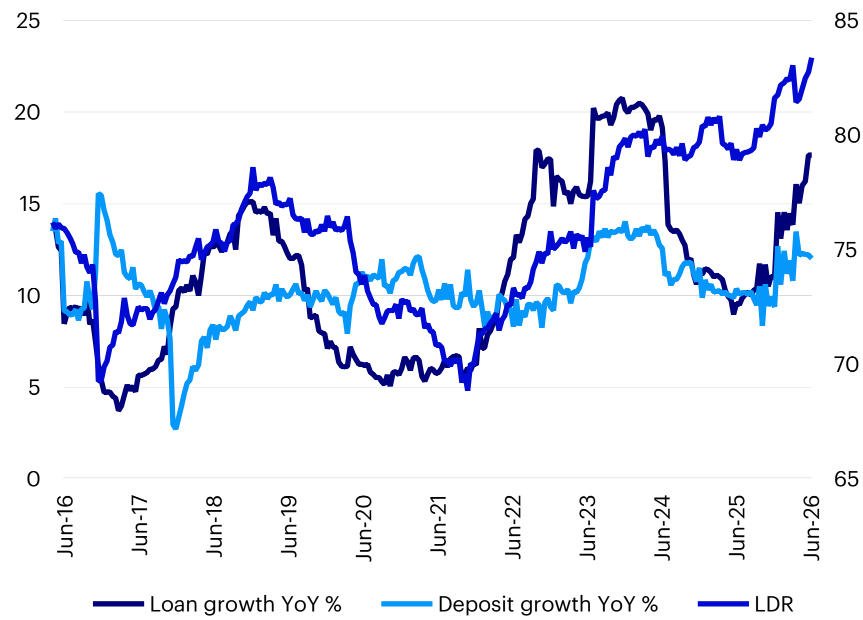
External market volatility starts stabilizing
India equities were volatile in the first half of 2026 amid softer global risk appetite, foreign outflows and heightened geopolitical uncertainty. More recently, however, conditions have begun to normalize. Geopolitical risks, particularly in the Middle East are increasingly perceived as moderating, contributing to an improvement in global sentiment alongside a decline in oil prices. As a net energy importer, India stands to benefit from lower oil prices, which can help ease inflationary pressures and support external balances.

Despite external volatility, domestic investor participation has continued to provide a stabilizing anchor, helping cushion the market against global risk-off sentiment and foreign outflows year-to-date.

Resilient macro backdrop and policy support
India's macro environment remains resilient, supported by solid underlying economic strength and continued policy support. While the Reserve Bank of India (RBI) has guided for a modest moderation in growth relative to 2025, GDP is still expected to remain robust at around 6.6% in 2026-27[1], comparing favourably with other emerging markets. High-frequency indicators further reinforce this constructive backdrop. Credit growth has remained robust, expanding by approximately 16% year-on-year in FY2026[2] while stable manufacturing and services PMI (Purchasing Manager's Index) readings continue to signal resilience across both consumption and business activity.

1. Economic Times, June 5, 2026
2. Ministry of Finance, 5 May 2026

Figure 1: System loans and deposits YoY growth (%)



Source: Bank of America, data as of 15 June 2026.

In terms of monetary policy, the RBI kept the repo rate unchanged at 5.25% but introduced a broad package of measures to support the Indian rupee and attract foreign capital inflows, including incentives for NRI (Non-Resident Indian) deposits, measures to encourage foreign investment into government bonds, expanded access to government securities, and steps to accelerate export-related FX inflows, helping strengthen external balances and investor confidence. The RBI raised its inflation forecast to 5.1% while lowering growth expectations to 6.6%, reflecting energy cost volatility and potential inflationary pressures.

At the same time, structural policy reforms and multi-year development priorities continue to underpin the country's long term growth outlook. The Union Budget for FY2026–27 maintains a growth-supportive stance, with a sustained focus on infrastructure investment, manufacturing expansion and supply-side improvements. Continued public capital expenditure is expected to crowd in private investment, strengthen productive capacity and support job creation, which in turn reinforces domestic demand.

We believe measures aimed at enhancing manufacturing competitiveness and supporting small and medium enterprises should further deepen the industrial base and improve long-term growth potential. Supportive financial measures, including Foreign Currency Non-Resident (FCNR) deposit policies, are also likely to continue attracting stable foreign currency inflows, helping strengthen external balances and enhance macroeconomic resilience. These inflows may also help provide currency stability and buffer against periods of external volatility, particularly in an environment of uneven global capital flows.

Earnings recovery and improved valuation support outlook
From a market perspective, the recent consolidation has improved the valuation backdrop, resulting in a more balanced risk-reward profile for long-term investors. Earnings growth is expected to normalise to around 16% in 2026[3], while earnings momentum remains broadly stable with consensus forecasting profit growth of roughly 4% quarter-on-quarter[4].

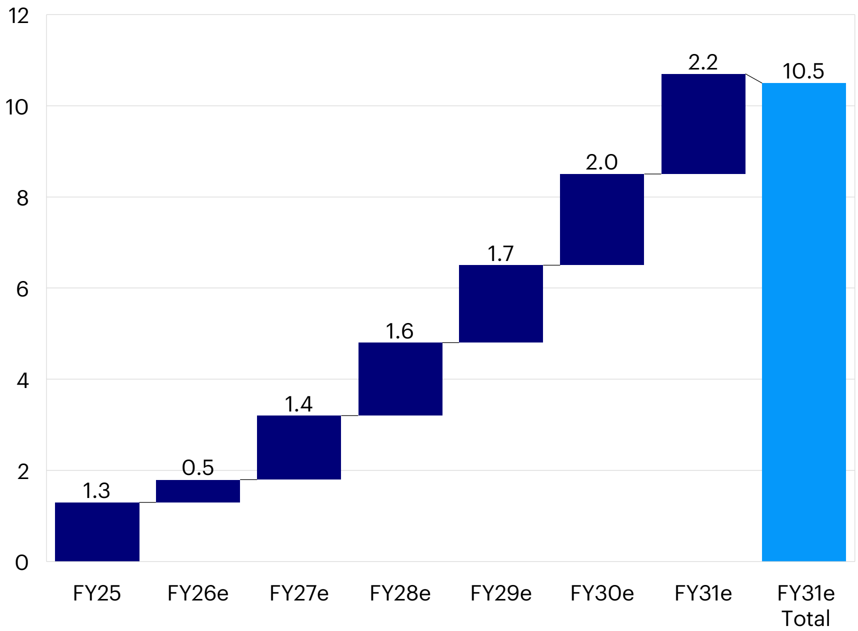
Importantly, earnings visibility remains relatively strong in domestically oriented sectors, supported by resilient demand conditions and stable margin profiles. This could provide a degree of support to broader market performance even as global uncertainties persist.

Market outlook for the second half
Looking ahead, Indian equities are likely to remain sensitive to global developments and cross-border flows, although we've recently seen that market conditions have begun to stabilize. In this environment, we continue to favour companies with sustainable long-term growth prospects, strong pricing power and resilient business models that can navigate input cost pressures while protecting margins.

We continue to favour three structural drivers that we believe could sustain India's long-term growth trajectory: financial transformation through digitalization and deeper capital markets, resilient domestic consumption supported by favourable demographics and rising incomes, and a manufacturing renaissance driven by government incentives and global supply-chain diversification.

In terms of sectors, we see growth potential in data centers. India's data center capacity is expected to grow rapidly, from 1.3 GW in FY2025 to 10.5 GW in FY2031[5], driven by data localization requirements, 5G adoption, cloud computing, and accelerating AI demand (Figure 2). Over US$30 billion of investment is expected to flow into India's data center ecosystem by 2030, supported by hyperscalers, institutional capital, and government initiatives to build the digital backbone of India's trillion-dollar digital economy.[6]

Figure 2: India data center capacity expected to step up to 10.5GW by F31e



Source: Morgan Stanley Research estimates, data as of May 31, 2026. Estimates are subject to change, and are not guarantees of future results.

3. HSBC, 8 April 2026
4. Ibid.
5. Morgan Stanley estimates, May 2026
6. KPMG India, December 2025

Risks to monitor

That said, volatility may re-emerge intermittently. A renewed bout of global risk aversion, whether driven by geopolitics, shifts in global growth expectations or tighter financial conditions, could weigh on sentiment and revive foreign outflows, which have already been an influence on near term market moves. In particular, a renewed rise in energy prices, should geopolitical disruptions persist, could increase inflationary pressures, widen the current account deficit and place pressure on the rupee.

Overall, India's long-term investment case remains supported by policy reform, improving competitiveness and a large domestic demand base. While near-term volatility might persist, the recent correction has brought valuations to more reasonable levels, potentially offering a more attractive entry point for long-term investors, particularly in sectors with visible earnings and structural growth drivers.

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