Letter n°162

What should we think of India?

"India must run before it has even learned to walk, because the world will not wait for us." Nehru.

Now the world's 5th largest economy, India has a GDP of $4.18 trillion in 2026, behind the United States at $31 trillion, China at $20.8 trillion, Germany at $4.5 trillion and Japan at $4.34 trillion, and ahead of France and the United Kingdom. This represents remarkable progress compared with the $475 billion recorded in 2000.

Despite this economic growth, the Indian market is one of the worst-performing markets this year, down 7.4% in USD terms and 3.7% in local currency for the Nifty 50 index, following China, down 14% in local currency and 10% in USD for the CSI 300, and Indonesia, down 43% in USD for the Jakarta Composite Index.

4 main reasons explain the decline in the Indian stock market. Firstly, India is one of the countries most dependent on imports to meet its energy needs. Furthermore, India has long relied heavily on remittances from Indian workers abroad. The bulk of these remittances comes from Middle Eastern countries, and the war has interrupted or reduced these flows. In addition, the Indian stock market has limited exposure to technology and energy stocks, the two best-performing sectors globally this year. Finally, the fourth factor is more political in nature: opposition to Mr Modi's policies among Generation Z, expressed through street protests.

We are not invested in this market, but has the time come to take another look at it? Oil prices are falling, economic activity in the Middle East appears to be picking up again, technology stocks are now facing turbulence, sector rotation is underway, and earnings growth for companies in the Indian Nifty 50 index is expected to reach between 20% and 25% in the quarter ending in September.

Let us therefore try to understand the drivers of India's growth, the vulnerabilities of its economy and the particular characteristics of its financial market.

What economic growth?

- ***Growth***:

For several years, India has been the fastest-growing major economy in the world. There are, admittedly, some doubts about the reliability of these figures, as certain indicators, such as youth unemployment at 40%, seem difficult to reconcile with reported growth of 7.7% last year and an expected 7.1% in 2026–2027, according to the central bank.

Nevertheless, industrial production increased by 8% year-on-year in August. Gross fixed capital formation represents 34% of GDP, a very high level. Bank credit growth is approaching 20% year-on-year, the highest rate in the past 10 years.

One downside to this growth is the disappointing monsoon. Harvests will be affected, and food price inflation risks worsening. Furthermore, this growth is partly driven by public spending, with a fiscal deficit of 4.3% of GDP (estimated) and public debt rising to 80% of GDP, which is high for an emerging economy.

Over the coming years, economic growth will remain strong, supported by population growth: 1.48 billion this year, rising to 1.7 billion by 2062, according to the United Nations. The working-age population, those aged

15–64, is expected to grow by 70 to 75 million between 2026 and 2034, whereas in China, it is expected to decline by more than 70 million over the same period.

- ***Sensitivity to oil prices***:

The country imports 90% of its oil, half of which comes from the Middle East. It also imports half of its gas requirements and two-thirds of its LNG needs, more than half of which comes from Qatar and the UAE.

To reduce this dependence, India became the second-largest buyer of Russian oil this year, accounting for 40% of its needs, notwithstanding US sanctions. Indian refineries were therefore able to operate at full capacity and export refined products.

If the decline in oil prices proves sustainable, it should support the country's economic growth. However, the impact will be partly offset because the government, in an effort to contain public discontent and inflation, had required refiners to moderate increases in pump prices.

- ***Sensitivity to the Middle East***:

The Middle East accounts for nearly 15% of India's exports. The economies of these countries are currently in recession, in some cases severe, as in Saudi Arabia. An end to the conflict, reconstruction work and economic stimulus policies could therefore help boost trade with India.

India is the country most dependent on remittances, which amount to $155 billion, or 3.5% of GDP, with nearly 40% originating from the Middle East.

What are India's structural weaknesses?

- ***The low weight of industry***:

India has never followed the same growth path as China. Manufacturing accounts for only 13% of GDP, compared with 25% in China. India has not achieved the growth rates seen in Vietnam or Mexico because education levels remain low. While the literacy rate stands at 77%, only one-quarter of children go on to higher education. One consequence of this low level of domestic production is dependence on external suppliers, particularly China. India's trade deficit with China in manufactured goods stands at $110 billion, out of total bilateral trade of $150 billion.

Another consequence of industry's limited weight is the insufficient creation of jobs to absorb the 12 million young people entering the workforce each year. The formal sector creates only 3 million jobs annually. As a result, female labour force participation remains low, while more than 80% of jobs are still in the informal economy, with over half (44% of the entire workforce) employed in agriculture, a low-productivity sector that accounts for only 17% of GDP.

- ***The difficulty in attracting foreign capital and weak exports***:

The balance of payments deficit is moderate, at less than 1% of GDP, but India attracts relatively little foreign capital, accounting for only 2.5% of global FDI flows. Net FDI amounted to just $7.5 billion in 2025–2026, in a country where domestic savings are relatively low at 34% of GDP, compared with 44% in China.

Foreign companies are often discouraged by cumbersome administrative procedures and persistent infrastructure shortcomings, although the number of airports doubled between 2014 and 2026, from 75 to 165, and the length of expressways increased from 18,000 to 45,000 kilometres.

According to the World Bank, exports account for only 22% of GDP. The trade balance recorded a deficit of $120 billion last year, compared with China's trade surplus of $1.2 billion.

- ***Low GDP per capita***:

At $2,700 in 2026, GDP per capita remains far below China's, estimated by the IMF at $15,000, and even further behind that of the United States, at $90,000–95,000. Nevertheless, according to the World Bank, nearly 500 million Indians have been lifted out of poverty between 2011 and 2023.

What should we think of the Indian stock market?

- ***Equities***:

The market capitalisation of the Indian stock market currently stands at $5.4 trillion, making it the fourth largest in the world. However, it remains far behind the United States, whose market is 15 times larger, at more than $75 trillion, China and Hong Kong combined, at approximately $20 trillion, the EU at $15.5 trillion, and Japan at more than $8 trillion.

Nevertheless, its development has been spectacular, as market capitalisation did not exceed $220 billion in 2000. Many associate the Indian market with IT, the development of Bangalore and the technology sector, and may therefore be surprised by the market's decline this year. In reality, looking at the composition of the MSCI India index, technology accounts for only 7.9% of the index, well behind financials at 30%, consumer discretionary at 12.8% and industrials at 10.4%, and at a similar level to healthcare at 7.2% and materials at 8.3%. Technology remains a relatively small sector because R&D spending is low: 0.65% of GDP according to the World Bank, compared with 6.7% in Israel, 5.1% in South Korea and 3.4% in the United States.

Earnings growth has slowed, and the MSCI India index declined over the first 10 months of the year, despite the beginning of a recovery in October, which continued into November. The P/E ratio has fallen to 19.6x, compared with an average of 23.5x over the past five years. The Indian market has no leading player in AI hardware. It could benefit from a global sector rotation away from technology. The largest company by market capitalisation today is Reliance Industries, a conglomerate operating in energy, telecommunications and retail, valued at $205 billion.

- ***Bonds***:

The bond market still calls for caution. In response to the resurgence in inflation, which reached 5.4% in September for headline inflation and 4.5% for core inflation (excluding energy), interest rates had to be raised in October to 5.5% for the first time since 2023. Two further rate hikes are likely over the coming months.

- ***Currency***:

The currency recently traded close to its all-time lows, having fallen 5.5% against the US dollar over the past year. However, it could appreciate somewhat. Since June, the government has had to spend $90 billion to curb its depreciation and has encouraged the diaspora to repatriate foreign currency, amounting to $30 billion. Foreign exchange reserves consequently fell to $725 billion in October. The government has also increased import duties on gold and silver to conserve foreign currency.

Conclusion: ***"Dams, factories and major projects are the temples of modern India," Nehru*** said at the inauguration of a dam.

From an economic perspective, the country is developing rapidly but cannot become an industrial alternative to China because its environmental challenges are immense. Its economy is characterised by a two-speed structure, with the five southern states taking a predominant role, while the business climate, although improved from 142nd place in 2014 to 63rd place in 2019 (the last year of publication) in the World Bank's Doing Business rankings, remains far behind that of other major economies.

From a stock market perspective, a rotation is underway. The three major East Asian markets – Taiwan, up 32% this year; South Korea, up 27%; and Japan, with the Nikkei 225 up 15% – which have benefited from enthusiasm for semiconductor stocks and technology stocks more generally, suffered significant declines in

October and again since the beginning of November. An initial shift towards the Indian and Australian markets began in October and could continue.

Developments in relations with Donald Trump remain an important variable, as the United States is India's largest export destination, accounting for 20% of total exports, and the threat of tariffs could resurface.

From a political perspective, Indian democracy, under Modi's influence, is becoming increasingly illiberal. The latest illustration is the removal of 130 million people, predominantly Muslims, from the electoral rolls.

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