

Narrowing the gap: India's market valuations create fresh opportunity

September 5, 2025



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Steep, new US tariffs on Indian goods—which doubled to 50% in August in retaliation for New Delhi's purchase of Russian oil—has added a layer of uncertainty for the subcontinent. Still, we believe investors seeking meaningful weightings in international equities may find India's current environment well-positioned for deeper consideration.

One notable exemption to the tariffs applies to certain high-end smartphones, a category in which India has become an increasingly important manufacturing hub. Even if this exemption were later withdrawn, analysts expect India to remain a key production center for US-bound smartphones, given the scale of recent supply-chain investments.

A convergence of what we consider more attractive valuations for Indian equities, robust financial sector fundamentals, structural technology investments and an evolving role within global supply chains is prompting many to view this as a timely entry point into this dynamic market.

Beyond the tariff risks—which may challenge India's export competitiveness—structural issues in the industrial sector persist, even as services and agriculture continue to drive growth. However, with ongoing US–India negotiations and President Trump's well-documented tendency to reverse course on trade policies, it remains unclear whether these heightened duties will ultimately stick. If reversed or softened, they may be viewed more as a temporary headwind than a structural threat. The United States accounts for about 20% of India's goods exports.¹

In response, Prime Minister Narendra Modi has accelerated a series of policy reforms to bolster domestic resilience, including an overhaul of the country's consumption tax aimed at softening the tariff blow. The government's renewed focus on infrastructure investment and consumption-led stimulus is also intended to reinforce economic momentum and support sustainable growth.

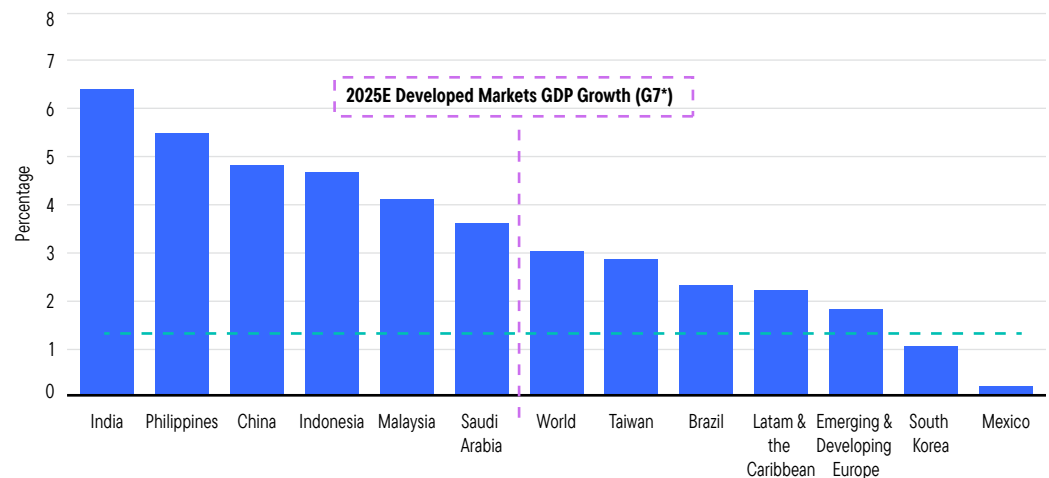
Set to take effect in late September, reductions to India's Goods and Services Tax (GST) should, in our opinion, represent significant fiscal stimulus to help blunt tariff impacts. Alongside February's direct tax relief, rate reductions and moderating inflation, these cuts may create multiple channels for demand acceleration. Lower GST on essential goods could also ease retail inflation, particularly if savings are passed on to consumers. Importantly, we believe these effects may begin to materialize as early as next quarter's corporate earnings. While direct beneficiaries include automobiles, fast-moving consumer goods and insurance, the broader boost to consumption may benefit sectors such as discretionary retail and non-bank financials.

Amid shifting trade dynamics, Prime Minister Modi recently met with Chinese President Xi Jinping on the sidelines of the Shanghai Cooperation Organization summit, marking Modi's first visit to China in seven years. The leaders held multiple discussions, expressing efforts at stronger partnership as well as India's ability to cultivate strategic bilateral options.

Encouragingly, the latest IMF World Economic Outlook projects India's GDP growth at 6.5% for both 2025 and 2026, positioning it ahead of China and many regional peers (see Exhibit 1 below). This sustained growth outlook alongside ongoing structural reforms, underscores India's status as the world's fastest-growing major economy.

Exhibit 1: India Tops 2025 Emerging Market Growth Forecasts

Estimated 2025 Emerging Market GDP Growth Compared to Developed Markets



*G7 composed of seven countries: Canada, France, Germany, Italy, Japan, United Kingdom and United States. IMF estimates as of August 2025.

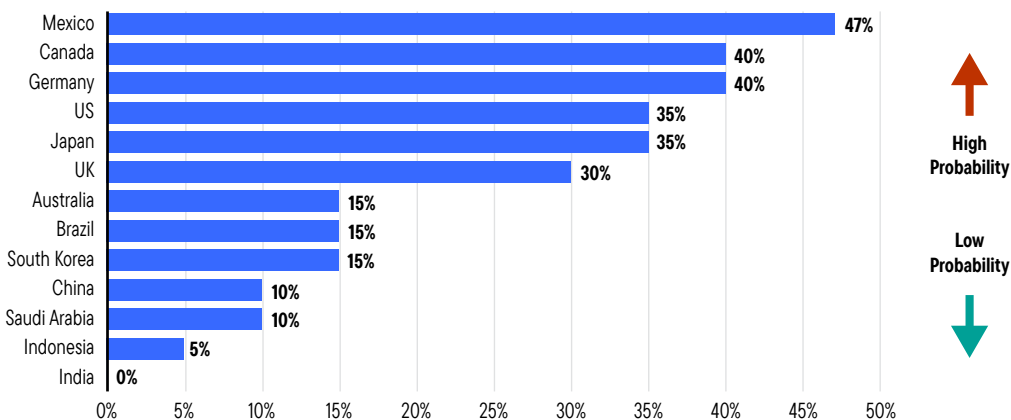
Sources: FactSet, International Monetary Fund. There is no assurance that any estimate, forecast or projection will be realized.

What's more, Bloomberg's survey of economists suggest that India faces virtually zero probability of entering a recession within the next year—a sharp contrast to Mexico, which remains highly exposed to US economic cycles and to Canada, where some indicators, like declining output and weakening employment, suggest a recession may already be underway (see Exhibit 2 on the next page).

Exhibit 2: Worldwide
Recession Probability

As of August 14, 2025

Recession Probability in a Year



Note: Displays the median forecasted probability of recession. These forecasts are derived from the latest monthly and quarterly surveys conducted by Bloomberg and from forecasts submitted by various banks.

Source: Bloomberg. There is no assurance that any estimate, forecast or projection will be realized.

Historically, India has traded at a premium relative to other emerging markets, reflecting its strong fundamentals and growth potential. Recent market corrections, however, have compressed valuations, bringing the MSCI India Index’s full 2025 calendar year price-to-earnings estimates to 24x—broadly in line with the United States at 24.2x.² This marks India’s narrowest valuation gap with the United States since 2016.³ With corporate earnings forecasts remaining resilient, we believe this valuation reset enhances the risk-reward profile for new allocations—particularly for investors seeking high-growth exposure with improving relative value.⁴

India’s financial sector has notably outperformed other segments, with the Nifty Financial Services Index—a benchmark for banking, insurance and diversified financials—reaching record highs in June and soaring more than 15% in the first half of the year.⁵ This rally reflects improving asset quality, stronger balance sheets and robust credit demand, underscored by record profits in the banking sector during fiscal year 2025.

From rhetoric to action on chips ambitions

India is translating ambitious semiconductor goals into concrete progress. Through a multibillion-dollar, government-backed initiative, Prime Minister Modi has signaled a clear commitment to building a self-reliant semiconductor ecosystem. This sector is not only attracting multinational corporations but also fostering a rapidly growing domestic talent pool—from highly-skilled research and development roles to manufacturing and supply-chain positions. This makes semiconductors a key contributor to India’s broader economic transformation and technology-driven growth story.

As global semiconductor supply chains undergo realignment—spurred by geopolitical shifts and the need for diversification—India’s rising prominence in this critical sector positions it as both a manufacturing hub and a significant employment generator. This evolution complements India’s broader emergence as a supply-chain alternative to China, as multinational corporations and investors actively seek to diversify their sourcing and production bases amid increasing geopolitical uncertainties.

A digital powerhouse

India is home to one of the world's largest populations of smartphone users, internet subscribers and digital transaction volumes. Its expansive public digital infrastructure—including a national biometric ID system and a real-time payments network—generates vast amounts of data daily. This digital momentum has made India the fastest-growing market for ChatGPT, with some estimates suggesting it now represents the platform's largest user base, accounting for around 14% of total users.⁶

India's most pressing challenges—in health care, education, agriculture and public services—also represent its greatest opportunities. With a vast population, a thriving technology sector and a robust digital infrastructure, we believe India is uniquely positioned to scale artificial intelligence (AI) and digital solutions that can drive meaningful social impact alongside economic growth.

In alignment with this vision, government officials have launched the bold IndiaAI Mission, backed by over US\$1.25 billion in public investment. This initiative aims to build national compute infrastructure, develop indigenous AI models, establish AI safety frameworks and promote startup funding and research centers—laying the foundation for India's leadership in AI innovation.

Beyond services and consumption—an evolving manufacturing hub

As global corporations and investors diversify away from traditional manufacturing hubs, we believe India is increasingly spotlighted as a vital alternative to China. Its growing manufacturing capabilities, improving infrastructure, favorable demographics and policy incentives make it a strategic node in global supply chains. In our opinion, this evolving role enhances India's long-term investment case—not just as a consumption-driven market but as a key player in the global industrial ecosystem.

Endnotes

1. Source: "National Import-Export Record for Yearly Analysis of Trade (NIRYAT)." Indian Government's Ministry of Commerce and Industry. From April 2024–March 2025.
2. Source: Bloomberg as of September 2, 2025. The MSCI India Index is designed to measure the performance of the large- and mid-cap segments of the Indian market. **Past performance is not an indicator or a guarantee of future performance.** Indexes are unmanaged and one cannot invest directly in an index. Important data provider notices and terms available at www.franklintempletondatasources.com. There is no assurance that any estimate, forecast or projection will be realized.
3. Source: Bloomberg. United States is measured using the S&P 500 Index.
4. There is no assurance that any estimate, forecast or projection will be realized.
5. Source: Yahoo Finance. The Nifty Financial Services Index is designed to reflect the behavior and performance of the Indian financial market which includes banks, financial institutions, housing finance, insurance companies and other financial services companies. **Past performance is not an indicator or a guarantee of future performance.** Indexes are unmanaged and one cannot invest directly in an index. Important data provider notices and terms available at www.franklintempletondatasources.com.
6. Source: "Can India be an AI winner?" *The Economist*. June 12, 2025.

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