India Growth Story Vs. Rising Borrowing Costs, Crude, Inflation and Currency

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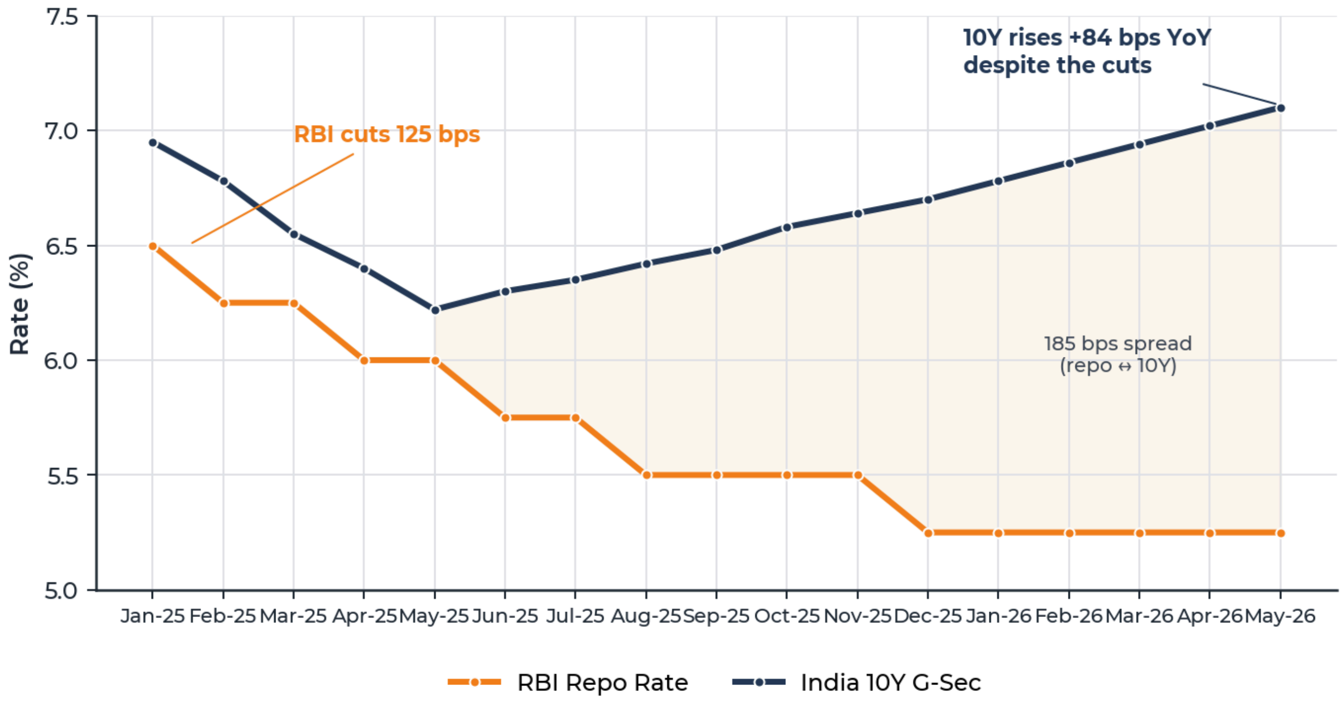
SOWILO
WEALTH ENHANCER

1. The divergence is the story

The cleanest framing of the Indian rate cycle today is also the most uncomfortable one. **The RBI has cut the repo rate by 125 bps since January 2025, taking it from 6.50% to 5.25%. Over the same window, India's 10Y government bond yield has not merely held; it has risen 84 bps, from a cycle low of 6.22% in May 2025 to 7.10% today.** The bond market has not just refused to follow the policy rate; it has moved decisively in the opposite direction. That divergence, visible in the chart below, is the most important fact in the Indian bond market right now, and the equity market has not yet absorbed it.

5.25%	7.10%	185 bps	8.30%
RBI REPO	INDIA 10Y G-SEC	REPO ↔ 10Y SPREAD	WPI APRIL 2026
−125 bps since Jan-25	**+84 bps** YoY	vs ~75–100 bps "normal"	vs 3.88% in Mar-26

Chart 1: RBI cuts the policy rate. The 10Y G-Sec ignores it.



Source: RBI; CCIL; TradingEconomics. Repo path: 6.50% in Jan-25 to 5.25% in Dec-25 (5 cuts, 125 bps cumulative).

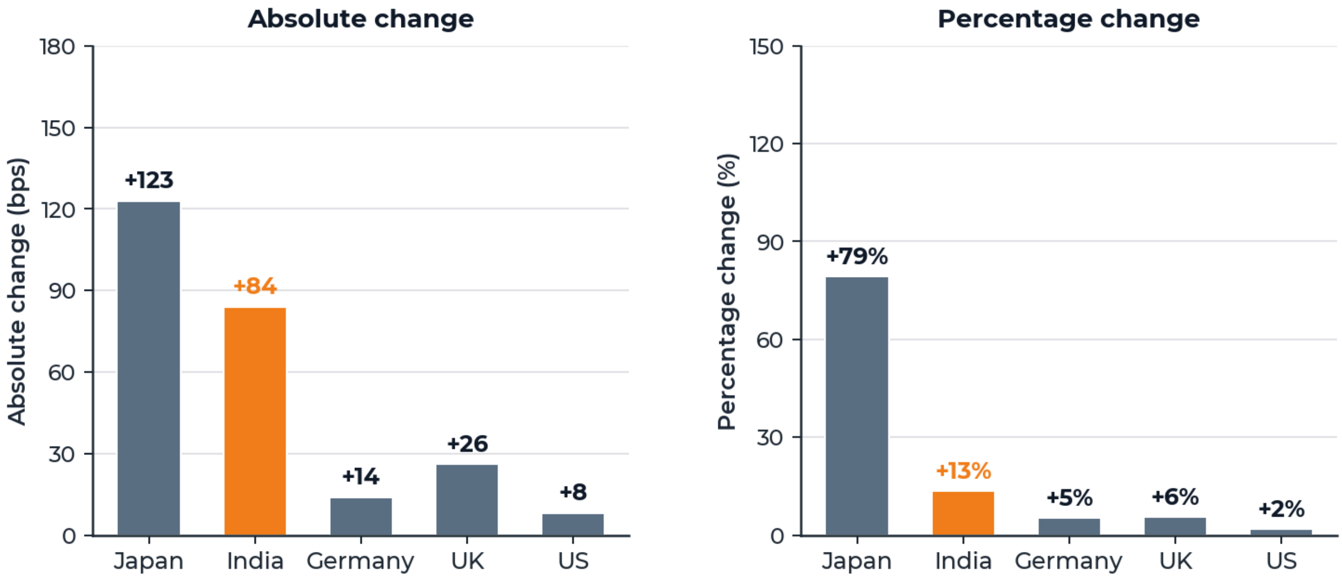
The core insight. The repo rate sets the price of overnight money for banks. The 10Y government bond yield sets the price of *capital for every other borrower that taps the bond market*: corporate bonds, NBFC and housing-finance-company debt issuance, and indirectly the rate at which banks themselves raise term deposits. **For any borrower whose funding mix tilts toward bond-market issuance, the cost of money has been rising, not falling, through the entire 2025-26 RBI easing cycle.** That is the mechanism we explore below.

2. The pull is global and synchronised

India's 10Y is part of a global pattern, but the global pattern is uneven, and the unevenness matters. **Japan and India are doing most of the work**; developed-market 10Y yields outside Japan have actually moved very little over the last twelve months. The cleanest way to see the picture is country by country, in both absolute basis points and as a percentage change in the yield level.

Japan stands out on every measure, with its 10Y JGB up around 123 bps in absolute terms (a roughly 79% rise in the yield level) as the Bank of Japan has been exiting its long-running yield-curve-control regime. **India is the next-largest absolute mover** at +84 bps YoY, despite the RBI cutting the policy rate by 125 bps over the same window. The rest of the developed world looks pedestrian by comparison: UK 10Y gilts are up only ~26 bps, German bunds ~14 bps, and the US 10Y is just ~8 bps. **The standout in the US complex is the long end**: the US 30Y Treasury is up roughly 20 bps over the year and crossed 5.0% on May 13, 2026 (the first time since 2007), with Citi flagging 5.5% as the next target. The US 10s-30s curve has steepened by ~12 bps year-on-year, reflecting term-premium repricing rather than a synchronised policy-rate move.

Chart 2: Rise in 10Y government bond yield over the last 12 months, by country



Source: US Federal Reserve H.15; TradingEconomics; Investing.com; RBI / CCIL. Change measured May 13-15, 2025 vs May 20-22, 2026, 10Y benchmark sovereign yield in each market. Left panel shows absolute change in basis points; right panel shows the percentage change in the yield level (the same absolute move translates into a much larger proportional increase in a low-yield market like Japan than in a higher-yield market like India). India's 84 bps absolute move is happening despite a 125 bps cumulative repo cut at home.

The drivers are mutually reinforcing rather than competing:

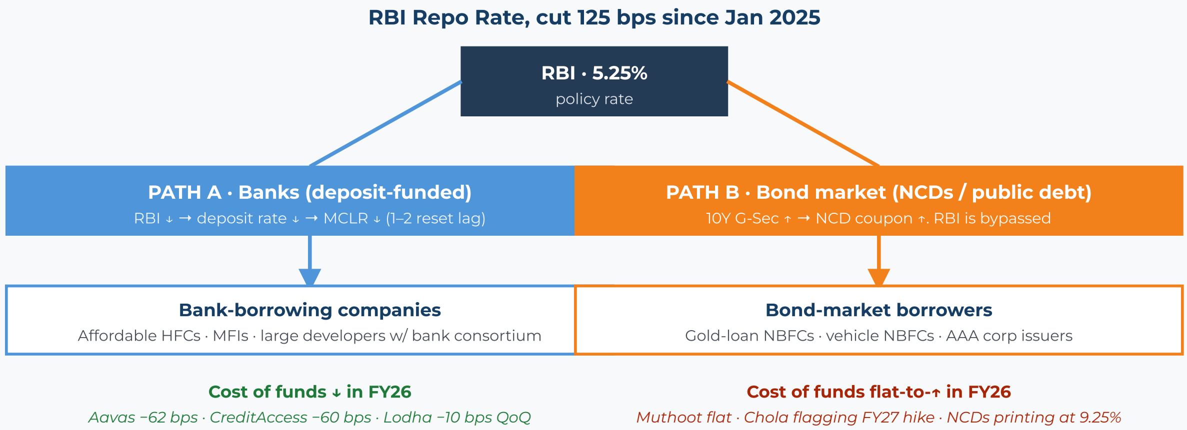
- **US inflation is sticky.** April US CPI, at **3.8% YoY**, is a three-year high; PPI surprised to the upside in the same week. Futures imply **zero Fed cuts in 2026 and a ~70% probability of a rate hike in 2027**.
- **An oil-driven inflation premium.** Brent crude above $110/bbl, on Strait of Hormuz risk, has fed directly into the inflation expectations the bond market prices in for longer-dated debt. The US 5-year forward inflation expectation has drifted up to 2.24%.
- **Treasury supply concerns.** US fiscal slippage and the end of quantitative easing mean investors now demand more compensation for holding long-dated government bonds, even without any move from the Fed.
- **Japan's policy normalisation.** Japanese institutional investors are bringing money home as Japanese government bond yields rise. Bank of Japan officials have called for rate hikes "as soon as possible."
- **UK political risk.** A brewing leadership contest drove the late-May gilt rout to 18-year highs, putting bond-unfriendly fiscal scenarios back on the table.

> **The bond market is no longer waiting on the Fed.** Long-term yields have decoupled from central-bank policy rates and are now driven by supply, inflation expectations, and the extra compensation investors demand for holding longer-dated bonds. Even a dovish surprise from the Fed is unlikely to push the US 30Y back below 5% in the absence of a growth scare. For Indian equity markets, the discount rate that matters is the one the long end is pricing, not the one the RBI is setting.

3. Why the repo cuts didn't travel: funding source is destiny

A repo-rate cut does not reach every borrower the same way. **Banks fund themselves mostly through customer deposits and the RBI's lending window; their loan-pricing benchmarks (MCLR / EBLR) track the repo rate, with a lag of one or two reset cycles.** When the RBI cuts, banks and the companies that borrow from them benefit, slowly but reliably. **NBFCs, housing finance companies and large corporates that fund themselves mostly in the bond market pay coupons tied to the 10Y G-Sec yield plus a credit spread. When the G-Sec yield rises, their cost of funds rises, regardless of what the RBI is doing at the policy rate.**

Diagram 1 · Two transmission paths, same RBI cut, opposite outcomes



The difference is not academic. **A gold-loan NBFC that funds roughly half its balance sheet through the bond market will price each new bond at the prevailing 10Y G-Sec yield plus a credit spread.** With the 10Y rising from 6.22% to 7.10%, even a constant credit spread implies a roughly 89 bps headwind on half the balance sheet, irrespective of any benefit the bank-MCLR side may be receiving. By contrast, a housing finance company with access to refinancing from the National Housing Bank and a bank consortium gets the full benefit of the MCLR cut, with bond-market borrowing layered on as a modest sweetener.

PATH A · BANK-FUNDED

How it transmits: RBI rate cut → deposit pricing eases → bank lending benchmark resets lower → borrowing cost falls.

Lag: 1 to 2 quarterly reset cycles (roughly 3 to 6 months).

FY26 outcome: Received the cuts, with a lag. Bond-market spreads contributed a marginal sweetener.

PATH B · BOND-MARKET-FUNDED

How it transmits: 10Y G-Sec rises → corporate bond coupons reprice higher with every new issuance.

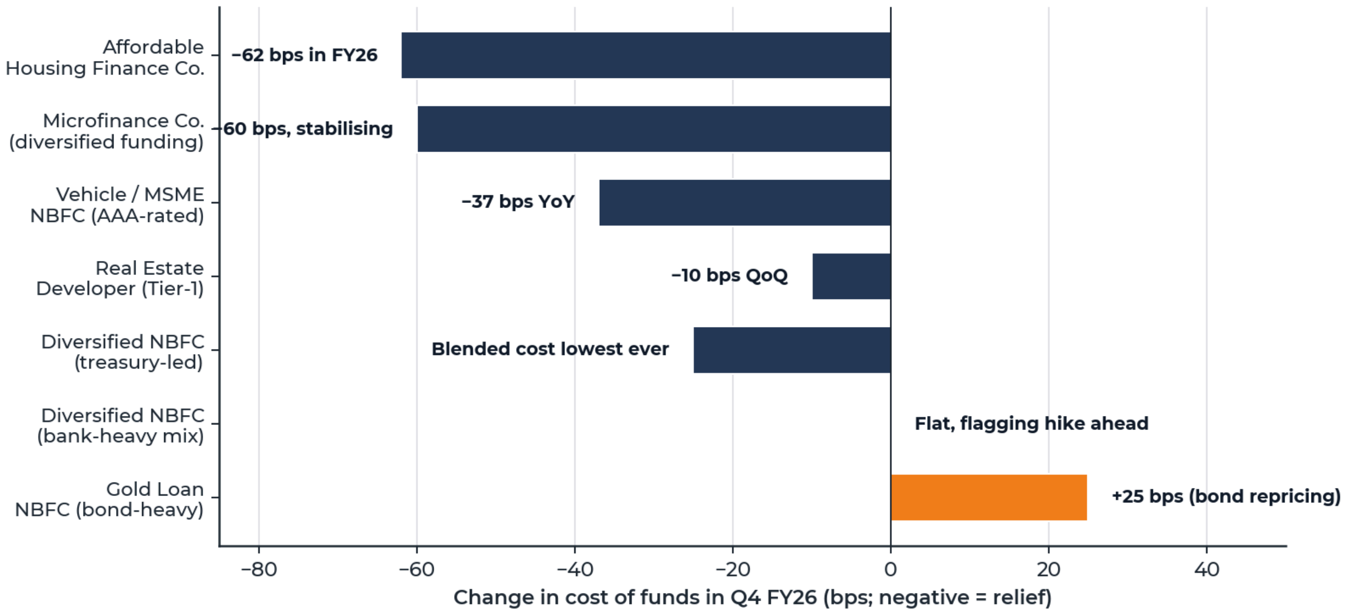
Lag: Immediate, at the next bond issuance, bypassing the RBI altogether.

FY26 outcome: No relief received. Costs were flat to higher as the 10Y rose 84 bps.

4. The Q4 FY26 print confirms the bifurcation

The cleanest test of the funding-mix view is what management teams told analysts during the Q4 FY26 earnings cycle. **Of seven large- and mid-cap Indian lenders and developers we surveyed, only one (a gold-loan NBFC with the heaviest bond-market funding mix in the cohort) reported no relief in cost of funds.** The other six, all with material bank-loan or refinance-agency exposure, reported 10 to 62 bps of cost reduction over FY26. Two of them have now flagged that the easing window is closing and that the bond market is already pricing the next leg as a reversal.

Chart 3: Cost-of-funds relief in Q4 FY26 was uneven across lenders



Source: Q4 FY26 and Q3 FY26 earnings calls of seven non-portfolio Indian lenders and developers; Sowilo compilation. Names anonymised. Negative bars indicate borrowing-cost relief; the positive bar belongs to the lender with the heaviest bond-market funding mix.

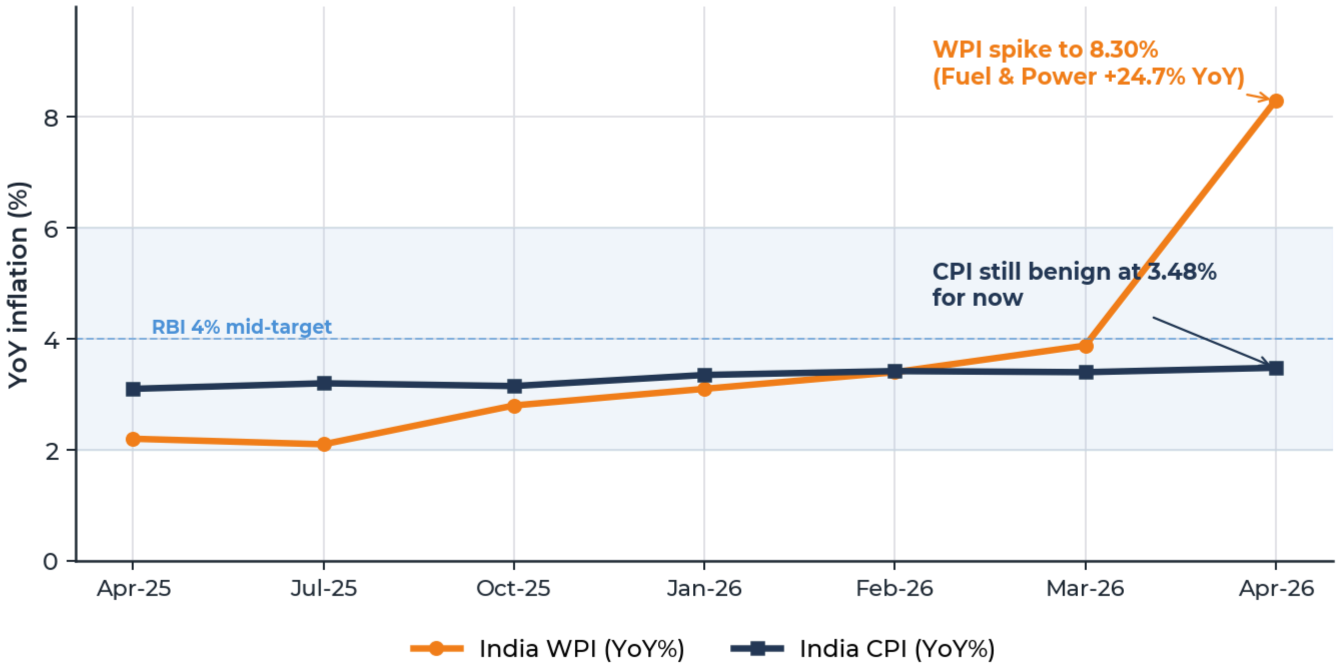
Across the seven lenders we surveyed, the names that reported relief were uniformly those with diversified bank funding, refinance-agency access, or AAA-rated bond-market pricing power. The single lender that reported no relief is the one whose funding mix is most concentrated in open-market borrowing.

The substance of what management teams told analysts falls into three patterns. The CFO of one large gold-loan NBFC, whose funding mix sits roughly half in bank borrowings and half in bond-market issuance, noted that banks have not been freely passing on the policy rate cut, and that most banks' lending benchmarks have moved by less than 50 basis points despite the RBI's cumulative 125 bps reduction. The CEO of a leading microfinance company, which booked around 60 bps of relief over FY26, told analysts that borrowing costs had now stabilised and that the domestic rate environment was likely to reverse over the next three to four quarters. The CFO of a large diversified NBFC, while reporting a flat cost of funds in Q4, has built in a marginal increase for FY27 in the company's published margin guidance, on the conservative view that the easing window has closed.

The forward call. Phase 1, in which the RBI's repo cuts reached bank-funded borrowers slowly and bond-funded borrowers not at all, is over. Phase 2, in which the cost of funds begins rising across both paths, is the scenario that at least two companies in the cohort above are now flagging to analysts and what the 84 bps year-on-year move in the 10Y G-Sec is already pricing in. **The risk to FY27 earnings is not that borrowing costs are rising today; it is that the easing tailwind that quietly supported FY26 profitability for the AAA-rated cohort is about to flip into a headwind, while the bond-market-dependent tier never saw the tailwind in the first place.**

5. WPI is the canary, and the RBI's room is narrowing

Chart 4: WPI is the canary. CPI lags by 3 to 6 months.



Source: MOSPI (CPI); Office of the Economic Adviser (WPI). April 2026 prints released May 12-14, 2026. April's WPI print is the inflection; the policy risk is second-round pass-through rather than the first-round energy shock itself.

April's WPI print at **8.30%**, versus **3.88%** in March, is a 42-month high and the sharpest single-month acceleration in the current series. The driver is Fuel & Power (+24.71% YoY), direct passthrough from Brent at $110+/bbl as the Strait of Hormuz risk premium crystallised. Manufactured products are also firming: basic metals +11.2%, pharma / plastics +7.45%. CPI at 3.48% is still benign because food (4.20%) is contained, but core and services pressure is building. **The RBI's April MPC already shifted its stance from accommodative to neutral, citing West Asia geopolitical risk.** The nuance is that this is not an automatic tightening signal. At the SNB-IMF panel on May 12, RBI Governor Sanjay Malhotra said the framework gives the MPC room to look through first-round supply shocks if they are transitory, while remaining ready to act if the shock becomes generalised through wages, transport costs, production costs or inflation expectations. **Our read: the June risk is less a reflex hike than a more data-dependent RBI with a lower tolerance for second-round effects.**

6. Why this matters for equities: the discount-rate channel

A stock's fair value is the present value of its future cash flows, discounted back to today using the long-term government bond yield plus an equity-risk premium. **When the long-term bond yield rises by 100 bps, the present value of every future cash flow shrinks, and the further out the cash flow, the bigger the shrinkage.** Growth companies derive most of their fair value from cash flows that arrive ten or more years from now; value companies derive most of theirs from cash flows in the next three to five years. A rough sensitivity: a long-duration growth stock loses roughly 20% per 100 bps rise in the discount rate; a shorter-duration value stock loses roughly 8%. That arithmetic alone explains a large part of why value tends to outperform growth when yields rise.

The 2022 cycle is the textbook case. The US 10Y rose by 236 bps over the year; the Russell 1000 Value index finished at **roughly −8%** while the Russell 1000 Growth index finished at **roughly −33%**, the largest factor reversal in two decades. In India during the same year, MSCI India's value-tilted basket returned **+7.2% in INR versus +3.0%** for the broad index. The pattern repeats across cycles: **once a yield rise becomes sustained, value-style strategies outperform growth.**

7. Past episodes: what happens to Growth vs Value when the 10Y rises ~100 bps

We mapped the MSCI India Growth and Value indices through the four most recent episodes in which the 10Y G-Sec moved up materially. The textbook says Value should outperform; the Indian record is more uneven, and the reasons matter.

2013 · TAPER TANTRUM · G-SEC +90BPS

Growth 19.5x → 20.4x (+4.7%) · Value 10.1x → 9.7x (−4.7%)

Growth held firm while Value multiples compressed: the opposite of the textbook. IT-heavy Growth benefited directly from the rupee's ~20% fall, with dollar-revenue translation masking any discount-rate headwind through the shock.

2018 · RBI HIKE + IL&FS CRISIS · G-SEC +100BPS

Growth 22.3x → 23.4x (+5.1%) · Value 15.4x → 14.0x (−9.2%)

Both indices ended nearly flat in total-return terms (Growth −3.3%, Value −3.2%), but Value's P/E compressed sharply. The yield move was real, but credit stress from the IL&FS collapse was the dominant driver, hitting Value-heavy NBFC and PSU bank names disproportionately.

2022 · RBI HIKING CYCLE · G-SEC +47BPS

Growth 29.1x → 25.2x (−13.2%) · Value 16.4x → 15.3x (−6.8%)

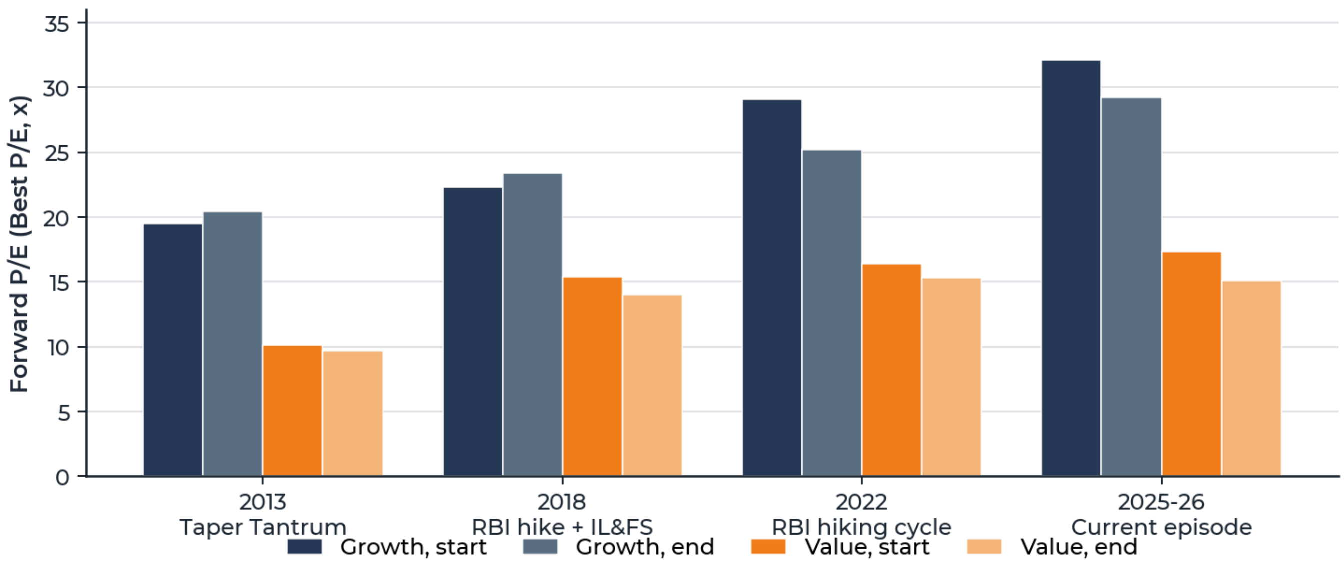
The only episode where the global duration thesis held cleanly. Growth de-rated by nearly twice as much as Value. With the rupee stable and no external shock, the domestic rate hike compressed high-multiple IT and consumer discretionary names more than low-multiple banks and commodities. Value outperformed by 8.6pp in total-return terms.

2025-26 · CURRENT EPISODE · G-SEC +87BPS

Growth 32.1x → 29.2x (−9.1%) · Value 17.3x → 15.1x (−13.1%)

Value has compressed more than Growth in P/E terms, yet Growth has outperformed by 7.3pp in total-return terms (+2.4% vs −4.9%). The rupee is again running interference, with IT dollar-revenue translation keeping Growth prices elevated. The Mar-26 trough (Growth 26.2x, Value 14.6x) was triggered by the Iran-conflict global risk-off, not the domestic yield move itself.

Chart 6: MSCI India forward P/E at start vs end of each rate-rise episode



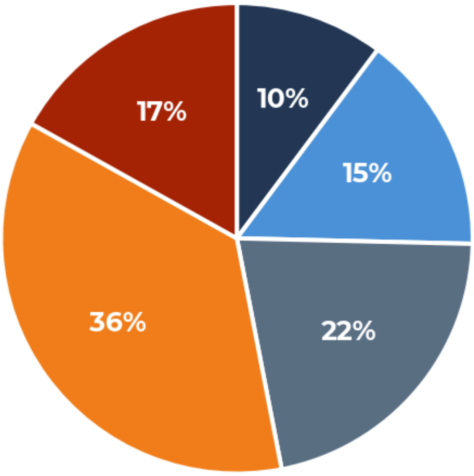
Source: MSCI India Growth vs Value (Bloomberg: MXIN000G Index, MXIN000V Index). Best P/E = forward consensus P/E, monthly end-of-period. Episodes: 2013 (May-Oct), 2018 (Jan-Dec), 2022 (Apr-Mar), 2025-26 (May-25-May-26). The 2025-26 window starts at the 6.245% G-Sec on 21 May 2025 and ends at 7.110% on 19 May 2026 (+87 bps).

The Indian pattern: the rupee, not the domestic yield curve, has been the dominant variable for whether Growth or Value wins. In every episode where the rupee weakened (2013, 2025-26), Growth outperformed despite the rising risk-free rate, because IT dollar-revenue translation offset the discount-rate headwind. A value tilt is the right starting bias in a rising-yield regime, but in India the call needs a view on the rupee alongside it.

8. Portfolio vulnerability: where Sowilo's cost-of-funds exposure sits

Mapping the funding-mix view onto the Sowilo portfolio gives a clear vulnerability profile. **We have excluded BFSI holdings from this analysis**, because interest expense in a BFSI business is largely a cost of margin funding for clients rather than an operating expense, and the ratio is therefore not comparable across sectors. For the non-BFSI portion of the portfolio, we bucket holdings by their **finance cost as a percentage of EBITDA**, which is the cleanest read on how much of operating profit is being absorbed by interest.

Chart 5: Portfolio holdings (ex-BFSI), bucketed by finance cost as % of EBITDA



BUCKET	AUM	WT-AVG	RANGE
Insulated	10%	1.2%	<2% EBITDA
Modest	15%	3.6%	2-7%
Sensitive	22%	10.6%	7-15%
High	36%	20.3%	15-30%
Acute	17%	37.8%	>30%

Source: Sowilo holdings P&L compilation, 25 non-BFSI active holdings as of 22 May 2026. FY26 (Mar 2026) annuals where reported; trailing-twelve-month finance cost and operating profit for the rest. 3 BFSI holdings (capital markets / wealth) and 2 loss-makers with negative FY26 EBITDA are excluded. AUM share re-normalised to the non-BFSI universe. No individual holdings named, per compliance.

53% of non-BFSI portfolio AUM sits in the High or Acute buckets, where finance cost absorbs more than 15% of EBITDA, and the **portfolio-weighted average ratio is 16.5%**. The Acute bucket (17% of non-BFSI AUM, averaging 38% finance cost/EBITDA) is clustered around three operating archetypes: **auto-dealership retail**, where floor-plan financing on inventory is structurally large and every basis-point move flows straight into operating PBT; **a leveraged hospitality platform midway through a deleveraging arc**; and a **cables manufacturer** whose FY26 EBITDA base has not yet caught up with a debt-funded capacity expansion. The High bucket (36% of non-BFSI AUM, averaging 20%) is dominated by working-capital-heavy EPC and transmission contractors, building-products and cables, an IT-distribution business funding inventory and channel float on short-tenor debt, and a value-fashion retailer with a large lease book under Ind AS 116.

9. Portfolio positioning and strategy

Our approach in this environment is anchored in **two principles**. **First**, we are concentrating active risk in businesses where the funding mix is structurally insulated (debt-light balance sheets, bank-funded with access to refinancing facilities, or genuine net-cash operators) and where the starting valuation already reflects a 7%-plus India risk-free rate. **Second**, we are closely monitoring the roughly 53% of non-BFSI AUM that sits in the High and Acute finance-cost buckets, where finance cost already absorbs more than 15% of EBITDA. Position-level conviction in this cohort is being tested against the bond-market signal, with particular focus on the auto-dealership, hospitality and capacity-build archetypes where a 100 bps move in funding cost compresses EBITDA by mid-single-digit to double-digit percentages. We are not adding to long-duration growth positions until consensus valuations reset to the discount rate the bond market is already pricing.

Regards,
Team Sowilo