Impact of falling rupee on ECBs

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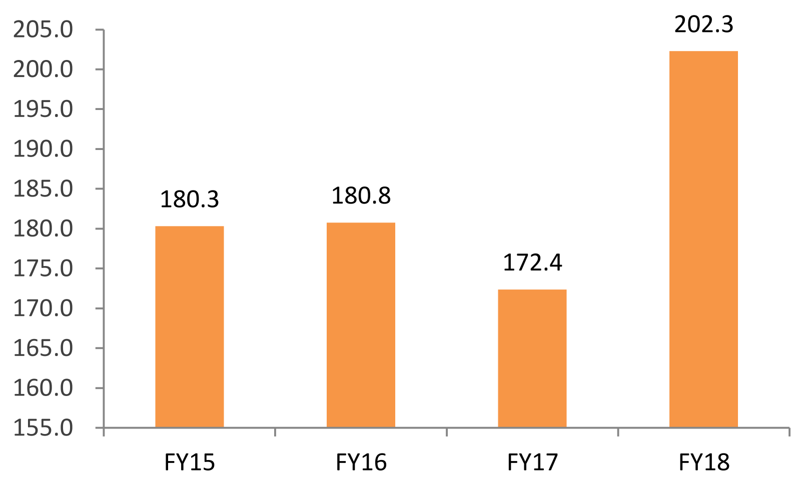
The Indian rupee has weakened further post the monetary policy announcement on October 5, 2018 and has closed at a fresh all-time low of 74.07/$ on October 8, 2018. The Indian rupee has depreciated by 13.6% from the beginning of the financial year, when the exchange rate was 65.18/$. The weakness in the rupee is often seen as a plus point for exporters but adversely affects importers. More importantly corporates who have large borrowings from the foreign markets in the form of "External Commercial Borrowings" (ECBs) not only have to pay higher rupee cost as interest but also have to manage their cash flows at the time of principal repayment.

This analysis examines the impact of the falling rupee on the repayment (interest + principal) burden of the corporates at the macro level. It is important to note that as corporates have resorted to ECBs at different points of time, the calculations have been based on certain scenarios with underlying assumptions. Also, corporates could hedge their foreign exposure at different levels depending on the forward rates. The cost to the companies that has been calculated here is arrived at based on the assumption of no hedging undertaken by the corporates.

India's total external debt as on March 31, 2018 is USD 529.3 Bn of which USD 202.2 Bn are ECBs. Chart 1 provides data on the outstanding ECBs during the last four years.

Chart 1: Trend of Outstanding ECBs (USD Bn)



Source: RBI

The ECBs remained stabled during year end FY15-16 around USD 180 Bn, following which it moderated to USD 172.4 Bn as on March 31, 2017. The outstanding amount as on March 31, 2018 witnessed a significant jump of 17.3% to end the year at USD 202.3 Bn. The lower interest rate regime overseas combined with a stable rupee were driving factors for higher ECBs in FY18.

Interest

The circular released by RBI dated April 27, 2018 on the rationalization and liberalization of ECBs stipulates a uniform all-in-cost ceiling of 450 bps over the benchmark rate. The benchmark rate to be used is the 6-month USD LIBOR. The 6-month LIBOR has increased from 1.43% as on April 3, 2017 to 2.62% as on October 5, 2018.

There are three interest rates scenarios (all-in cost ceilings) which are studied in Table 1 analyzing the impact of the depreciation in the Indian rupee on the interest outflow of the ECBs. The rates calculated and selected are based on the following assumptions:

- Scenario 1: 5.9% (LIBOR 1.4% as on Apr 3, 2017 + 450 bps)
- Scenario 2: 6.4% : Adding 50 bps to the interest rate calculated in Scenario 1
- Scenario 3: 7.1% : (LIBOR 2.6% as on October 5, 2018 + 450 bps)

Table 1: Computation of impact of depreciating currency in interest outflow

	Scenario 1 :Interest rate- 5.9%		**Scenario 2: Interest rate – 6.4%**		**Scenario 3: Interest rate – 7.1%**	
	As on 2018 March 31	**As on 2018 October 5**	**As on 2018 March 31**	**As on 2018 October 5**	**As on 2018 March 31**	**As on 2018 October 5**
Annual interest outflow (USD Bn) *	11.9	11.9	13.1	13.1	14.3	14.3
Annual interest outflow (INR ’000 crs)	77.8	88.4	84.4	95.9	93.6	106.4
Incremental outflow (INR ‘000 crs)		10.6		11.5		12.8

*Interest has been calculated based on the ECB outstanding as on March 31, 2018

Exchange rate for March 31 is Rs 65.18 and 74.07 for October 2018.

Source: RBI, CARE Ratings

Table 1 reveals that there could be an additional interest outflow between Rs 10,600 crs to 12,800 crs on account of the depreciation in the Indian rupee during the current financial year depending on the interest rate and exchange rate assumptions. This is the additional burden for the corporates having borrowed funds via the ECBs route and is purely based on the assumption of no hedging. This could be unfavorable for corporates as the profitability of such companies will be adversely impacted.

The additional interest outflow on account of the fall in the Indian rupee is around 1% -1.3% of the total interest expenses of Rs.9.3 lakh crs reported by a sample of 2700 companies for FY18. (This also includes banks where interest on deposits is substantial – but cannot be distinguished from other interest payments)

Repayment of Principal

The principal repayment of the ECBs during the last four years (FY15-FY18) have been range bound around USD 25 Bn. If one assumes that the same amount is going to be repaid by the corporates during the current financial year (FY19), the effect of the depreciating Indian rupee on repayment of the principal amount is to the tune of Rs. 22,500 crs.

Concluding Remarks

- The above calculation shows that there could be an additional burden of Rs. 10,600 crs – 12,800 crs of interest outflow and Rs. 22,500 crs of principal repayment for the corporates having exposure to ECBs and under the assumption of ***no hedging undertaken by these corporates.*** The total impact could be in the range of Rs. 33,000 – 35,000 crs.

- If it is assumed that there is a hedging cover of around 20% of the ECBs exposure, then there could be a total saving of Rs. 6,000 – Rs. 7,000 crs, which could moderate the impact on the corporates.

- The rupee, which is expected to be in the range of 71/$ to 75/$ till the end of the financial year could have an adverse impact on the profitability of the corporates for FY19. The sharp fall in the rupee since the beginning of the financial year and the expectations of it being in this range (71/$ - 75/$) could also make corporates uncertain in availing the ECB facility going forward.

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