

Depreciating Rupee: Impact on Industries

Since Nov'14 the rupee has been trending downwards, breaching the 63 mark against the dollar. Various domestic as well as external factors have contributed to the weakening of the domestic currency which has in turn raised concerns of an increase in the import bill as well as widening of the trade deficit.

The objective here is to analyze the impact of the sliding rupee across various industries particularly those dependent on imports of raw materials and capital goods. Given the continued depreciation of rupee against the dollar, these companies are likely to be under pressure in terms of rising costs which will weigh on their margins. This study is a quick guide to identify the sectors most susceptible to rupee depreciation based on the forex exposures of the industries in FY14.

For this study, we have taken a data sample of 1,657 listed companies having forex exposure (excluding IT and the financial companies). Further, these companies have been classified under 92 industry groups. Net forex flows of various industries have been analyzed as it is assumed that there would be some natural hedge on the forex earnings side for some industries which will finally reflect the net vulnerability to rupee depreciation.

Based on the Forex flow data for FY14, the following is analyzed:

1. Industry-wise gainers and losers of forex based on net forex inflows/outflows
2. Industries dependent on imported raw materials
3. Industries affected on account of import of capital goods

1) Industry-wise- Forex Losers and gainers

In order to identify the industries which would largely benefit and those adversely affected by the depreciating rupee, the difference between their aggregate forex earnings and expenditures i.e. net forex flows for the year FY14 have been considered.

- The aggregate gross forex earnings of these 1,657 companies under coverage were recorded at \$ 131 bn while the aggregate gross expenditure stood at \$ 241 bn in FY14 resulting in a net forex outflow of \$ 110 bn. Total exports for the same companies was \$ 117 bn while imports (c.i.f. for raw materials, capital goods etc.) was \$ 208 bn.
- For the country, total exports were \$ 314 bn and imports \$ 450 bn of which oil imports were \$ 165 bn and non-oil imports \$ 285 bn.
- Out of the 92 industries, 41 industries have been net gainers with \$ 15.8 bn of net forex earnings - the highest being recorded by drugs & pharmaceuticals, textiles and automobiles- two & three wheelers.
- The other 51 industries were the net spenders recording \$ 125.8 bn of net forex outflows. The highest being refineries followed by steel and industrial gases & fuels.

a. Net Forex- Gainers

While exporters tend to gain from the rupee depreciation as the export value of the commodity increases, it may also be noted that the falling rupee also acts as a natural hedge for those importers that export commodities. The top 20 leading industries which made net positive forex earnings are listed in Table 1.

- The top 20 net spenders (losers) industries comprise 389 companies with a net outflow of \$ 122 bn.
- Within these 20 net spenders groups, there were 8 industries which had net outflows of over \$ 1 bn each. These 151 companies in these industries had a net forex outflow of \$ 117 bn.
- The top 20 net gainer industries had a net inflow of \$ 15 bn with the top 4 industries comprising 281 companies getting in around \$ 10 bn.

Table 1: Industry-wise: Top 20 Forex Gainers & Losers- FY14(US\$ Mn)

Industry- Losers	Net Forex Expenditure (\$ Mn)	Industry- Gainers	Net Forex Earnings (\$ Mn)
Refineries	92,366	Pharmaceuticals & Drugs	5,927
Steel/ Sponge Iron / Pig Iron	5,906	Textile products	1,605
Industrial Gases & Fuels	5,598	Automobile- 2 & 3 wheelers	1,166
Oil Exploration	3,670	Textile - Spinning	1,092
Power Generation & Distribution	3,355	Automobile- trucks/LCVs	793
Fertilizers	3,211	Engineering	457
Gas Transmission /Marketing	1,492	Cigarettes/Tobacco	443
Mining & Minerals	1,061	Castings & Forgings	379
Airlines	776	Sugar	363
Consumer food	716	Tea/ Coffee	362
Aluminum and products	689	Ferro and Silica Manganese	359
Automobile passenger cars	652	Dyes & Pigments	309
Paints	495	Hotels resorts and restaurants	302
Telecommunication	469	Pesticides & Agrochemicals	292
Auto-ancillary	444	Trans Towers / Equipment	249
Diamonds & Jewellery	409	Chemicals	232
Cement & Constn Materials	376	Metal- Non Ferrous	216
Air conditioners	338	Textile- Manmade Fibers	197
Lubricants	331	Automobile- Tractors	168
Tyres & Allied	321	Leather	152

Source: ACE Equity

b. Net Forex - Losers

Table 1 also provides data on the top 20 net spenders of forex. These import dependent industries would tend to be impacted sharply by the depreciating rupee and have to bear the rising input cost which ultimately weighs on their margins. As indicated in the Table 1 refineries, steel and industrial gases & fuels appear to have largely affected on account of rupee depreciation.

The Refineries and Oil exploration companies are the biggest losers with large net forex expenditures. The energy companies are adversely affected by the depreciating rupee being the net importers of oil. Besides, these sectors also incur further losses due to under recoveries particularly of the state run companies in this segment. While the recent decline in crude oil price has benefited these companies, on account of the rupee depreciation the imported cost would get adjusted to the extent that the higher price is not passed on to the consumer.

2. Industries importing raw materials

Table 2 below provides the share of imported raw materials to total raw materials consumption for various industries. This gives an idea on those sectors where there is greater dependence on imported raw materials whose cost would increase with rupee depreciation. Such sectors will have to look for domestic alternatives depending on the price differentials taking into account rupee depreciation.

Table 2: Share of Imported raw Materials: Top 20 Industries- FY14

Industry	Raw Material Imported (US \$ Mn)	Raw Material consumed (US \$ Mn)	% share of raw material imported to consumed
Refineries	103,211	232,840	44
Steel/ Sponge Iron / Pig Iron	7,623	19,057	40
Industrial Gases & Fuels	5,559	6,873	81
Mining & Minerals	2,997	3,912	77
Aluminium and products	2,772	3,685	75
Diamonds & Jewellery	2,664	11,160	24
Pharmaceuticals & Drugs	2,344	6,917	34
Fertilizers	2,043	7,132	29
Electric equipment	1,382	6,180	22
Tyres & Allied products	1,270	2,890	44
Consumer food	1,250	12,141	10
Chemicals	1,174	4,249	28
Steel & Iron Products	1,098	3,664	30
Gas Transmission /Marketing	1,095	7,625	14
Auto-ancillary	1,025	5,515	19
Plastic Products	1,001	3,811	26
Textile	988	7,599	13
Textile- Manmade Fibers	736	2,230	33
Pesticides & Agrochemicals	643	1,834	35
Engineering -construction	540	7,350	7

Source: ACE Equity

- It may be noted that the total imports (raw materials+ capital goods) of the companies taken in the sample account for nearly 46% of the total imports of the country while the exports account for 37%.
- Of the total imports, raw materials form an important component of imports for these industries accounting for 72% of total.
- Imported raw material for the sample companies were 34.7% of the total raw material consumed by them. This clearly indicates the degree of dependence of these industries on imports and the impact of exposure to currency fluctuations
- The top 20 industries listed above in Table 2 together account for nearly 95% of the total raw material imported by the sample companies.
 - Refineries, steel, industrial gases and fuels, mining & minerals and aluminium industry are largely dependent on imports for their raw materials. The total raw material imports of these top 5 industries together account for more than 80% of the total raw material imported (of the companies under coverage in this report).

3. Industries importing capital goods

Table 3: Industry-wise import of capital Goods (FY14): Top 20 (In US \$ Mn)

Industry	Total Capital Outflow (\$Mn)
Oil Exploration	3,068
Steel/ Sponge Iron / Pig Iron	1,314
Power Generation / Distribution	1,293
Refineries	835
Telecommunication -Service Provider	612
Automobile passenger cars	286
Pharmaceuticals & Drugs	213
Textile	175
Steel & Iron Products	138
Cigarettes/Tobacco	130
Auto-ancillary	119
Engineering -construction	100
TV Broadcasting & Software Production	87
Plastic Products	79
Metal- Non Ferrous	78
Gas Transmission /Marketing	70
Electric equipment	68
Textile - Spinning	66
Aluminium and products	63
Tyres & Allied	60

Source: ACE Equity

Import of capital goods is affected by rupee depreciation on two counts. The first is the higher rupee cost of the product and the second is the servicing of the debt which normally is associated with this process. Normally loans are taken to finance such an expense which has to be serviced and hence, a falling rupee will increase this cost too.

What should corporates be doing?

Given the relatively significant importance of imported raw materials and capital goods, companies should ideally be hedging their forex risk by taking positions in the derivative market. The decision to hedge and the amount to cover will depend on the nature of the business as well as the 'natural hedge' provided by either exports or the ability to pass on the higher cost to the end consumer. Given that the latter may not be possible always, hedging a certain part of the risk could be an approach.

For such decisions, the expectations of future exchange rate movements would be important. In the last 10 years on an average annual basis, the exchange rate depreciated by 3.1% per annum, with 4 years of appreciation. In the last 3 years, the rupee was particularly weak, declining by 10% per annum, while for the last 5 years the depreciation was 5.9% per annum. Depending on the call taken on the rupee depreciation, and the forward premium which is around 7.2-7.4% annualized for the 6-month contract, the company could look forward to hedging this risk.

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