

Forex risk of India Inc.

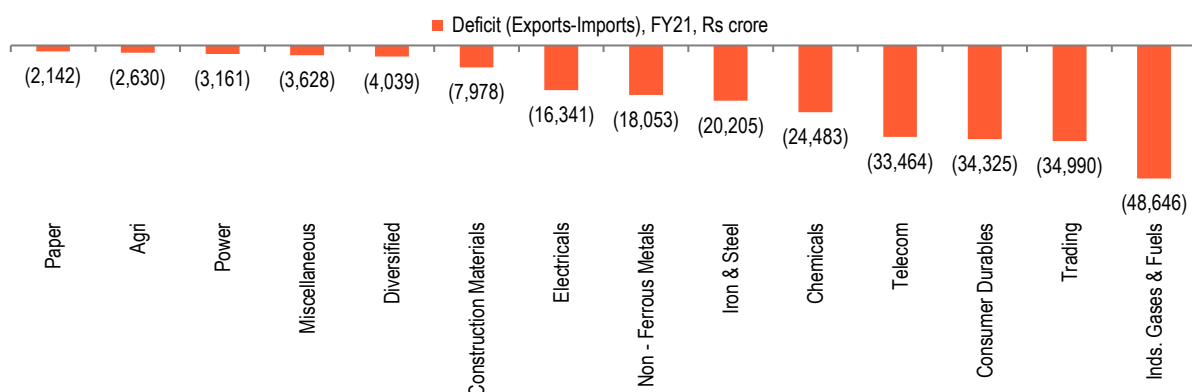
The recent decline in the rupee has ignited concerns on the external sector stability of the economy. Apart from macro economy repercussions, a depreciating currency also impacts the profitability of companies which have high exposure in terms of foreign currency. In this study we have evaluated a sample of 2,171 companies and focused on those industries which are more vulnerable due to higher trade deficit value (Exports: FOB –Imports: CIF). Notably, our sample constitutes 20% of the exports in merchandise trade basket, while imports comprise 33% of total in FY21. Sectors such as crude oil, industrial gas and fuels, trading, consumer durables and telecom are the top 5 industries with highest deficit. Extrapolating the export-import growth for FY22 to the data, we find that for FY22 as well, the deficit as a proportion of net sales is likely to increase. For FY23, a volatile currency will provide further discomfort to these companies.

Against the backdrop of depreciating INR (5.2% in CYTD22) stemming from several factors such as hawkish US Fed leading to rising DXY (recently touched its high since CY02), overheating of economies leading to higher inflation, FPI outflow on account of slowdown concerns and rising international oil prices; it is important to examine the extent to which India Inc. is insulated in terms of their forex cover. We have analyzed data on exports and imports of 2,171 companies, to see which sectors are the most vulnerable ones to depreciating currency.

It needs to be pointed out here that companies or sectors that have high imports would have a natural hedge in exports where there would be automatic pass through of a weaker rupee. Therefore, the concept of trade deficit for sectors is relevant.

Crude oil, industrial gas and fuels, trading, consumer durables and telecom are the top 5 sectors with the highest deficit. Here the deficit is calculated as the difference between Exports: FOB value and Imports: CIF value of companies. In the Fig1. below we have excluded crude oil which contributes to the maximum deficit (Rs 3,92,427 crore).

Fig 1. Top sectors with high trade deficit:

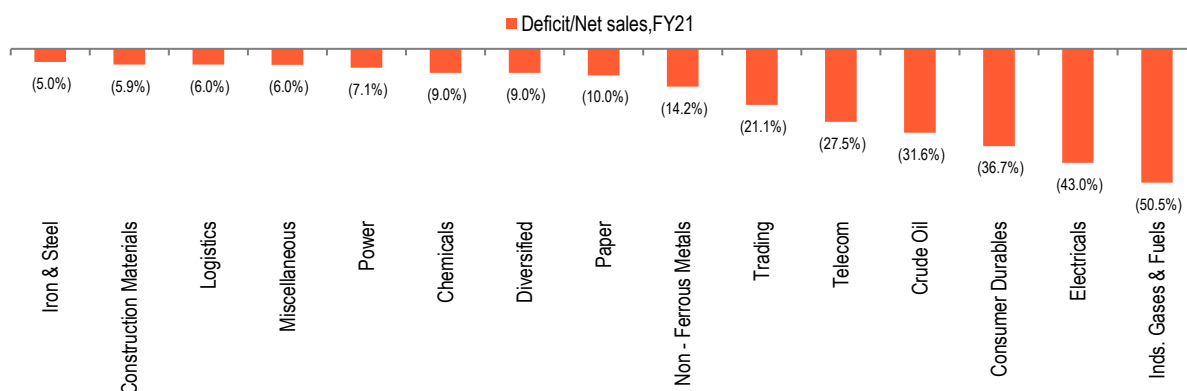


Source: Ace equity, Bank of Baroda Research, Note: Crude oil is an outlier with a deficit of Rs 3,92,427 crore

The total exports of these 2,171 sample companies constitute 20% of the exports in merchandise trade basket, while share in imports is 33%. This study provides a picture of how companies will be impacted under ceteris paribus conditions.

We have also looked at how the net sales of companies might be impacted due to the rupee depreciation. Industrial gas and fuels, Electricals, Consumer Durables, Crude Oil and Telecom sectors have the highest share of deficit to net sales. In case of these industries the profits tend to get impacted when the rupee depreciates and hence there is need for hedging forex risk by getting into forward/futures contracts. In the absence of such cover the risk carried on their books will tend to increase with successive doses of rupee depreciation.

Fig 1. How much is the deficit as a portion of net sales:

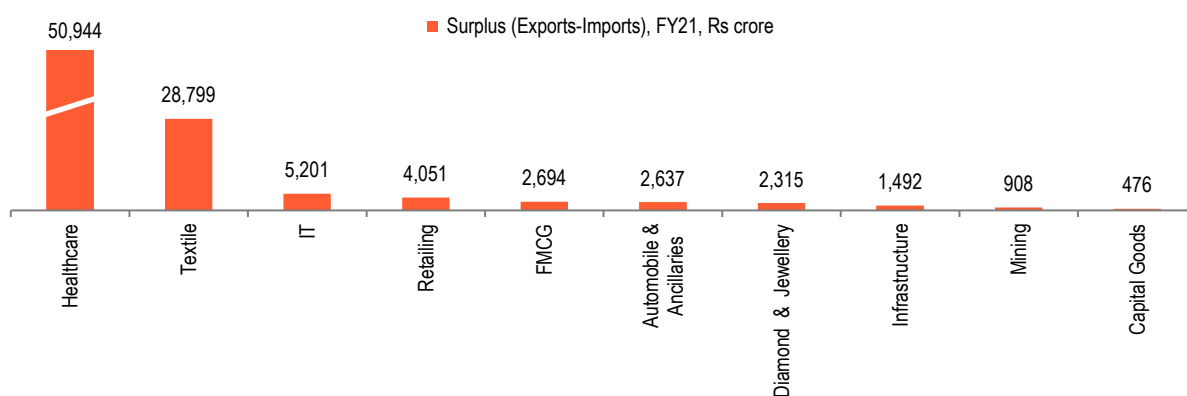


Source: Ace equity, Bank of Baroda Research, Till 14 Jun 2022, Note: deficit hence negative ratio

Which are the sectors that are insulated?

Sectors such as healthcare, textile, IT, retailing and FMCG etc. are insulated as they are net earners of forex. These sectors hence gain when the rupee depreciates.

Fig 2. Sectors which have a surplus in terms of forex cover:



Source: Ace equity, Bank of Baroda Research

So what to expect in FY22 and FY23?

21 of the 31 industries considered here had a trade deficit which cumulated to Rs 6.5 lakh crore or about US\$ 88 bn (assuming an average rate of Rs 74.22/\$). If crude oil is excluded it would be Rs 2.5 lakh crore or US\$ 34 bn. Since then the rupee has moved down to Rs 78/\$ in June 2022 and could go to Rs 79-80 by the end of the year.

On an average basis the rupee would have depreciated by around 6.5% in FY22 and FY23. The trade deficit had peaked at around US\$ 192 bn for the country in FY22. Given that the forward premia for the year has been in the range of 3.5-4.5%, there may have been a disincentive to take cover for forex

exposures. Ideally a part of the exposure should be covered or else the loss to be borne would be high at a time when the rupee is depreciating.

Industries which have a high ratio of trade deficit to net sales should be actively hedging their forex exposure especially when there are limits to which the cost can be passed on to the consumer. Besides in an environment where the commodity prices are also increasing across the board input costs are bound to increase. It would be advisable to have hedging policies in place at the firm level to also address the issue of forex risk given that the average depreciation in a year could be in the region of 3-3.5%.

Appendix:

Table 2. Forex cover of sectors:

Industry	No: of companies	Net Sales, FY21	Exports - FOB Value, FY21	Imports - CIF Value, FY21	Deficit, FY21	Deficit/Net sales, FY21
Agri	88	105756	11549	14179	-2630	-2.5%
Alcohol	12	22038	488	714	-226	-1.0%
Auto & Ancillaries	245	515335	53499	50861	2637	0.5%
Capital Goods	210	115456	15876	15400	476	0.4%
Chemicals	206	271659	37794	62277	-24483	-9.0%
Construction Mat	78	135833	3522	11500	-7978	-5.9%
Consumer Durables	35	93407	2590	36915	-34325	-36.7%
Crude Oil	14	1242710	152721	545147	-392427	-31.6%
Diamond & Jewel	18	38742	6505	4191	2315	6.0%
Diversified	10	44761	2808	6847	-4039	-9.0%
Electricals	46	38004	3215	19556	-16341	-43.0%
FMCG	137	240346	17138	14444	2694	1.1%
Healthcare	169	223084	82660	31717	50944	22.8%
Hospitality	9	996	1	16	-15	-1.5%
Inds. Gases & Fuels	10	96322	5	48651	-48646	-50.5%
Infrastructure	31	56333	2698	1206	1492	2.6%
Iron & Steel	88	407876	51340	71545	-20205	-5.0%
IT	51	192158	6887	1685	5201	2.7%
Logistics	17	14866	576	1463	-887	-6.0%
Media & Entertainment	35	16374	1429	1503	-75	-0.5%
Mining	16	51783	3156	2248	908	1.8%
Miscellaneous	58	60110	7299	10928	-3628	-6.0%
N-Ferrous Metals	32	126732	27855	45908	-18053	-14.2%
Paper	44	21464	2292	4434	-2142	-10.0%
Plastic Products	85	50723	7646	8111	-466	-0.9%
Power	19	44631	735	3896	-3161	-7.1%
Realty	12	5693	1	36	-35	-0.6%
Retailing	22	51447	5372	1321	4051	7.9%
Telecom	17	121790	27699	61164	-33464	-27.5%
Textile	230	118666	36988	8189	28799	24.3%
Trading	127	165848	11589	46579	-34990	-21.1%
Total	2171	4690943	583933	1132632	-548699	-11.7%

Source: Ace equity, Bank of Baroda Research, Note: Sectors with major share in deficit have been highlighted

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