23 Jun 2022

**Dipanwita Mazumdar**
**Economist**

# Forex risk of India Inc.

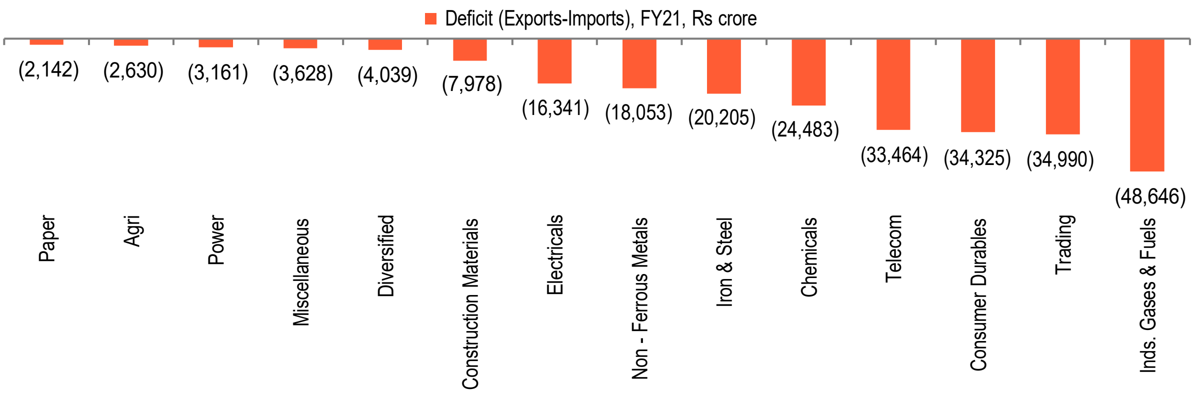
*The recent decline in the rupee has ignited concerns on the external sector stability of the economy. Apart from macro economy repercussions, a depreciating currency also impacts the profitability of companies which have high exposure in terms of foreign currency. In this study we have evaluated a sample 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:**

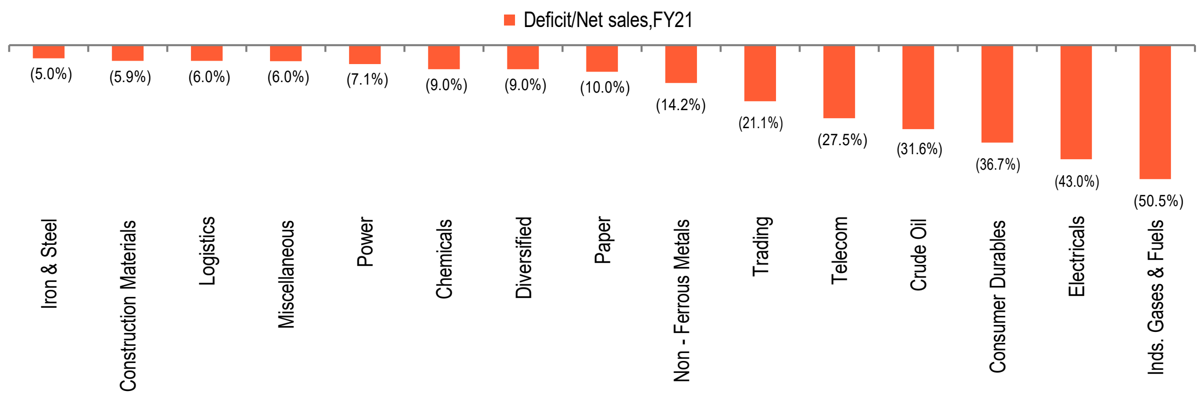



Source: Ace equity, Bank of Baroda Research, Note: Crude oil is an outlier with a deficit of Rs 3,92,427 crore

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:**

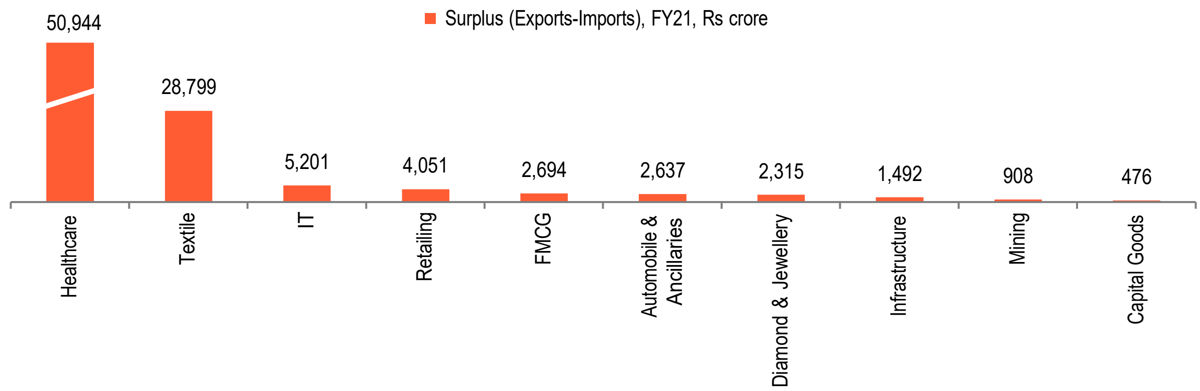



Source: Ace equity, Bank of Baroda Research, Till 14 Jun 2022, Note: deficit hence negative ratio

**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




**For further details about this publication, please contact:**

Economics Research Department
Bank of Baroda
chief.economist@bankofbaroda.com