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CHAMPIONING RUPEE DECLINE TO BOOST EXPORTS IS DOING MORE HARM THAN GOOD: *DOWNGRADES OUTPACE UPGRADES*

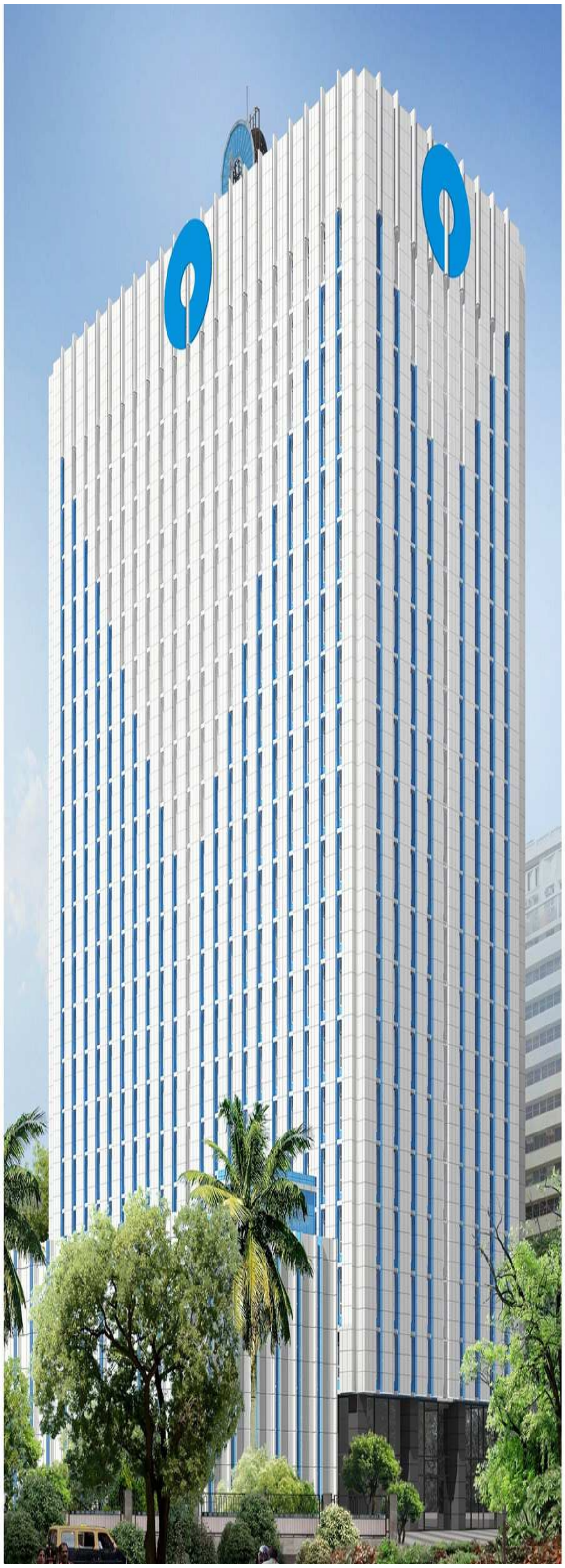
We believe a decline in rupee value is doing more harm than good currently for the following reasons.

Firstly, month wise ECB data suggests, during Mar'18 to Aug'18, industries like Petroleum, NBFCs, Power, Telecommunication and Automobile are heavily borrowing through automatic route and aggregately contributing more than 71% of total borrowing. So, any depreciation in rupee will have significant impact on their bottom line if the corporates have not adequately naturalised their risk through hedging.

Secondly, we also analysed the rating migration of 478 export intensive companies falling under Textile, Agriculture, Leather, and Automobile, Gems & Jewellery sector during Mar'18 to Aug'18 and it shows that the credit ratio (number of upgrades to downgrades) stood at 0.58 times. Interestingly, 15% of the companies out of total 478 companies under the study, have slipped into default category and most of them are in textile business. Gems & Jewellery, Leather etc are also doing badly. The good thing is that under upgrades, Auto Ancilliary, Pharma (Bulk Drugs), Industrial Paper and Chemicals (Speciality) sector saw maximum upgrades.

Similarly, while examining the rating migration of import intensive industries, the result suggests that out of 1092 companies falling under Electrical, Engineering Goods, Metal and Oil & Gas industries, the credit ratio is 0.95 times. The good thing is that small entities, being nimble footed and localized, in segments such as Steel (Ferro Alloys), Steel (Others, TMT, Semi Integrated) appear to have weathered the rupee depreciation by passing on the hike in costs to customers or may have clearly opted for import substitution.

Thirdly, an analysis of top 10 exports and imports from /into India suggests that on a net basis exports have declined and imports have surged in the first half of the current fiscal. We estimate that the net incremental impact on trade deficit is $4bn. Thus the common refrain that rupee depreciation will lead to export increase and import decline stands challenged. We thus believe that deciphering rupee as only a pure by product of price in the foreign exchange market may not be prudent in current times and may do more harm than good.



RUPEE DEPRECIATION AND SLIPPAGES IN CREDIT QUALITY OF BORROWERS

- Beginning August the rupee has been battered by various external factors including the recent spike in crude oil prices weakening the balance sheet of State exchequer. Over the years we have been heavily dependent on crude oil import to meet our consumption needs (nearly 80% is imported). In FY18, the Rupee has depreciated by more than 14% and this is now impacting the credit quality of borrowers, particularly export intensive industries. This is also substantiated by the overall deterioration in exports of top 10 commodities in our basket in current fiscal.
- Additionally, month wise ECB data suggests, during March'18 to Aug'18, industries like Petroleum, NBFCs, Power, Telecommunication and Automobile are heavily borrowing through automatic route and aggregately contributing more than 71% of total borrowing. So, any depreciation in rupee will have significant impact on their bottom line if the corporates have not adequately naturalised their risk through hedging.

ECB through Automatic Route During Mar-Aug'18		
Sectors	ECB (in $ mn)	% of Total
Automobile	966	6.6%
Cement	270	1.8%
Chemicals	314	2.1%
Financial services	3655	24.9%
Iron & Steel	662	4.5%
Machine tools	514	3.5%
Metal & metal products	125	0.9%
Miscellaneous Manufacturing	418	2.8%
Petroleum & Petroleum Products	3307	22.5%
Pharmaceuticals	347	2.4%
Power	1830	12.4%
Telecommunication	750	5.1%
Electrical Goods	186	1.3%
Construction	179	1.2%
Others	1178	8.0%
Grand Total	**14700**	**100.0%**

Source: RBI, SBI Research

- Theoretically it is argued that, the weaker rupee positively helps export intensive industries like Textile, Agriculture, Leather, and Transport Equipment and at the same affect negatively impacts the performance of import intensive industries like Electronics, Pharmaceuticals, Electricals and Gems and Jewellery.
- Against this background, we carried out an exercise to analyse the performance of both export and import intensive industries during last six months through their external rating data published by various rating agencies, like CRISIL, ICRA, CARE, BRICKWORK etc as it is widely believed that improvement in balance sheet of corporates will be reflected through their rating upgrade and similarly any deterioration in balance sheet will be reflected by their rating downgrade.

EXPORT INTENSIVE INDUSTRIES

- The result suggests that the argument of weaker rupee supporting strong export growth is not established during this period as most of the goods that we export have fairly inelastic demand like chemicals, textiles, handicrafts, agri products, etc. We analysed the rating migration of 478 export intensive companies falling under Textile, Agriculture, Leather, and Automobile, Gems & Jewellery sector during Mar'18 to Aug'18 and it shows the credit ratio (number of upgrades to downgrades) stood at 0.58 times. Interestingly, 15% of the companies out of total 478 companies under the study, have slipped into default category and most of them are in textile business.

Rating Migration Matrix of Export Intensive Industries									
	Present Rating								
	External Rating	AA	A	BBB	BB	B	C	D	Number of Company
Previous Rating	AA	100%	0%	0%	0%	0%	0%	0%	4
	A	18%	66%	16%	0%	0%	0%	0%	38
	BBB	0%	9%	49%	40%	0%	0%	2%	126
	BB	0%	0%	15%	53%	16%	3%	13%	158
	B	0%	0%	0%	33%	38%	1%	29%	147
	C	0%	0%	0%	20%	0%	0%	80%	5
	Total								478

Source: Crisil, SBI Research

- For the purpose of this exercise, we have ignored insignificant upgrades and downgrades in the form of +/- as, we believe, they are of little significance in assessing the entity from a lenders perspective.

- Under upgrades, we observe that Auto Ancilliary, Pharma (Bulk Drugs), Industrial Paper and Chemicals (Speciality) sector saw maximum upgrades as the depreciation in rupee seems to have worked for these entities. There were 70 downgrades are in 'D' category, of which 3 had sharp downgrades from BBB to D mainly in Textiles (Ready Made Garments [RMG]). There may be instances where companies in the industry may not be exporting.
- Alternate source of importing by destination countries, change in consumer preference in importing countries seem to have affected sectors such as Leather, RMG (Textiles), Jewellery etc. forming the bottom list as per table given below. There is a possibility that some Indian exporting entities may have set up units as joint ventures in importing countries to cater to local demand and hence, may not reflect the change in ratings.

Export Intensive Industries

Industry	Downgraded (ii)	Upgraded (i)	Diff (i-ii)
Automobile	7	12	5
Chemical - Agro Chemicals	5	1	-4
Chemical - Fertiliser	4		-4
Chemicals - Bulk & Polymers	2	2	0
Chemicals - Speciality	7	9	2
Coal & Consumable Fuels	1	2	1
Coal washery and beneficiation	2		-2
Engineering & Capital Goods	11	5	-6
FMCG	5	3	-2
Footwear	4	2	-2
Gems & Jewellery	11	4	-7
Home Furnishings	8	2	-6
Housewares & Specialties	1		-1
Industrial Paper		3	3
Leather & Leather goods	6		-6
Leisure Products	1		-1
Pharmaceuticals	11	10	-1
Pipe and Pipe Fittings	3	2	-1
Textile - Cotton - Integrated	2		-2
Textile - Cotton - Spinning	14	7	-7
Textile - Manmade - Spinning	7	2	-5
Textile - Others	6	1	-5
Textile - RMG	19	7	-12
Textile - Weaving, Knitting and Processing	10	11	1
Textiles- Ginning	6	6	0
Tyres & Rubber	4		-4
Grand Total	**157**	**91**	**-66**

Source: SBI Research

IMPORT INTENSIVE INDUSTRIES

- Similarly, while examining the rating migration of import intensive industries, the result suggest out of 1092 companies falling under Electrical, Engineering goods, Metal and Oil & Gas industries, 67 companies have been downgraded while 64 companies have been upgraded during last six month. The credit ratio, the ratio of upgraded to downgrade is 0.95 times. Out of the total 975 companies, 19 companies which became "Default" during this period are mostly from Steel and Engineering Goods industries.
- There may be instances where companies in the import intensive industry may not be net importers. Hence, we only laid emphasis on the rated constituents in the industry / sectors. Small entities, being nimble footed and localized, in segments such as Steel (Ferro Alloys), Steel (Others, TMT, Semi Integrated) appear to have weathered the rupee depreciation. Entities in these segments may have been successful in passing on the hike in costs to customers or may have clearly opted for import substitution. In steel, SME sector seem to have benefitted. However, in import intensive segments such as Integrated Steel, Sponge Iron, Electrical Components and Heavy Electrical Equipment the credit ratio appear to be dragged down by the downgrades with overall credit ratio posting below 1.
- It is thus interesting to note that rupee volatility has impacted export intensive industries more severely than import intensive industries as the credit profiles of import intensive industries are cushioned by presence of natural or contracted hedges, ability to pass on increased costs to customers, support from strong parents or government and being able to substitute imports in select circumstances.

Rating Migration Matrix of Import Intensive industries

	External Rating	Present Rating							
		AA	A	BBB	BB	B	C	D	Number of Company
Previous Rating	AA	100%	0%	0%	0%	0%	0%	0%	48
	A	6%	91%	2%	0%	0%	0%	0%	81
	BBB	0%	3%	86%	11%	0%	1%	0%	200
	BB	0%	0%	7%	84%	6%	0%	2%	326
	B	0%	0%	0%	10%	87%	0%	3%	306
	C	0%	0%	0%	0%	0%	83%	17%	12
	D	0%	0%	50%	0%	50%	0%	0%	2
	Total								975

Source: Crisil, SBI research

Import Intensive Sector

Industry	Downgrade (ii)	Upgrade (i)	Diff (i) - (ii)
Aluminum	1	1	0
Electrical Components & Equipment	7	4	-3
Heavy Electrical Equipment and EPC	4	1	-3
Industrial Machinery and consumables	10	10	0
Oil & Gas Drilling	1		-1
Oil & Gas Equipment & Services	4	1	-3
Oil & Gas Exploration & Production	1		-1
Oil & Gas Storage & Transportation	1	2	1
Power Storage equipments	1	2	1
Power Utilities	1	2	1
Precious Metals & Minerals	1		-1
Steel - Billet/ Ingot	6	5	-1
Steel - Ferro Alloys	1	3	2
Steel - Integrated TMT/ Rolled/ Structural Products	7	2	-5
Steel - Iron Ore Mining	1	1	0
Steel - Non integrated TMT/ Rolled/ Structural Products	5	6	1
Steel - Others	3	9	6
Steel - Primary Steel Producers	0	1	1
Steel - Semi integrated TMT/ Rolled/ Structural Products	2	7	5
Steel - Sponge/ Pig Iron	9	5	-4
Others	1	2	1
Grand Total	**67**	**64**	**-3**

Source: SBI Research

IMPACT OF RUPEE DEPRECIATION ON TOP TEN EXPORTS AND IMPORTS

- Comparing Apr'18 and Sep'18, it is visible that monthly exports have increased for almost all top commodities except engineering goods. The total change comes at around $1977 million. However, when the same comparison is done for previous year, the monthly exports had increased by $3428 million. This means that there has been a net decline in the exports growth, even as rupee has depreciated.
- For the top imports, there has been an increase as well. The Sep'18 imports are higher by $1931 million from Apr'18 imports. However, coal, coke and briquette, organic chemicals and transport equipment have seen decline. For last year comparing Apr'17 and Sep'17 data for imports shows that monthly imports had declined by $687 million. This shows that there has been a net increase in imports growth in current fiscal.
- In effect, this means we are having a situation of declining exports and increasing imports. **We estimate that the net incremental impact on trade deficit is $ 4bn.** Thus the common refrain that rupee depreciation will lead to export increase and import decline stands challenged.

Trade in Sectors					
Commodities	Change in Export ($ million)		Commodities	Change in Import ($ million)	
	Apr-Sep'18	Apr-Sep'17		Apr-Sep'18	Apr-Sep'17
Engineering Goods	-192	1185	Petroleum, Crude & products	501	810
Gems & Jewellery	452	817	Electronic goods	1537	672
Petroleum Products	1587	526	Machinery, electrical & non-electrical	66	188
Organic & Inorganic Chemicals	149	366	Gold	14	-2141
Drugs & Pharmaceuticals	190	304	Pearls, precious & Semi-precious stones	312	-529
RMG of all Textiles	-246	-86	Coal, Coke & Briquettes, etc.	-198	-208
Cotton YarnHandloom Products etc.	55	144	Organic & Inorganic Chemicals	-53	-137
Plastic & Linoleum	51	47	Transport equipment	-460	411
Rice	-209	68	Iron & Steel	140	288
Electronic Goods	142	56	Artificial resins, plastic materials, etc.	71	-42
Total	1977	3428	Total	1931	-687
Net Change	-1450		Net Change	2618	
Memoranda: Net Impact on Trade Balance : deterioration of $4068 mn					
Source: SBI Research					

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ABOUT US

The Economic Research Department (ERD) in SBI Corporate Centre is the successor to the Economic and Statistical Research Department (E&SRD). The latter came into being in 1956, immediately after the State Bank of India was formed, with the objective of "tendering technical advice to the management on economic and financial problems in which the Bank has interest and which required expert analysis".

After the first reorganization of the Bank, when specialized departments like Management Science, Management Information Systems, Planning and Market Segment Departments took over the statistical work of E&SRD, the Department was renamed as ERD.

However, with the ERD team now taking on multidimensional functionalities in the area of risk management, corporate analytics, strategy and so on, who knows, the time may have come to rename it again!

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