

IMPACT OF RUPEE DEPRECIATION

An innocuous statement by the US Federal Reserve indicating the possibility of tapering its monetary stimulus caused a chaos amongst global stock markets, which started trading in red, leading to an overall decline in the currencies worldwide, hence strengthening the dollar. The Indian Rupee slumped to an all time low at close. This persistent decline in the rupee has raised conspicuous concerns amongst investors and consumers as they fear that a weaker rupee will make capital imports expensive forcing firms to delay investments and also impact inflation thus making consumer commodities expensive.

The currency has lost 11% since May and this has come at a time when revenue growth is slowing thereby causing a double blow. Policy makers have to keep in mind that global investors fear an uncharted currency trajectory and this colossal drop will adversely affect capital intensive sectors, firms with large foreign debt and also those firms who import their raw materials. India being an import intensive country, will suffer extensively. Most of the oil demand is met by imports and since the value is declining, the imports will become costlier. Foreign investors too, will shy away from offers.

However, sectors such as software services and pharmaceuticals won't bear// the brunt of a weaker rupee, but instead will gain immensely. Having major export revenues, software services and pharmaceuticals will benefit due to foreign hedging policies and higher net profit levels.

Higher inflation, an increase in the cost of borrowings and also an increase in the import bill are some of the consequences of a declining rupee. An increase in import prices of raw materials will directly affect the prices of the final goods thereby making it costlier for consumers and thus magnifying inflation in the nation.

The following illustrates the impact of a falling rupee on various industries.

PHARMACEUTICALS SECTOR:

Rupee depreciation will be a benefit for pharmaceuticals companies who derive a major chunk of their revenues from exports as it boosts their net sales and operating margins. Market analysis shows that a depreciation of Re 1 results in a 1-2% increase in the EPS.

INFORMATION TECHNOLOGY:

Being an exporter of software services, the IT sector will also have a positive impact due to a falling rupee. However, in order to realize this effect on the margins, the execution of hedging policies and the rate of which receivables are sold in the currency forward markets will be the deciding factor.

TELECOM:

Most companies in this sector have a burden of foreign debt. A falling rupee would result in an increase in the interest payments. However, this increased outgo may be partially offset by overseas revenues and the extent to which they hedge their exposure eg. Idea and RCom have 60-70% of total debt in the form of foreign currency denominated. Idea has hedged over half the exposure where as RCom will witness a partial offsetting due to revenues from its overseas subsidiaries, Globalcom.

AUTOMOBILES:

The automobile sector imports a significant portion of their auto components. Thus these imports become expensive due to a falling rupee which will hurt its profitability. Many companies will have to pay higher royalty to their foreign parent firms. Several companies also have a lot of foreign currency loans in the form of external commercial borrowings. Maruti Suzuki has a sizeable exposure to the Japanese Yen and Tata Motors has foreign currency borrowings on its books. Many companies such as Hyundai, Honda and Ford, who largely import their components, will have to increase their prices which may not be taken lightly by consumers. The entire auto industry is already facing a slowdown due to delayed consumer spending.

PETROLEUM INDUSTRY:

The benefit of low Brent Crude is being negated by the rupee depreciation. Even though both petrol and diesel pricing are deregulated yet large under recoveries are being witnessed by downstream companies.

Oil producers may benefit, but these benefits will be negated by higher subsidy burden.

POWER:

A sharp decline in the value of the rupee is bound to affect the power generation capability of power plants that are heavily dependent upon imported coal for electricity generation. Many power companies have foreign debt on their books. A fall in rupee will result in an increased outgo in the form of interest payments and thus an increase in the level of energy deficit in the country.

All these effects will make it very expensive for these companies to produce power. Their inability to pass on these increased costs entirely or partially will add to their woes as the state distribution companies are financially feeble to purchase such high priced power.

METALS:

The coupled effect of foreign debt, raw material import and slow demand will result in steel companies taking a hit on their profitability in a depreciating environment. The revenues of companies dealing in non-ferrous metals like aluminum, copper, lead etc should improve as their prices are linked to The London Metal Exchange.

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