Implications of Rising External Commercial Borrowings on India's Financial Landscape

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Introduction

External commercial borrowings (ECB) refer to the borrowing of funds by Indian companies from foreign sources in the form of loans, bonds, or other financial instruments. ECBs can be used to finance a variety of purposes, including the expansion of business, the acquisition of assets, and the repayment of existing debt. As per RBI guidelines, all entities except a Limited Liability Partnership are allowed to raise ECBs.

ECBs can be obtained through either the automatic route or the approval route. In the automatic route, the Authorized Dealer (AD) Category-I bank assesses the case. Alternatively, in the approval route, the borrower submits a request to the Reserve Bank of India (RBI) through the AD for evaluation. Although the regulatory provisions are largely alike, distinctions between the two routes encompass the borrowing amount, borrower eligibility, and permissible end-uses.

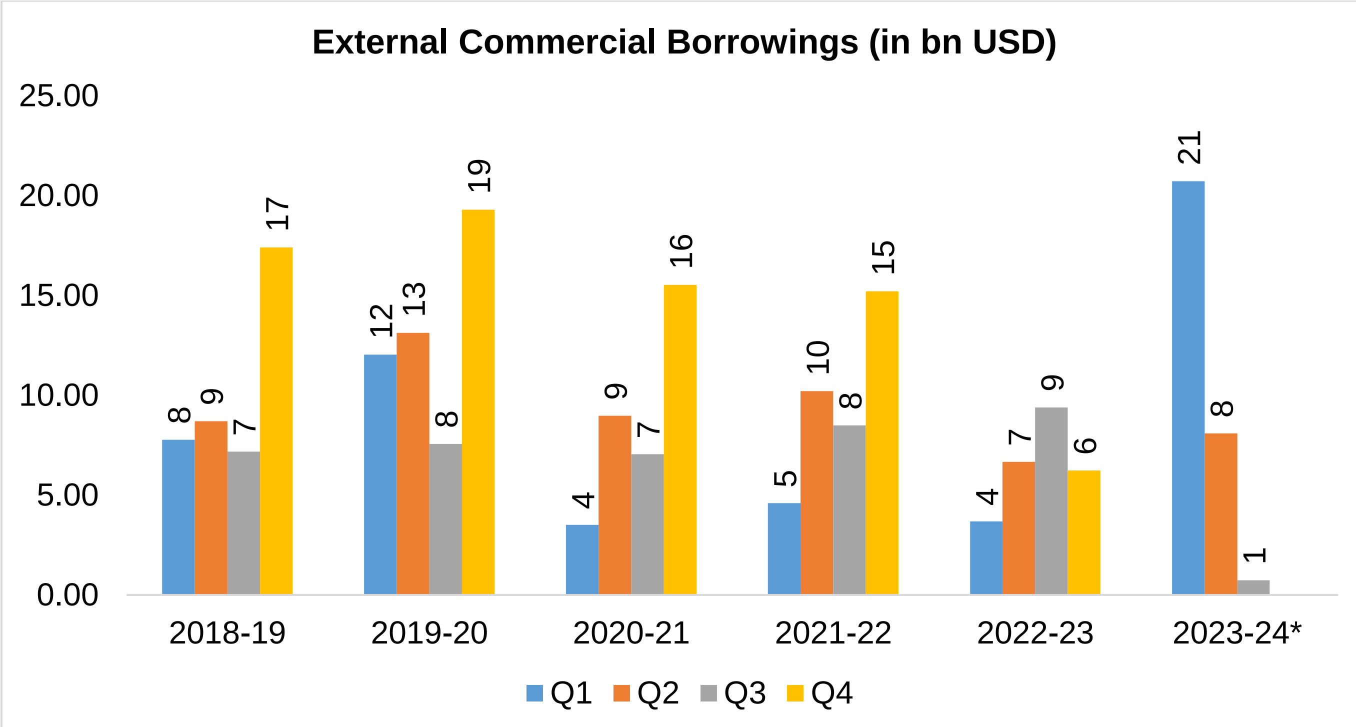
Analysis

It is to be noted that the data available on the RBI is based on applications made for ECB or foreign currency convertible bonds (FCCB), against which registrations are allotted during that period. This may or may not be the same as the actual amount brought into the country through the ECB route. It, however, does reflect the trend in demand for such borrowings.

Table 1: Year wise ECBs (in billion USD)

Year	Q1	Q2	Q3	Q4	Total	Growth Rate
2018-19	7.78	8.71	7.18	17.41	41.07	-
2019-20	12.04	13.13	7.57	19.30	52.04	27%
2020-21	3.51	8.98	7.04	15.53	35.06	-33%
2021-22	4.59	10.20	8.49	15.21	38.49	10%
2022-23	3.68	6.67	9.40	6.23	25.99	-32%
2023-24*	20.73	8.09	0.74	0.00	29.56	14%

**includes data only until October 2023*
Source- RBI, EIC



Source- RBI, EIC

Total ECB registrations in the fourth quarter of 2018-19 increased sequentially by 143 per cent over Q3 FY19. They went on to record a 27 per cent growth in the subsequent year, 2019-20. This happened as the regulator relaxed the guidelines for approval of ECB applications in January 2019. These relaxations included expanding the range of qualified borrowers, increasing the limit on such borrowings from $500 million to $750 million for all applicant categories, and up to $10 billion for OMCs (Oil Marketing Companies), along with a reduction in the minimum maturity period for such borrowings.

In the year 2020-21, ECB registrations fell by 33 per cent in the aftermath of the pandemic, before growing by 10 per cent in the following year. Total ECB registrations fell by a third (32 per cent) in 2022-23, on the back of rising global interest rates and tightening liquidity conditions. They stood at a 5 year low of $25.98 billion. During this period, the US Fed raised interest rates by 500 bps- the most aggressive tightening cycle in 4 decades, to combat high inflation, which resulted in a spike in the cost of funds globally. Additionally, volatility in rupee increased the risks of borrowing funds from overseas markets. Another reason for the drop in volume in 2022-23 was the strong growth in bank credit in the domestic economy.

In the current financial year (2023-24), while ECB registrations picked up in the first quarter, rising to 20.73 billion USD, the highest in last 5 years, they have declined subsequently due to evolving geopolitical conditions. According to RBI, nearly two thirds of new ECBs in the April-July period this year were raised for capital expenditure.

The average maturity profile for the ECBs in the 10 months of 2023-24, up to October 2023, was 6.95 years, down from 7.01 years in 2022-23.

As per data, NBFCs make up for approximately 25-35 per cent of the total ECB registrations in any given year. In 2022-23, 30 per cent of total borrowings were made by NBFCs. This figure stood at 21 per cent up to October 2023. The end uses for NBFCs can broadly be categorized in the following areas- refinancing, working capital needs and on-lending/sub lending and micro finance activities.

In November 2023, as a prudential measure, RBI increased the risk weightage on bank credit to NBFCs by 25 per cent, over and above the risk weight associated with the external rating, in all cases where the extant risk weight as per external rating of NBFC is below 100 per cent. This is expected to raise the domestic cost of funds for NBFCs, pushing them towards raising funds from the global markets in the remaining year.

Notably, the maturity profile for the borrowings raised by NBFCs has been considerably shorter compared to the average for all corporations taken together. The average maturity for NBFCs in the current financial year up to October 2023 stood at 4.68 years compared to 6.95 years for all the borrowers during this period.

In 2019, RBI relaxed the norms for ECBs by reducing the mandatory hedging requirement to 70 per cent from the then existing 100 per cent. The relaxed norms were to apply to ECBs with a maturity period between 3 and 5 years. This move was aimed at lowering the final cost of overseas borrowings in the light of increasing costs of hedging. However, in the present context, it is advised that NBFCs voluntarily undertake hedging of their overseas borrowings over and above the prescribed limits to ensure mitigating exchange rate volatility, and maintaining healthy balance sheets.

Outlook

Going forward, as long as the macroeconomic uncertainties persist, and the interest rate differential is not substantial, the ECB registrations are expected to continue to remain measured.

In the near term, we expect the external commercial borrowings by NBFCs to rise as the cost of funds in domestic markets is likely to increase, given the change in regulatory requirements of banks. In this backdrop, given the relatively short-term nature of borrowings undertaken by NBFCs, it will expose them to exchange rate risks emanating from volatility in the global currency markets. A strengthening US dollar will impact the ability of these firms to finance their debt, forcing them to undertake greater borrowings for refinancing purposes.

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