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Aditi Gupta
Economist

Taking stock of ECBs

Background

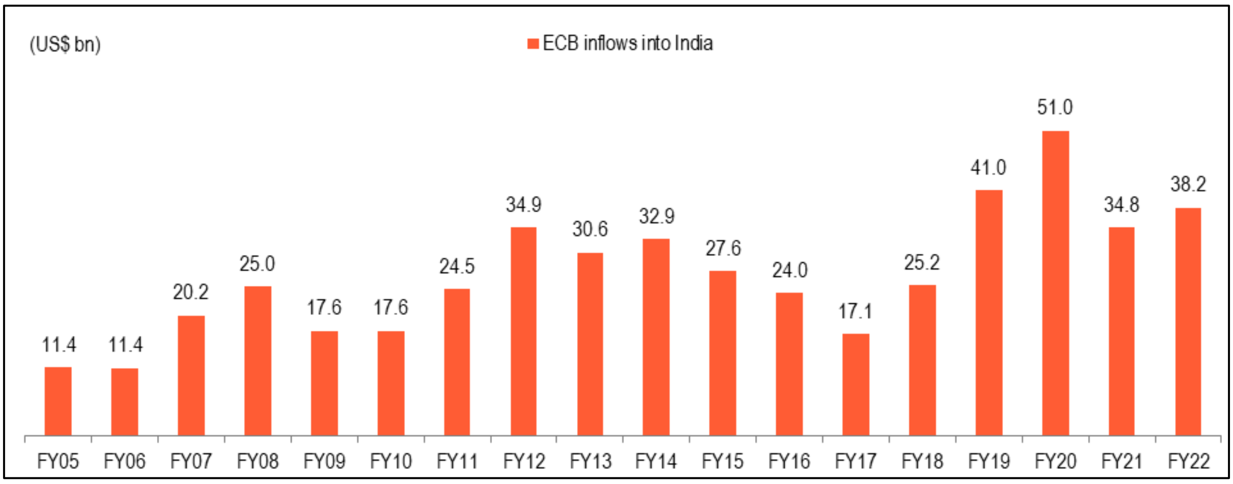
External commercial borrowings (ECBs) have emerged as an important source of financing for corporates including PSUs. Apart from their relative cost advantage (owing to lower global interest rates for an extended period of time), it also supplements the credit demand of the country thus supporting growth. The growing importance of ECBs can be gauged from the fact that ECBs account for a major share of India's external debt. In fact, ECBs accounted for 36.8% of India's external debt as of end of Dec'21. ECB approvals rose to US$ 38.3bn in FY22 from US$ 34.8bn in FY21. However, with global interest rates poised to edge up, the relative attractiveness of ECB inflows may diminish. Further, the recent depreciation seen in INR will also weigh on ECB inflows this year.

ECB Inflows: Historical trends

From US$ 11.4bn in FY05, ECB approvals surged to US$ 25bn in FY08, before moderating to US$ 17.6bn in FY09 due to the global financial crisis. Thereafter, ECB inflows recovered and touched a high of US$ 34.9bn in FY12. There was a moderation in ECB approvals in the succeeding years, with ECB approvals falling sharply to US$ 17.1bn in FY17. In the period thereafter, RBI introduced several relaxations with respect to ECBs, leading to greater inflows. In Jan'19, RBI introduced the new ECB framework. Under this, RBI expanded the list of eligible borrowers and lenders to include all entities eligible to receive FDI to tap ECB flows. Further, the minimum average maturity period (MAMP) was kept at 3 years for all ECBs, barring a few exceptions. Additionally, the borrowing limit for all eligible borrowers was raised to US$ 750mn under the automatic route, thus doing away with sector wise limits. This was followed by further easing of restrictions on working capital, general corporate purpose and repayment of rupee loans in Jul'19. On the other hand, RBI continued to tighten regulations on bank credit and working capital, thereby limiting credit supply to borrowers. Credit growth was also severely curtailed by the NPA crisis. As a result, ECB approvals surged sharply in the next 3-years, to a high of US$ 51bn in FY20. It must be noted that credit growth by SCBs slowed down to just 6.3% in the same period (12.9% in FY19) even as both WALR and repo rate were lower.

In FY21, ECB approvals moderated to US$ 34.8bn due to the Covid-19 pandemic and loss in economic activity. However, in FY22, ECB approvals have jumped to US$ 38.2bn as economic activity picked up, thus spurring demand for credit.

Fig: 1: ECB approvals have surged recently



Source: RBI, Bank of Baroda Research

ECB: automatic and approval route

In terms of composition, automatic route was preferred by borrowers in the early phase as significant restrictions existed under the approval route. In fact, ECB inflows under the automatic route accounted for about 90% of total inflows in FY05. However, during the financial crisis in FY09 and the taper tantrum during FY13-14, share of inflows under the automatic route dropped to 49.4% and 36.5% respectively. In the last 5 years (FY18-FY22), ECB inflows under automatic route have averaged ~72% of total inflows, while the rest has come through the approval route. This is notwithstanding the fact that the RBI has successively eased restrictions on ECB inflows through the approval route.

Use of ECBs

- In terms of purpose of ECBs, on-lending/sub-lending is the dominant reason for firms to borrow funds from abroad. The share of this purpose stands at 21.5% in FY22.
- Companies also utilize funds mobilized through ECBs to fund earlier ECBs. From about 32.3% of total ECB approvals in FY17, the share of this category has declined to 18.4% in FY22.
- Firms are also increasingly using ECBs to meet their working capital requirements. While funds used for working capital accounted for just 2% of total approvals in FY17, the share has risen to 13.7% in FY22.
- Refinancing of rupee loans through fresh ECB approvals has increased from just about 6.5% in FY17 to 13.2% in FY22.
- ECBs are also increasingly being mobilized for new projects as well as modernization of existing projects.

- Infrastructure development also attracted significant funding through ECBs between FY19 to FY21. However, in FY22, its share has declined to just 6.4% from 14.7% in FY21.
- Another important use of ECBs has been for import of capital goods. In FY22, 5% of total ECBs approvals were earmarked for this purpose.

Table 1: ECB approvals by purpose

% share	FY17	FY18	FY19	FY20	FY21	FYTD22
On-lending/Sub-lending.	22.4	19.0	19.3	31.5	18.6	21.5
Refinancing of Earlier ECB	32.3	35.2	12.5	9.3	13.6	18.4
Working Capital	2.0	0.7	13.4	8.3	10.8	13.7
Refinancing of Rupee loans	6.5	6.2	2.3	8.9	3.4	13.2
New Project	5.3	9.3	4.3	4.9	8.8	6.6
Infrastructure development	0.0	0.0	2.3	8.0	14.7	6.4
Modernisation	2.9	5.5	4.3	6.4	3.3	6.1
Rupee Expenditure Loc.CG	5.3	1.1	12.0	10.9	2.6	5.2
Import of Capital Goods	5.8	5.7	6.8	8.4	3.1	5.0
Other	1.5	0.0	16.0	2.7	15.4	2.5

Source: RBI, Bank of Baroda Research

Where are funds sourced from?

Data for the last 4 years suggest that the four main sources were capital market, banks and foreign collaborator which together accounted for above 85% of the approvals.

- International Capital market remains the major source of funds for Indian companies to raise funds outside. Lower global interest rates have driven corporates to explore funding options in capital markets across the globe. Share of international capital market in total ECB approvals has increased sharply from 12.6% in FY19 to 33.2% in FY22 amidst a sharp dip in global interest rates.
- Share of other commercial banks has declined from about 44.4% in FY19 to 25.3% in FY22. However, approvals from Indian commercial bank branch abroad has increased from 14.7% to 19.8% in FY22.
- Foreign collaborator/equity holder is also an important source of finance for ECBs funds by Indian companies, though the share of this category in total ECB approvals has shown some moderation between FY19 to FY21, before picking up to 15.1% in FY22.

Table 2: Share of different lender category in total ECB approvals

Lender category (% share)	FY19	FY20	FY21	FY22
International Capital Market	12.6	37.7	30.2	33.2
Other Commercial Bank	44.4	26.1	30.1	25.3
Indian Commercial Bank branch abroad	14.7	13.1	14.6	19.8
Foreign Collaborator / Foreign Equity Holder	22.9	13.6	11.7	15.1
Government owned Development Financial Institution	1.3	1.3	1.7	2.2
Multilateral Financial Institution	2.1	4.0	2.3	1.7
Others	0.2	2.1	7.5	1.5
Leasing Company	0.0	0.5	0.0	0.5
Export Credit Agency	0.0	1.4	0.0	0.3
Supplier of Equipment	0.0	0.0	0.6	0.2

Source: RBI, Bank of Baroda Research

Which sectors have been accessing this market?

In terms of the economic sector of the borrower, financial services account for a major share of total ECB approvals. However, share of ECB funds mobilized by this sector has declined from 26.6% in FY19, to 21.7% in FY22. Financial services use such funds for onward lending and would tend to have a continuous demand for ECBs provided other conditions are favourable. Manufacturers of coke and refined petroleum products have raised a significant share of total ECBs. It must be noted that there was a sharp drop in the share of this sector in FY20 to 9.7%; however since then, the share has improved to 21.6%. On the other hand, share of electricity and power transmission has increased substantially from 6.7% in FY19 to 19% in FY22. Funding by this sector has been used mainly by companies engaged in providing renewable energy.

These three sectors have accounted for around 60% of total approvals over the last 4 years. Also the bulk is from the manufacturing sector is financial services are excluded. Also within manufacturing it is more from industries which require relatively heavier investments and also contribute to the overall capital formation in the economy.

Warehousing and support activities for transportation has seen an uptick in ECB approvals in the past 3 years. From virtually nil share in FY19, its share has increased to 6.5% in FY22. Manufacture of basic metals has seen a dip in ECB approvals from 14.2% to just 5.3% in FY22. Other sectors which have seen an acceleration in ECB approvals in recent years are: extraction of crude petroleum and natural gas, manufacturing of chemicals and electronics and water transport. On the other hand, telecom services has seen a sharp dip in overall ECB approvals.

Table 3: ECB approvals by economic sector of the borrower

Economic Sector of the borrower (% share)	FY19	FY20	FY21	FY22
Financial service activities, except insurance and pension funding	26.6	40.4	28.1	21.7
Manufacture of coke and refined petroleum products	26.6	9.7	22.3	21.6
Electricity, gas, steam and air conditioning supply	6.7	12.4	9.6	19.0
Warehousing and support activities for transportation	0.0	6.1	7.4	6.5
Manufacture of basic metals	14.2	4.3	0.7	5.3
Telecommunications	8.9	2.5	2.2	3.3
Extraction of crude petroleum and natural gas	0.0	3.9	6.7	3.2
Manufacture of chemicals and chemical products	1.5	1.5	2.5	2.7
Manufacture of computer, electronic and optical products	0.0	2.9	1.5	2.3
Water transport	0.0	0.2	1.7	2.2

Source: RBI, Bank of Baroda Research

Table 4 below gives the names of some of the larger borrowers in this market in FY22.

Table 4: Borrowings by major companies in FY22

S.No.	Borrower	ECBs in US$ mn	% Share of total	Purpose
1	Reliance Industries Limited	4764.4	12.5	Refinancing of Earlier ECB, Working capital
2	Indian Oil Corporation Limited	2550.0	6.7	Refinancing of Earlier ECB, Rupee Expenditure Loc.CG, Working Capital
3	REC Limited	2452.8	6.4	On-lending/Sub-lending.
4	Mumbai International Airport Limited	1250.0	3.3	Refinancing of Rupee loans
5	JSW Steel Limited	1230.0	3.2	Modernisation, Refinancing of Rupee loans
6	Indian Railway Finance Corporation Ltd	1104.3	2.9	Infrastructure development
7	ONGC Videsh Limited	1100.0	2.9	Refinancing of Earlier ECB, Others
8	Adani Green Energy Limited	750.0	2.0	On-lending/Sub-lending.
9	Adani Ports And Special Economic Zone Ltd	750.0	2.0	Working capital
10	JSW Hydro Energy Limited	750.0	2.0	Refinancing of Rupee loans
11	NTPC Limited	750.0	2.0	Infrastructure development
12	Reliance Jio Infocomm Limited	750.0	2.0	Rupee Expenditure Loc.CG

Source: RBI, Bank of Baroda Research

Tenure and cost of ECBs

Table 5 below shows that the average tenure of ECBs was in the range of 5.320-6.1 years. However, in FY22 the tenure increased to 6.86 years. While the elongation of tenure does provide for the befit of lower interest rates for an extended period of time and some comfort on repayment, the forex risk carried would also tend to be a concern. The weighted average cost as provided in the table had come down to 1.20% over LIBOR in FY19, but has started increasing subsequently and was at 1.81% in FY22.

Table 5: Summary

	FY17	FY18	FY19	FY20	FY21	FY22*
ECB approvals (US$ bn)	17.1	25.2	41.0	51.0	34.8	38.2
Weighted average maturity (in years)	5.30	6.10	5.20	6.00	6.03	6.86
Weighted average margin over 6-month LIBOR or reference rate for Floating Rate Loans	1.62	1.34	1.20	1.34	1.93	1.81

Source: RBI, Bank of Baroda Research | * Simple weighted average of the period Apr'21 to Mar'22

Conclusion:

ECBs play an important role in India by supplementing the funding need for corporates. India has seen a steady increase in resources mobilized through this route in the last few years. Improvement in economic activity as well as low global rates have contributed to the attractiveness for this source of funding for India Inc. Some of the country's leading corporates are mobilizing resources through this route. However, with global central banks on a monetary policy tightening cycle, interest rates are likely to go up. This may lead to a moderation in ECB inflows. Furthermore, the steady depreciation in INR recently will also be a headwind for ECB inflows going forward.

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For further details about this publication, please contact:

Economics Research Department
Bank of Baroda
+91 22 6698 5143
chief.economist@bankofbaroda.com
aditi.gupta@bankofbaroda.com