Performance of ICRA-Assigned Ratings in H1 FY2020

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Rating downgrades rise even as defaults stay low

Amidst slowing economic growth in the real sector and funding cliffs faced by the financial sector, there was a sharp rise in the number of rating downgrades by ICRA in the just concluded half-fiscal. ICRA downgraded the ratings of 266 entities reflecting a downgrade rate[1] of 14.6% (annualised) which was significantly higher than the past five-year average of 8.8%. At the same time, instances of upgrades, at 170, witnessed a decline, as did the upgrade rate[2] of 9.4% (annualised) which was relatively lower than the past five-year average of 10.2%.

These indicators, as do several others, underscore a rise in pressure on the credit quality of India Inc. For instance, the volume of debt downgraded by ICRA at Rs. 5.2 trillion in H1 FY2020 was patently higher than the figure of Rs. 3.2 trillion for the full year FY2019. To a large extent, the sharp increase was attributable to the downgrade in debt of select financial sector entities, including housing finance companies, non-banking finance companies and private sector banks. That said, the debt of even non-financial sector entities experienced a substantial increase in downgrades contributed by select entities in the power sector, construction sector, besides automobile OEMs. Also, there was a marked increase in the proportion of 'fallen angels' i.e. the percentage of investment grade entities downgraded to the non-investment grade. In H1 FY2020, this proportion rose to 7.7% (annualised), the highest since FY2013.

Commenting on the credit quality trends, **Mr. Jitin Makkar, Head-Credit Policy, ICRA**, said: "*The credit quality pressures on India Inc. have been persisting for several years now but the past 12 months have been particularly troublesome. While banking sector asset quality concerns have likely bottomed out, the non-banking sector concerns relating to asset quality of wholesale book, liquidity and asset-liability mismatches continue to brew. This, coupled with slowing economic growth because of sluggish consumption and investment demand, implies that credit quality pressures will take a while to dissipate. Nevertheless, despite the somber trends overall and risk aversion being shown by investors in general, the relatively stronger corporate and financial sector entities have been able to attract large volumes of capital, even higher than in the past. Effectively, these trends have widened the schism between the exceptionally strong and the moderately strong entities which manifests in the rating actions taken by ICRA.*"

Even as credit quality pressures endured, and instances of downgrades increased, this wasn't accompanied by an increase in the overall default rates which softened to 2.5% (annualized) in H1 FY2020 in comparison with the past five-year average of 3.0%.

The Government of India (GoI) has taken several measures lately to push-up economic growth and invigorate financial sector health, particularly that of the public sector banks. Also, in a bid to support growth, the RBI has cut the policy rates on four occasions since the beginning of CY2019 by a cumulative of 110 basis points. This has also been accompanied by a sizeable infusion of liquidity by the RBI to the extent of Rs. 3.9 trillion over the past 12 months. However, the efficacy of these measures in inducing a turnaround in economic growth and supporting an improvement in credit profiles over the near term would hinge on the alleviation of various other demand-side and supply-side concerns. These include the currently moderate capacity utilization levels,

[1] Downgrade Rate is defined as the number of entities downgraded divided by the total number of entities that had a rating outstanding at the beginning of the year, excluding the [ICRA]D rated entities.
[2] Upgrade Rate is defined as the number of entities upgraded divided by the total number of entities that had a rating outstanding at the beginning of the year, excluding the [ICRA]AAA and [ICRA]A1+ rated entities.
Note: The numerical data excludes the entities that were non-cooperating at the beginning of the year

concerns around slippages in the fiscal health of the Centre and the states, the continuing structural constraints such as the pendency of land and labour reforms, relatively high debt levels of some corporate groups and the prevalent risk aversion among investors and lenders both because of an uncertain growth outlook as well as the skepticism around the corporate governance practices followed by borrowers. In consequence, a meaningful and a broad-based improvement in credit quality may not be on the horizon yet.

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