Performance of ICRA-Assigned Ratings in FY2020

April 1, 2020

Credit quality worsened in FY2020; certain to worsen further

The credit quality of India Inc. faced elevated pressures in FY2020 against the backdrop of a slowing economy because of sluggish consumption and investment demand. The pressures were further intensified by the increasing vulnerabilities of the financial sector, specifically non-bank finance companies, in terms of deteriorating asset quality and concerns around liquidity and asset-liability mismatches. As these strains took root, the risk aversion among investors and lenders became more prominent creating a vicious spiral of credit weakness. As a result, rating downgrades by ICRA increased significantly during the year, both in terms of number as well as severity.

- ICRA downgraded the ratings of 584 entities in FY2020 reflecting a downgrade rate[1] of 16% which was significantly higher than the past five-year average of 9%.
- At the same time, instances of upgrades, at 282, witnessed a decline, as did the upgrade rate[2] of 8% which was relatively lower than the past five-year average of 10%.
- Further, the Large Rating Change Rate (LRCR)[3] of ICRA-assigned ratings, a measure of the severity of rating actions, rose to 4.9% in FY2020, as against the past five-year average of 3.8%.
- The volume of debt downgraded by ICRA in FY2020 touched a high of Rs. 7 trillion, dwarfing the debt volume of Rs. 3 trillion downgraded in the preceding fiscal. The significant increase was attributable to the downgrade in debt of several financial sector entities, including housing finance companies, non-banking finance companies and private sector banks. Also, several debt-heavy non-financial sector entities experienced a downgrade, mostly in the power sector, ferrous metals sector and the construction sector.
- 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 2.3% in FY2020 in comparison with the past five-year average of 3.0%.

Commenting on the credit quality trends, **Mr. Jitin Makkar, Head-Credit Policy, ICRA**, said: “*The corporate and the financial sector entities have continued to face some or the other non-idiosyncratic risk over the past several years. From demand risk, to regulatory risk, to currency risk, to commodity risk, to funding risk -- India Inc. has experienced a wide gamut of challenges. The year gone by was no less turbulent with new sources of risk coming to the fore. Accompanying the concerns around slowing economic growth and simmering global trade tensions, was skepticism relating to the corporate governance practices followed by some of the borrowers, making investors both cautious and selective in their investment choices. The surge in rating downgrades in FY2020 reflected these trends, besides the concerns emanating from a range of firm-specific factors. That said, the credit challenges that lie ahead because of the COVID-19 crisis are going to be exceptionally overwhelming and would likely put unprecedented strain on the credit profiles of a large number of entities across sectors.”*

[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.
[3] LRCR is defined as the ratio of entities for whom the rating change (downgrade or upgrade) was by three or more notches at one go to the number of live rated entities at the beginning of the period under review. The LRCR, in practice, is influenced mainly by downward rating changes since multiple-notch movements happen primarily in the downward direction.

Note: The numerical data excludes the entities that were non-cooperating at the beginning of the year

While it is clear that the credit quality of a large swathe of entities, across a wide range of sectors would worsen as a fall-out of the COVID-19 crisis, the acuteness of the impact remains uncertain at this stage and would depend on how quickly the pandemic is contained and the measures taken by the Government to soften the deleterious impact.

Mr. Anjan Ghosh, Chief Rating Officer, ICRA, said: *"In a crisis like that induced by the COVID-19, the stress scenario assumptions get severely tested and factors that are conventionally considered as uncorrelated begin to reflect otherwise. Accordingly, we anticipate a significant deterioration in credit quality in the near term, and the extent of the same would be a function of various factors like the duration of the lockdown, the pace at which normal business activity resumes, the quantum of Government and regulatory support and the dynamics of the individual sectors. ICRA has recently charted out a heat map for various sectors with the objective of delineating the most vulnerable sectors and the relatively less exposed. This is being followed-up by a review of the portfolio of vulnerable ratings in the coming weeks with rating actions having already been taken for a sizeable number of entities. Some of the sectors where rating downgrade pressure would likely be higher, include Aviation, Hotels, Cut and Polished Diamonds, Retail and Textiles (Cotton Spinning) and Real Estate (Retail). At the same time, sectors that might be less exposed to cash flow disruption, include Telecom, Healthcare, Roads (Annuity), Agri-products, FMCG and Education. Also, in general, rating actions are likely to be more tempered for higher-rated entities that have multiple levers to pull such as strong on-balance sheet liquidity, strong refinancing ability or the backing of a strong parent or group".*

The Central Government and the Reserve Bank of India have announced significant relief measures recently on the fiscal and the monetary policy front. These include cash transfers and providing food security for the vulnerable sections of the society, besides introducing the trinity of moratoriums, systemic liquidity enhancement measures and large repo rate cuts. The latter set of measures should lend some support to market stability and offer protection against widespread defaults in the near term. However, if the extant business disruption prolongs, more relief measures might be needed to avoid severe economic imbalances.

ICRA has already published research and commentary across a wide gamut of sectors highlighting our view on the credit implications and would be providing further updates to the market as credit conditions evolve. Further, ICRA would be taking rating actions as warranted to reflect the breadth and the severity of the ongoing crisis. The year FY2021 thus portends to be a challenging year for credit quality of India Inc. as it might be for various other human, social and economic facets.

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