Performance of ICRA-Assigned Ratings in H1 FY2021

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Negative rating actions rise amid a turbulent operating environment

The business disruption and the fall in economic activity induced by the COVID-19 crisis has led to a weakening in the credit profile of a large number of entities. This is reflected in the sharp increase in negative rating actions taken by ICRA in the just concluded half-fiscal[1]. In H1 FY2021, ICRA took 582 negative rating actions, which on an annualized basis accounted for 32% of its rated portfolio[2], compared with the proportion of 23% in FY2020. Around half of the negative rating actions were downgrades. As downgrades rose, the annualized downgrade rate[3] touched a high of 17% in H1 FY2021 compared with the past five-year average of 10%. At the same time, instances of upgrades were unsurprisingly sparse. ICRA upgraded the ratings of only 94 entities in H1 FY2021, reflecting an annualized upgrade rate of a mere 5%, compared with the past five-year average of 9%. This is hardly surprising considering the severity of the crisis and the synchronized impact it has had on economies, both domestic and global.

In H1 FY2021, the top five sectors—in terms of the count and the proportion of entities in the sector—that faced a negative rating action included Textiles, Real Estate, Hospitality, Auto Ancillaries and Construction. All these sectors (barring Hospitality) were already facing a demand slowdown prior to the onset of COVID-19 and the pandemic-induced disruption further amplified the adverse effects. While negative rating actions in these sectors and the overall portfolio in general were high, there were lesser instances of defaults. Only 11 defaults were observed in ICRA's rated universe in H1 FY2021 compared with 83 defaults seen in FY2020. To a large extent, this is because many entities in ICRA's rated portfolio (27%) availed a moratorium on payments on their bank loan facilities as permitted by the RBI alleviating default risk during the period of moratorium. Even in the remainder of the fiscal, instances of defaults are expected to remain low as the stressed entities would likely seek a restructuring of loans from the lending institutions which may involve, *inter alia*, the pushing ahead of loan payments.

Commenting on the credit quality developments, **Mr. Jitin Makkar, Head-Credit Policy, ICRA**, said: "*While credit quality pressures have remained elevated, the situation could have been worse without the interventions seen on the fiscal, monetary and regulatory fronts. The mitigating effects of these measures manifested favourably in the broader financial markets as well as some specific sectors. For instance, the Reserve Bank of India (RBI) supported both a system-wide as well as a targeted improvement in liquidity conditions in specific sectors such as Non-Banking Finance Companies and Microfinance Institutions. Other relief measures included permitting the lending institutions to grant a moratorium on loan payments to borrowers for six months, and the subsequent allowance to carry out loan restructurings. These measures did and will likely work to alleviate liquidity stress, providing businesses more time to recover from demand and supply shocks. Further, liquidity support to the extent of Rs. 900 billion for state power distribution utilities, through PFC and REC[4], have eased cash flow concerns, for now, across the power sector value chain. Yet, amid the continued economic uncertainty and health concerns, aggregate consumption and investment demand is likely to remain dull in the near term. Weak growth impulses, both in terms of domestic and export demand, would likely be the predominant risk factor*

[1] In this bulletin, negative rating actions refer to rating downgrades, change in outlook to Negative from Stable, and change in outlook to Stable from Positive.

[2] The data mentioned in this document relates to the performance of financial, non-financial and public finance ratings. It does not cover the performance of structured finance ratings.

[3] Downgrade rate (upgrade rate) is defined as the number of entities downgraded (upgraded) in the period of analysis as a percentage of the total number of rated entities as of the beginning of the period.

[4] Power Finance Corporation and REC Limited

causing continued pressures on credit quality, going forward. Vulnerabilities of the financial sector and weak fiscal heath of the Centre and State governments would add to the pressures."

ICRA has recently further slashed its GDP growth forecast for FY2021 to -11.0%, from -9.5% earlier. As banks and non-banks in general face elevated asset quality pressures, and public sector banks in particular face capital constraints, credit growth is expected to fall to low single digits in FY2021 which would both be a cause and an effect of weak economic activity. A prolonged weakness in the financial sector would likely restrict the credit quality of the real sector from improving materially. While entities in many sectors may not see a further deterioration in credit quality as economic activity improves sequentially, the recovery period is expected to be both long as well as uneven. Further, in sectors such as travel, tourism, hospitality, discretionary retail and recreation, improvement might be the slowest. Notwithstanding the above, some already strong entities across sectors might become even stronger in the aftermath of the ongoing crisis.

In responding to severe and extensive shifts in the operating environment, the current ICRA-assigned ratings and outlooks capture the near-term and medium-term credit risks stemming from the pandemic, as well as the mitigating effect of policy support. Our ratings continue to reflect our expectations for medium to longer-term performance and are not predisposed solely to the credit quality weakness being seen in the extant period, unless an entity has inadequate liquidity buffers and weak financial flexibility that warrants an immediate and a relatively sharper rating change. As the situation evolves, our rating reviews will continue to incorporate emerging developments and new information.

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