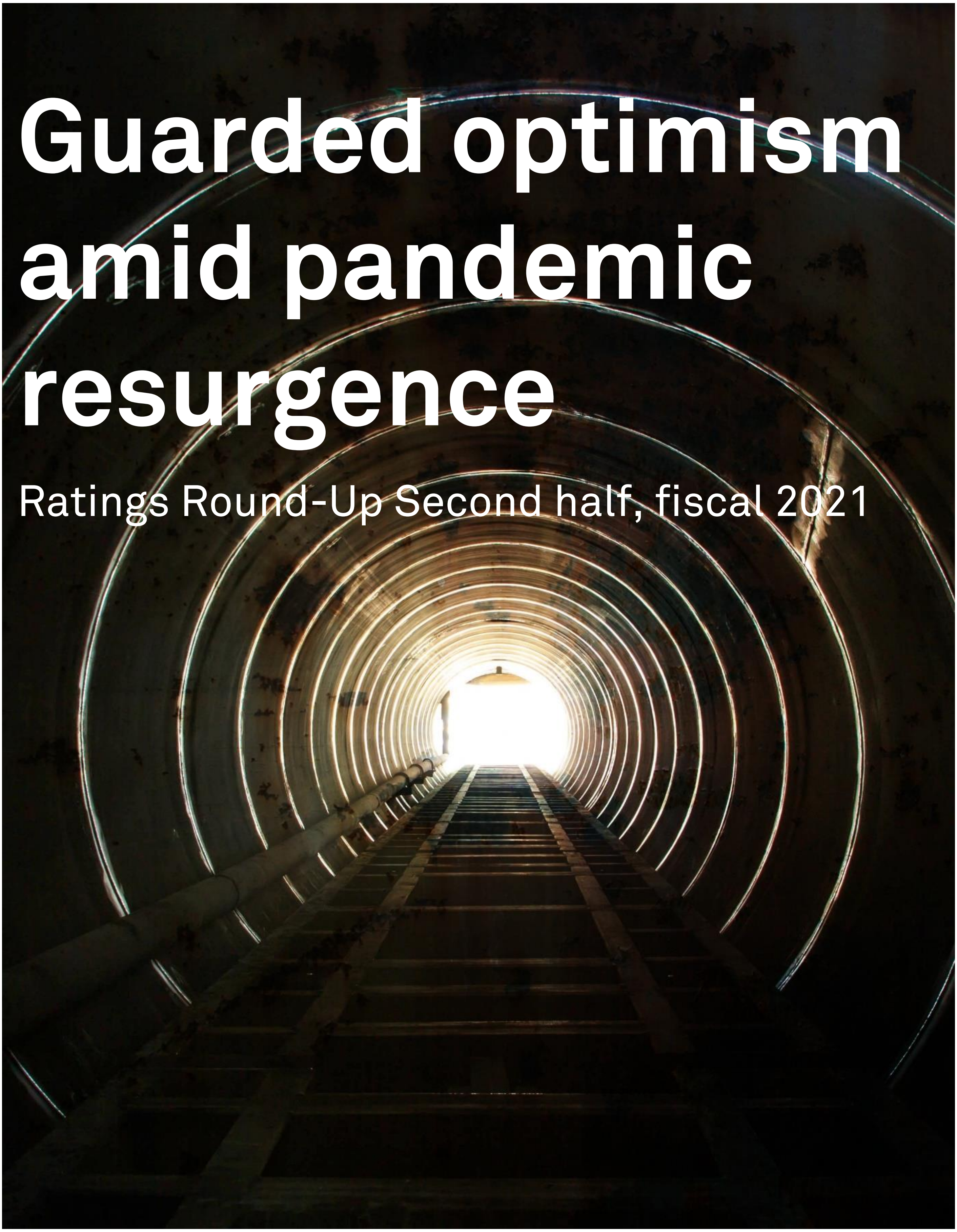
CRISIL
An S&P Global Company

Guarded optimism amid pandemic resurgence

Ratings Round-Up Second half, fiscal 2021



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Executive summary

The CRISIL Ratings credit ratio (upgrades to downgrades) scaled to 1.33 in the second half of fiscal 2021 – with upgrades and downgrades at 294 and 221, respectively – from a decadal low of 0.54 in the previous half, as demand recovery strengthened and GDP growth returned to positive territory in the third quarter. The debt-weighted credit ratio too increased to 1.26 from 0.52.

The impetus to infrastructure development in Union Budget 2021-22, steady farm performance and sustained rural demand, together with rollout of vaccination, hold promise for continued improvement in the credit quality of India Inc. even as the spectre of a second wave of Covid-19 infections looms large.

There were fewer downgrades across the spectrum in the second half despite the sunset of policy and regulatory measures such as the debt servicing moratorium in August and relaxation of default recognition norms in December 2020. These had provided temporary relief at the peak of the lockdown.

The emergency credit line guarantee scheme (ECLGS) provided much-needed liquidity support to jump-start business activity in the second half of the fiscal. But the biggest driver for the increase in credit ratio were the unlock measures, which released pent-up demand across sectors, kick-started the economy and got cash flow from operations flowing for India Inc.

Moderately resilient sectors such as automotive components and packaging saw a sharp increase in credit ratio led by increased pace of upgrades, even as credit ratio for the moderate resilient category was below 1.

Highly resilient sectors such as pharmaceuticals and agrochemicals had performed well and maintained credit ratio above 1 even during the worst phase of the pandemic, backed by sustained demand.

Low-resilience sectors such as hospitality and real estate developers continue to see more downgrades than upgrades, even as the pace of downgrades slowed in the second half.

The financial sector, too, benefitted from the rebound in corporate credit quality. Regulatory support by way of ECLGS and targeted long term repo operations (TLTRO) kept reported gross non-performing assets in check, as testified by rising collection efficiencies in the latter half of the fiscal. Public sector banks (PSBs), which benefitted from capital infusions in the past, returned to black at a systemic level after five years.

Bank credit growth is set to speed up to 9-10% in the new fiscal after mid-single digit growth in fiscal 2021. The proposed privatisation of two PSBs is a key monitorable, apart from collection efficiency and fund-raising ability, the latter especially for non-banks.

The growth-oriented Union Budget for next fiscal, which provides for higher infrastructure spending and targeted incentives for domestic manufacturing - besides a normal monsoon and the low base of fiscal 2021 - shall drive GDP growth of 11% next fiscal and, in turn, improve the credit profiles of India Inc.

The sharp rise in Covid-19 cases since mid-February 2021 and the impact of any stringent containment measures on businesses are the key threats to the nascent demand recovery and could impact the credit quality outlook adversely. That said, the CRISIL Ratings resilience study of 42 sectors indicates that only 6 (accounting for 4% of rated debt) are highly sensitive to a Covid-19 resurgence, while 20 are moderately sensitive.

Among highly sensitive sectors, airlines, airport operators, hospitality and retail have a long road to recovery, while gems & jewellery and automotive dealers have benefitted so far with supressed demand breaking free.

Rapid progress on inoculation, clearly, is key to decisively quell the risk posed by the second wave of the pandemic. Slower-than-anticipated demand growth, delays in implementation of budgetary or other fiscal measures, and a sub-normal monsoon are the other downside risks to the credit quality outlook.

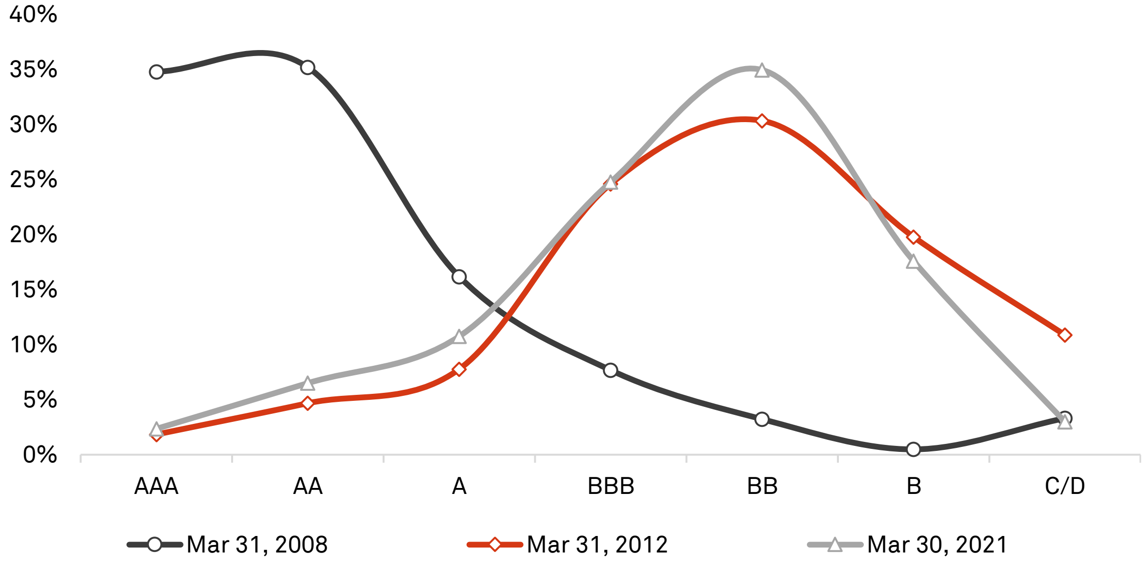
About Ratings Round-Up

The Ratings Round-Up is a semi-annual publication that analyses rating actions by CRISIL Ratings and traces the linkages between such actions and the underlying economic and business trends. This edition analyses the rating actions for the period from October 1, 2020, to March 30, 2021.

Note: A credit rating is an opinion on the likelihood of timely repayment of debt. Therefore, analysis of rating actions on a large and diverse portfolio of companies is also a reasonable indicator of an economy's directionality.

The CRISIL Ratings portfolio: Median rating unchanged

Chart 1: Trends in rating distribution



Source: CRISIL Ratings

Our outstanding ratings as on March 30, 2021, cover around 8,000[1] companies. Of these, 56% are in the 'BB' or lower rating categories. Consequently, the median rating has stayed put in the 'BB' category. With the introduction of bank loan ratings in 2007 and rapid expansion of our portfolio, especially into lower rating categories, the median rating moved to 'BB' as on March 31, 2012, from 'AA' as on March 31, 2008.

[1] This excludes companies in the 'Issuer not cooperating' or INC category. The CRISIL Ratings portfolio had 9,957 such issuers as on March 30, 2021. Including such ratings our outstanding rating list would comprise 17,835 issuers. But the median rating would remain in the 'BB' category.

Analysis of rating actions in H2-21

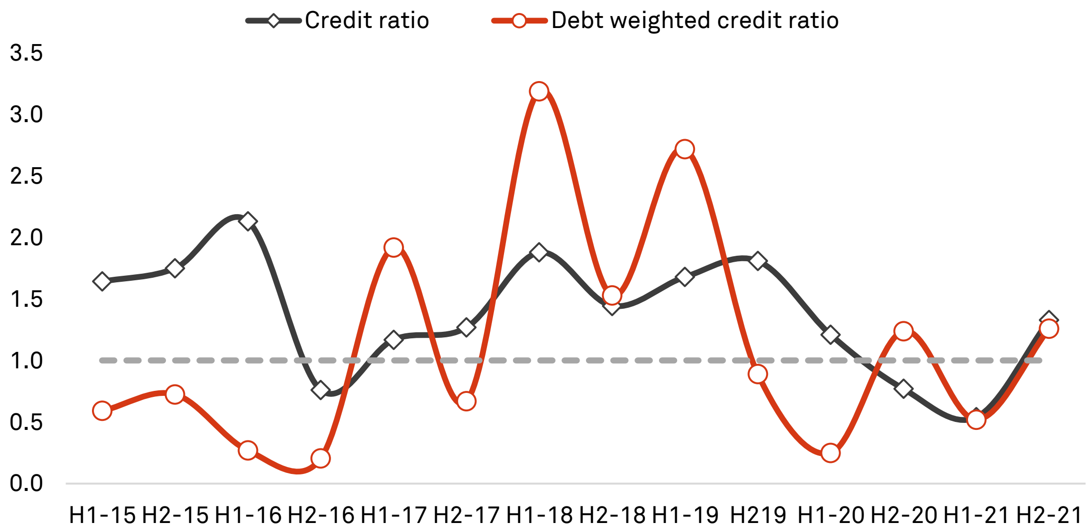
Over a year since it gripped the world, the Covid-19 pandemic continues to figure in all discussions on the economy, business or credit quality. Across industries and sectors, unlock measures over the past few months have freed latent demand and overall economic recovery in the second half of fiscal 2021 has been reassuring. The availability of several good vaccines, with more in the pipeline, augurs well. However, fears of a second wave of Covid-19 and containment measures refuse to die down.

Amid all this, how did the credit quality of India Inc pan out in the second half of fiscal 2021? And what is the outlook for next fiscal?

We have tried to answer the first question in this section, by analysing the trends in rating actions in the second half of fiscal 2021 and their key drivers. In subsequent sections, we have discussed the credit quality outlook for the first half of fiscal 2022.Credit quality improves with demand rebound post lockdown

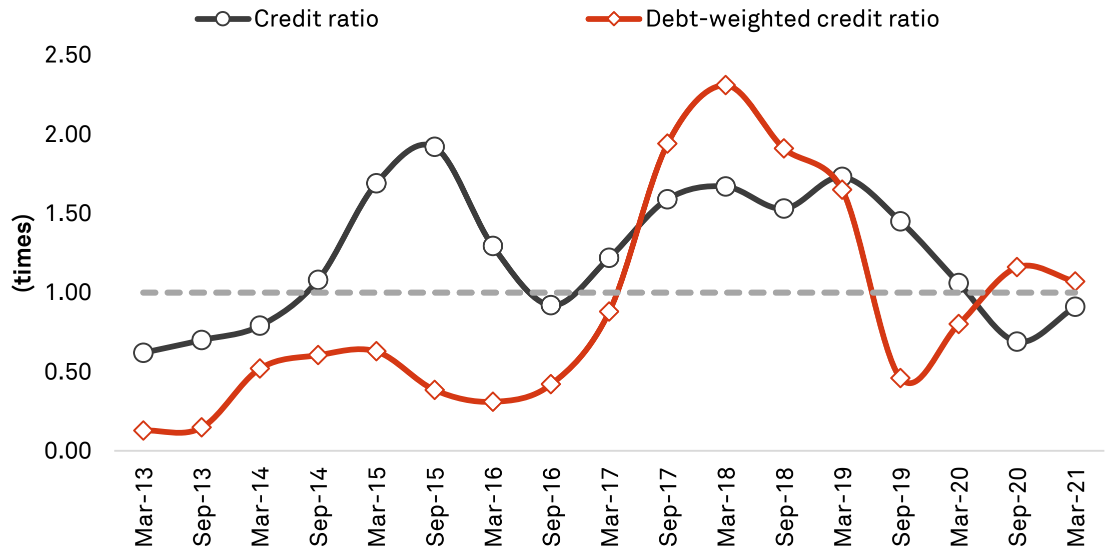
The CRISIL Ratings' credit ratio and debt-weighted credit ratio fell to a decadal low of 0.54 and 0.52, respectively, for the first half of fiscal 2021. The previous edition of Ratings Round-Up indicated our expectation that the credit ratio would remain below 1 for fiscal 2021 but would improve marginally in the second half, driven by gradual demand recovery, albeit at a varying pace across the high, moderate and low resilience sectors. As predicted, the credit ratio increased to 1.33 and debt-weighted credit ratio to 1.26 for the second half. On a 12-month rolling basis, the credit ratio and debt-weighted credit ratio change to 0.69 and 1.16, respectively, in September 2020 to 0.91 and 1.08 in March 2021.

Chart 2: Credit ratio and debt-weighted credit ratio on the rise after the Covid-induced blip



Source: CRISIL Ratings

Chart 3: Trends in credit ratio and debt-weighted credit ratio (on a rolling basis)



Source: CRISIL Ratings

The economic recovery seen in the second half of fiscal 2021 is poised to sustain this fiscal, notwithstanding the recent spike in Covid-19 cases as the cases are concentrated in a few states and containment measures are likely to be localised / targeted and less stringent this time. Recovery will be driven by investment-focussed government spending, a normal monsoon sustaining rural incomes and spend, revival of urban demand with people adapting to the post-pandemic new normal, and, of course, the low base of fiscal 2021. CRISIL expects India's GDP growth to reach 11% in fiscal 2022 after an 8% contraction in last fiscal 2021.

CRISIL Ratings recorded 294 upgrades and 221 downgrades in the second half of fiscal 2021 vis-a-vis 161 upgrades and 296 downgrades in the first half. The increase in credit ratio was driven by upgrades picking pace as the unlock measures released pent-up demand across sectors, kick-starting the economy and opening up cash flow from operations for India Inc. A few players even saw profitability improve as revenue grew and the benefits of the cost cutting measures implemented in the previous half kicked in. Among the sectors that saw a sharp rebound in the credit ratio were moderate resilience sectors such as construction, engineering and electricity generation.

There were fewer downgrades and defaults compared with the previous half despite the end of the term loan moratorium in August 2020 and relaxation of default recognition norms in December 2020. The emergency credit lines offered by lenders were a great help, especially for mid-sized and small companies, and so was the one-time debt restructuring scheme announced by the Reserve Bank of India (RBI) in August 2020.

Sectors such as speciality chemicals, pharmaceuticals and metal & glass containers, classified as highly resilient to the impact of the pandemic and the subsequent lockdown, continued to witness higher upgrades than downgrades. A few low resilience sectors such as hotels and resorts and real estate developers, continued to see downgrades outnumbering upgrades, though at a slower pace.

CRISIL Ratings continues to monitor the impact of the pandemic and unlock measures as well as the second wave and potential containment measures on the credit profiles of rated entity. As the economy revived in the second half of fiscal 2021, CRISIL Ratings continued its endeavour to keep investors informed, publishing 57 press releases and hosting 17 webinars on sectoral developments.

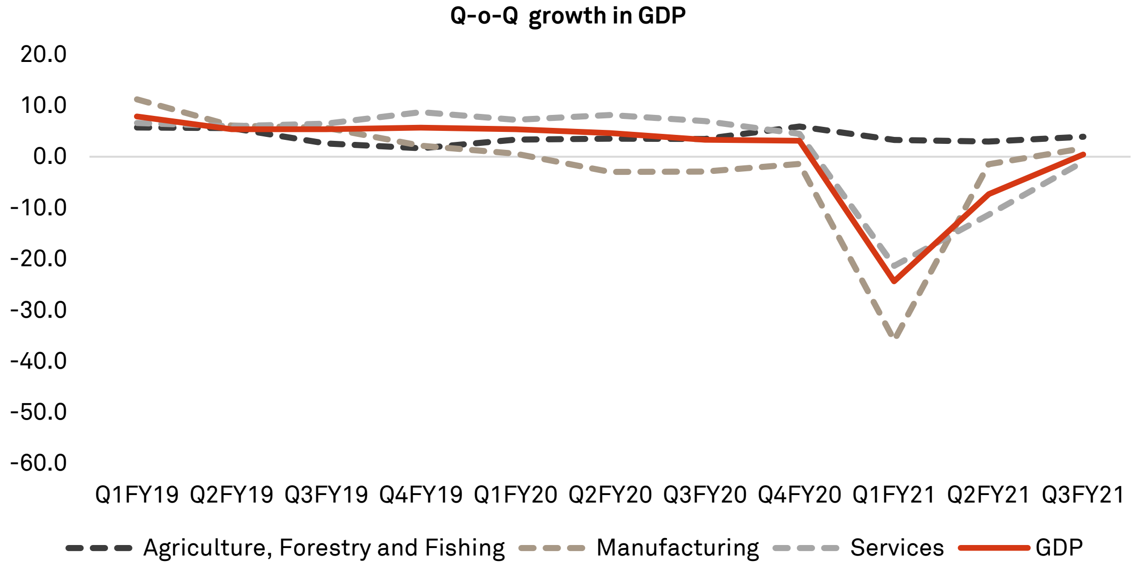
Driven by its comprehensive analysis, robust criteria and proactive surveillance, CRISIL Ratings has sustained its best-in-class quality metrics with the lowest default rates, highest stability rates, and lowest intensity of rating actions among all credit rating agencies.

Macroeconomic revival post the Covid-19 blip

The macroeconomic outlook for India indicates promising recovery, albeit clouded by fears of containment measures in the wake of a second wave of the pandemic.

The country's gross domestic product (GDP), after the worst ever quarterly contraction of around 23% in the first quarter of fiscal 2021, actually grew 0.4% in the third quarter and should continue on the path of recovery, closing the fiscal with only about 8% contraction, unless marred by a bigger second wave of cases or a vaccine-resistant virus variant.

Chart 4: GDP and IIP growth trend analysis



Source: CRISIL Research

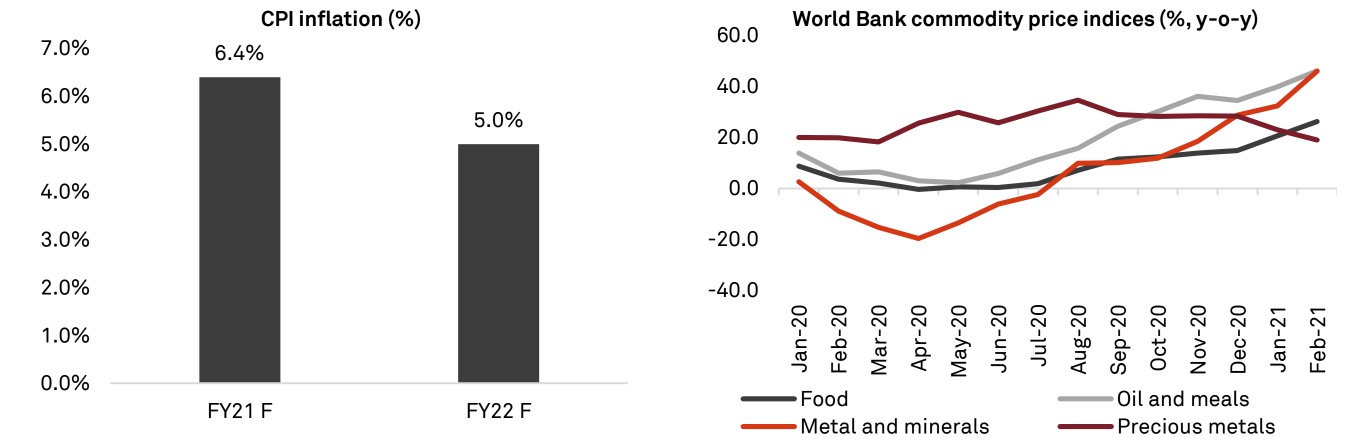
Economic indicators other than GDP have also rebounded from the troughs seen in the first quarter of fiscal 2021, with some sectors nearly touching pre-Covid-19 levels.

CRISIL expects India's GDP growth to rebound to 11% in fiscal 2022 over a weak base, flattening of the Covid-19 curve amid increasing vaccinations, and investment-focused government spending. The expectation is based on the already realised sharp recovery in the second and third quarters of fiscal 2021 in aggregate GDP. Deconstructing the recovery indicates that manufacturing, which saw the sharpest drop when the pandemic first struck, bounced back the hardest as the lockdown restrictions were eased. Agriculture had remained steady and positive even during the peak of the pandemic, backed by yet another good monsoon buoying rural incomes and demand. The services sector was the laggard, held back by lower demand for travel, hospitality and other services involving regular human contact. Increased stress in the financial sector, a second wave of the pandemic, and a below-normal monsoon (a third consecutive monsoon is a rarity!) could pose downside risks to the forecast. India's GDP growth will likely average 6.3% between fiscals 2023 and 2025. The global economy is projected to grow 5.5% in 2021 and 4.2% in 2022 as per IMF.

Rise in inflation

After declining in the previous two months, Consumer Price Index (CPI) inflation rose to 5.0% in February 2021 from 4.1% in January mainly because of incremental core and food inflation. Core inflation, that is, sans food and beverages and fuel and energy inflation, rose sharply in February, even as the economic recovery was still nascent. This suggests upside pressure to core inflation as recovery gains momentum. CPI inflation is expected to cool, while core inflation is likely to remain high in fiscal 2022. CRISIL forecasts India's CPI inflation to soften to 5.0% in fiscal 2022 despite firming international commodity prices. The high base effect of 2021 and lower food prices will push inflation downward. Core inflation, however, is expected to remain obdurate at 5.5-6.0% amid the ongoing economic recovery and improvement in demand. Rising commodity prices, especially of crude oil, would exacerbate.

Chart 5: CPI inflation vs International commodity prices



Source: National statistical office, CRISIL, World bank

A growth-oriented Union Budget

- The Union Budget for fiscal 2022 provides a much-needed impetus to infrastructure development which could reduce trade and transaction costs and improve factor productivity.
- Capital infusion of Rs 20,000 crore in PSBs to revive credit growth and the Rs 20,000 crore allocation for a development finance institution will boost funding of infrastructure projects.
- To bolster domestic manufacturing and export, the government announced the Production-Linked Incentive (PLI) scheme of Rs 2.04 lakh crore for 13 sectors.
- In the backdrop of the pandemic, higher allocation of Rs 2.23 lakh crore was announced for healthcare with schemes to develop primary, secondary and tertiary healthcare systems.

These measures, along with the gradual and complete unlocking of the economy, will help improve consumption as well as investment.

The first half of fiscal 2022 will benefit from a low base effect and the second half will truly indicate the pickup in the economy. The rural economy has remained strong backed by good monsoon and improvement in agriculture and allied sectors. However, labor-intensive and small businesses, which bore the major brunt of the pandemic, continue to lag.

The narrowing fiscal deficit, forecast at 6.8% in fiscal 2022 after a forecast of 9.5% for fiscal 2021, is a relief. However, rising inflation and crude prices remain key monitorables. Timely and successful implementation of the growth-oriented and ambitious budget measures will be critical for a smooth[2] economic recovery. The outlook for the medium term, hence, remains cautiously positive

[2] Please refer to CRISIL Research publication ‘The policy support imperative’

Orientation wise sectoral trends in credit ratio

Investment-linked sectors: Gradual unlocking and fiscal stimulus spurred improvement in investment-linked sectors. Steel and cement sectors had declined in the first half of fiscal 2021, but the boost to infrastructure spending lifted demand in the second half. The cement sector is expected to see decadal high growth of 13% in fiscal 2022. Steel consumption in India fell 6% in the second quarter of fiscal 2021. While exports buoyed demand for steel earlier, the recovery in the automobile and construction segments shored up the sector in recent months. Rising prices and the government boost to infrastructural spending will aid growth in the sector. Domestic crude oil production fell 5.4% during the first 11 months of fiscal 2021 against 5.9% de-growth a year earlier, driven by technical mishaps due to Covid-19 implications, reservoir issues and shut-in wells, and delays in field development activities.

Consumption-linked sectors: Good monsoon, lower diesel consumption, higher government procurement and a resilient rural economy revved up tractor sales growth to 18-20% in fiscal 2021. The growth is expected to slow in fiscal 2022 owing to the high base of the previous fiscal. Passenger vehicles (PVs), two wheelers and Commercial vehicles (CVs) have demonstrated positive growth in demand (refer Table 4) after declining sharply in first half. PV demand benefitted from less-than-anticipated salary cuts and job losses while two-wheeler demand was impacted by high price increase. The retail segment also benefitted from a low base and recovery in discretionary consumption as the unlock measures unchained demand. Sectors such as FMCG showed faster recovery compared with fashion apparel.

Export-linked sectors: Within export linked sectors, textile was the worst hit amid muted demand and slackened retail sales. Readymade garment revenue is projected to have declined 20-22% in fiscal 2021 given the drop in both domestic and export demand. Exports saw a steeper fall in the first half of fiscal 2021 as the pandemic spread across the US and the EU. Demand remained muted in the second half amid the second and third waves in the EU. In the domestic market, there was some revival in the second half of fiscal 2021 with the festive season in the third quarter and reopening of malls and retail outlets along with further unlocking of economic activities in the fourth quarter of the fiscal.

Pharmaceuticals saw a negligible impact. Domestic demand fell 11% in the first quarter and 6% in the second quarter, but picked up in the second half of fiscal 2021 and is projected to end the fiscal with a growth of 1-3%. Resilient demand, opportunities in vaccine supply, and product diversification augur well for formulation exports.

An analysis of the sectoral credit impact in the second half of fiscal 2021 is detailed below.

Investment-linked sectors

Rise in government spending

42%

of ratings outstanding as on date

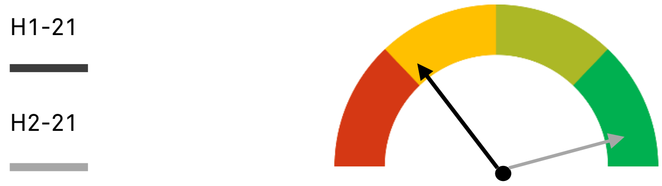


Table 1: Trends in investment linked sectors in H2-21 vs H1-21

	Demand	Realisations	Working capital	Credit quality H2-21	Remarks
Construction and engineering	↑	↑	↔	↑	*Healthy order book, improved project execution capabilities with sites opening up after the nationwide lockdown, and easing of issues regarding availability of raw material and labour have improved credit ratio.*
Real estate (commercial)	↔	↔	↔	↔	*Marginal improvement, but credit ratio remains weak because of lower footfall and lease rentals and increased vacancy.*
Real estate (residential)	↔	↔	↔	↔	*Demand growth remains restrained. Collections started improving marginally from September 2020, but remain under pressure, resulting in no notable change in the credit ratio.*
Steel	↑	↑	↔	↑	*Sharp improvement in realisations and efficient working capital management. Larger players benefitted from economies of scale, uptick in prices and strong dealer network/brand recall. Volatility in raw material prices, intense competition and downturn in end-user industry continue to constrain.*
Speciality chemicals	↑	↑	↑	↑	*End-user industries (FMCG, personal care, pharmaceuticals) weren't much affected by the pandemic, and sustained demand supported credit profiles.*

Source: CRISIL Ratings

The credit ratio of investment-linked sectors improved from 0.60 in the first half of fiscal 2021 to 1.62 in the second half.

Gradual unlocking of businesses, opening of sites regularising cash flows, and Covid-19 relief packages provided the necessary stimulus to industries in the investment-linked sector, such as construction & engineering, industrial machinery, steel and speciality chemicals, improving their credit ratio. Nevertheless, small companies with low revenue visibility continued to suffer. Also, slowdown in certain end-user industries impacted a few companies in the industrial machinery segment. Credit ratio for real estate (commercial and residential) remained low with downgrades outnumbering upgrades significantly on the back of tepid realisations and cautious footfall.

Consumption-linked sectors

Expansion in private consumption

42%

of ratings outstanding as on date

Table 2: Trends in consumption linked sectors in H2-21 vs H1-21

	Demand	Realisations	Working capital	Credit quality H2-21	Remarks
Metal & glass containers	↑	↑	↑	↑	*Demand for packaging and value-added films were buoyant amid the pandemic; large end-user industry base also helps diversify business risks*
Auto dealers	↑	↑	↔	↑	*Growth in sales volume in recent months as unlock measures released suppressed demand; preference for personal transport amid the pandemic to boost demand*
Hotels	↔	↔	↔	↔	*Tourism and hospitality industry remains grounded as corporate and leisure travel still fairly restricted; occupancy increased marginally in some pockets post lockdown measures, but its sustenance to be seen*
Educational services	↔	↔	↔	↔	*Delayed fee collection constrains cash flow and decline in occupancy and revenue continues, driven by low demand despite slight improvement from September (led by migration to online platform)*
Agricultural products	↑	↑	↔	↑	*Supported by good monsoon, but hangover of the pandemic remains*

Source: CRISIL Ratings

The credit ratio of consumption-linked sectors improved from 0.55 in the first half of fiscal 2021 to 1.11 in the second half.

Consumption-linked sectors remained a mix bag. Sectors such as metal containers, automotive dealers and agricultural products showed substantial improvement as increased demand from end-users resulted in better revenue growth and accruals in the second half of fiscal 2021. Trepidation over health safety, intermittent lockdowns, and restrictions on social gatherings continued to batter the hotel industry where downgrades outnumbered upgrades. Collections in the educational services sector, despite relaxation of lockdown rules and migration to online platforms, remained subdued resulting in a low credit ratio.

Export-linked sectors

Uptick in demand with tapering of global uncertainties

12%

of ratings outstanding as on date

H1-21

H2-21

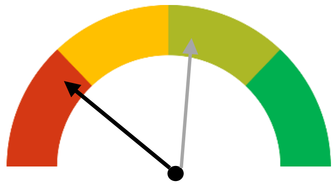


Table 3: Trends in export linked sectors in H2-21 vs H1-21

	Demand	Realisations	Working capital	Credit quality H2-21	Remarks
Textiles (readymade garments)	↔	↔	↔	↔	*Muted demand in overseas markets, especially with the second and third waves of Covid cases in Europe; domestic demand seen picking up lately*
Textiles (ginning and spinning)	↔	↔	↔	↔	*Yarn demand, both in India and abroad, remained muted, leading to continued pressure on prices. Furthermore, the sale of fabrics has slackened amid limited retail offtake*
Electronic components	↑	↑	↔	↑	*Growing importance of network availability, seamless connectivity and network security have helped certain electronic component businesses*
Pharmaceuticals	↑	↑	↑	↑	*Revenue bounced back to pre-Covid levels in the second quarter of fiscal 2021 backed by higher customer offtake*

Source: CRISIL Ratings

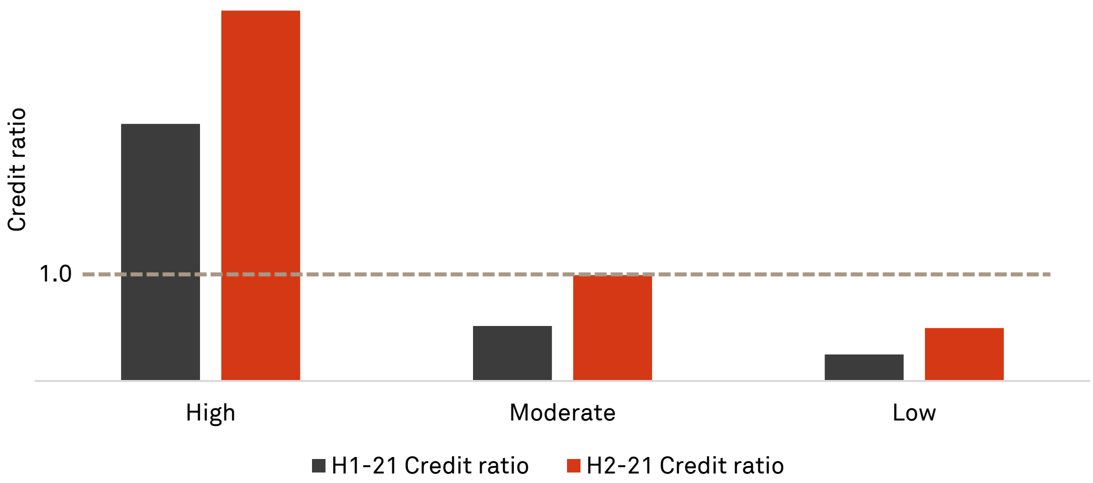
The credit ratio of export-linked sectors improved from 0.46 in the first half of fiscal 2021 to 1.18 in the second half.

Export-linked sectors saw a medley of rating actions. Sectors such as textile, which were already under pressure pre-pandemic, continued to see higher downgrades with the pandemic wreaking havoc in Europe, the key market, and volatility in raw material prices adding to the mayhem. The pharmaceutical industry, being more resilient and insulated to cyclicality because of the essential nature of products, maintained strong operating performance and revenue growth. Upgrades in the pharmaceutical sector significantly outnumbered downgrades. Similarly, the electronic components segment saw burgeoning demand as people took to working from home and with certain products under the gambit of essential commodities, and credit quality improved in the second half of fiscal 2021.

Update on the resilience framework: How sectors fared compared with expectations

At the onset of the pandemic, CRISIL Ratings released its sectoral resilience framework. We assessed the credit quality outlook for 42 sectors based on their ability to survive the lockdown and to recover demand to pre-pandemic levels, and classified the sectors into three buckets: high, moderate and low resilience. The underlying assumptions were: the nature of demand (discretionary or non-discretionary), immediate impact of the lockdown on revenue, and the estimated time for recovery. Post the unlock measures and nascent demand recovery, we took stock of the green shoots in business activity in our October 2020 Ratings Round-up. We have now analysed trends in rating actions in the first and second half of fiscal 2021 to gauge the efficacy of the resilience framework.

Chart 6: Credit ratio as per sectoral resiliency in H2-21



Source: CRISIL Ratings

Not surprisingly, the rating trends are aligned with our resiliency classification.

- For highly resilient sectors, upgrades continue to outpace downgrades, supported by sectors such as pharmaceuticals and agrochemicals which performed well because of sustained demand. The credit ratio for these sectors remained above 1 even during the bleakest period of the pandemic.
- Moderate resilience sectors demonstrated a recovery trend with more upgrades in sectors such as construction, engineering and electricity generation, which benefitted from the lockdown relaxation, revival in demand and higher commodity prices. Some sectors continued to see more downgrades than upgrades in the second half but an improved credit ratio compared with the first half.
- Low resilience sectors such as hotels and resorts, real estate developers and airport operators continued to see more downgrades than upgrades because of discretionary demand and leveraged balance sheets.

Credit quality outlook for corporates

Demand near pre-pandemic levels, but wariness persists as Covid-19 remains untamed

Business activity almost back to normal…

Majority of the key corporate sectors either recovered fully or inched closer to the pre-pandemic levels by the fourth quarter of fiscal 2021, helped by the festive season and reduced daily infections in the previous quarter. This sparked a return of GDP growth after two quarters of decline.

Most of the high-frequency indicators show an uptick in business recovery.

On the consumption side, the auto sector recovery is supported by rising consumer preference for personal mobility and resilient rural consumption on the back of a good monsoon. Similarly, electricity consumption has been rising every month across states and overall consumption in fiscal 2021 will be just a shade lower compared with the previous fiscal. Demand for consumer durables rose because of increased usage as people worked from home, and was cheered on by the festive season. While essentials drove the FMCG sector's recovery, we are now seeing improvement in demand for discretionary goods too. Even the retail sector saw increased footfall in the second half of fiscal 2021, as depicted by the Google Mobility index. Increasing mobility drove fuel consumption, though air turbine fuel (ATF) consumption continues to lag on account of subdued air travel. Infra-linked core sectors such as steel and cement gained from the significant uptick in construction activities. The movement of material (transport and logistics) and increased commercial traffic on toll roads, port activity and rail freight trends indicate that industrial and commercial activity is back to pre-pandemic levels.

A part of the improvement can be attributed to the spurt in demand amid the festive season and its long-term sustainability remains to be seen. Also, sectors with high consumer contact such as hospitality and airlines continue to face headwinds and recovery remains distant..

...but recent resurgence of infections makes for a rocky road ahead

The surge in active Covid-19 cases almost to the 6 lakh mark in March 2021 from less than 1.5 lakh in mid-February 2021 has raised some doubts regarding the potential recovery. India remains among the largest contributors to the daily global tally.

Though India began its mass vaccination drive in January 2021, a potential second wave of the pandemic could trip up business activity and consumption and wreak the country's growth plans.

Table 4: Month on Month trend of high frequency indicators from April 2020 to February 2021

Y-o-y change (unless otherwise mentioned)	Unit	Apr-20	May-20	Jun-20	Jul-20	Aug-20	Sep-20	Oct-20	Nov-20	Dec-20	Jan-21	Feb-21
Macro trend												
Active Covid case tally (#)	#	24,641	93,349	2,20,546	5,64,856	7,85,127	9,41,552	5,71,529	4,37,000	2,55,525	1,70,203	1,70,293
IIP	%	-57.3	-33.4	-16.6	-10.5	-7.1	1.0	4.5	-2.1	1.6	-1.6	
PMI mfg	Pts	27.4	30.8	47.2	46	52	56.8	58.9	56.3	56.4	57.7	57.5
PMI services	Pts	5.4	12.6	33.7	34.2	41.8	49.8	54.1	53.7	52.3	52.8	55.3
Export growth	%	-61.0	-35.7	-12.2	-9.5	-12.2	6.0	-4.9	-8.4	0.2	6.2	0.7
Import growth	%	-59.7	-51.0	-48.0	-29.6	-26.0	-19.6	-11.5	-13.3	7.6	2.0	7.0
CPI inflation	%	7.2	6.3	6.2	6.7	6.7	7.3	7.6	6.9	4.6	4.1	5.0
Wholesale bank credit growth	%	6.0	5.9	6.0	5.0	4.2	4.2	3.4	3.7	3.4	3.2	
Industry	%	1.7	1.7	2.2	0.8	0.5	0.0	-1.7	-0.7	-1.2	-1.3	
Services	%	11.2	11.2	10.7	10.1	8.6	9.1	9.5	8.8	8.8	8.4	
Retail bank credit growth	%	12.1	10.6	10.5	11.2	10.6	9.2	9.3	10.0	9.5	9.1	
Transportation & mobility trend												
Domestic airline passenger traffic	%	-99.9	-97.4	-83.5	-82.6	-75.8	-65.1	-56.8	-50.2	-42.9	-38.7	
Rail freight traffic	%	-35.3	-21.3	-7.7	-4.6	3.9	15.5	15.4	9.0	8.7	8.7	5.5
Toll road revenue	%	-60	-25	-11 to 3	-9 to 5	-6 to 8	8 to 11	9 to 13	9 to 10	11 to 14	12 to 13	7 to 11
GST E-way bills	%	-83.6	-53.0	-12.7	-7.3	-3.5	9.6	21.4	8.1	15.9	10.5	11.6
Intrastate	%	-79.8	-46.1	-7.9	-3.9	1.4	15.1	23.3	9.6	17.3	13.0	14.5
Interstate	%	-88.9	-62.8	-19.9	-12.3	-10.4	2.2	18.8	6.0	13.8	6.8	7.6
Port traffic	%	-21	-23	-15	-13	-10	-2	-1	3	4	4	2
Transport & logistics-trucking revenue	%	-75	-45	-25	-20	-20 to -15	-10 to -5	0 to 5	5 to 10	5 to 10	10 to 15	10 to 15
Transport & logistics-shipping revenue	%	-40	-25	-11	-8	-5	4	7	8	12 to 15	13	13
Google mobility index (measured as % change from baseline)												
Residential	%	28.5	21.9	14.7	15.8	13.1	13.5	11.6	10.2	10.8	10.4	7.0
Grocery & pharmacy	%	-52.0	-25.9	-2.5	-9.2	-11.2	-4.9	6.6	10.8	9.5	6.9	15.8
Workplaces	%	-61.7	-44.0	-30.6	-31.9	-28.8	-24.0	-23.9	-24.3	-17.9	-17.0	-14.9
Transit stations	%	-67.8	-52.9	-38.3	-41.5	-38.0	-30.0	-21.0	-17.5	-10.7	-12.7	-6.9
Retail & recreation	%	-81.5	-76.1	-59.8	-59.3	-51.5	-41.9	-33.8	-28.1	-27.5	-27.6	-22.7
Parks	%	-56.5	-58.6	-51.6	-50.9	-51.8	-45.3	-41.5	-34.2	-17.2	-13.4	-13.1
Consumption pattern												
Credit card transactions	%	-53.8	-40.6	-23.5	-26.0	-20.6	-17.1	-15.4	-9.0	-15.1		
Debit card transactions	%	-61.4	-47.6	-37.0	-38.5	-35.6	-31.4	-28.4	-5.6	-11.7		
Electricity consumption	%	-25.0	-15.2	-10.5	-2.7	-2.1	4.5	12.1	3.6	5.1	4.8	3.4
Petroleum consumption	%	-48.7	-19.4	-9.0	-12.1	-16.0	-4.4	2.7	-3.3	-1.3	-2.7	-5.5
ATF	%	-91.4	-83.8	-65.9	-64.5	-61.5	-52.0	-48.4	-46.8	-41.3	-40.3	-37.2

Y-o-y change (unless otherwise mentioned)	Unit	Apr-20	May-20	Jun-20	Jul-20	Aug-20	Sep-20	Oct-20	Nov-20	Dec-20	Jan-21	Feb-21
Diesel	%	-55.6	-29.5	-15.5	-19.4	-20.7	-5.9	7.5	-6.9	-2.7	-1.9	-8.5
LPG	%	11.2	11.8	15.1	2.0	-5.4	4.7	3.1	4.1	7.5	1.8	7.2
Petrol	%	-60.4	-35.3	-13.5	-10.4	-7.5	3.3	4.5	5.1	9.4	6.3	-3.0
Auto	%	-100.0	-84.8	-43.0	-18.6	-1.3	7.2	10.5	6.0	0.7	0.4	6.3
PV	%	-100.0	-85.2	-49.6	-3.9	14.2	26.5	14.2	4.6	13.6	11.1	17.9
2W	%	-100.0	-83.8	-38.6	-15.2	3.0	11.6	16.9	13.4	7.4	6.6	10.2
Tractor	%	-100.0	-100.0	22.4	38.5	74.7	28.3	7.7	51.3	43.1	47.5	30.4
MHCV	%		-94		-75	-53	-16	-6	-11	9	6	15
LCV	%		-80		-2	4	5	-5	6	-8	-21	-10
FMCG revenue	%		-15		-5 to 0	0 to 5	5	5	8 to 9	9 to 10	8 to 10	11 to 12
Packaging revenue	%	-60 to -50	-40	-20 to -10	-10 to 0	-5 to 0	-2	0 to 5	0 to 3	0 to 5	7 to 8	7 to 8

Data is in terms of volume unless otherwise specified

Source: Health ministry, RBI, MOSPI, IHS Markit, Indian Ports Association, AAI, Indian Railways, GST Network, Power System Operations Corporation Ltd, SIAM, Ministry of Steel, DIPP, PPAC, Department of Commerce, Google mobility tracker and CRISIL estimates

Methodology & assumptions

CRISIL has analysed 42[3] key sectors on three parameters a) extent of recovery b) sectoral resilience c) sensitivity to a Covid-19 resurgence. These sectors comprise 75% of its rated portfolio (excluding financial services).

Some of the key terminologies used are:

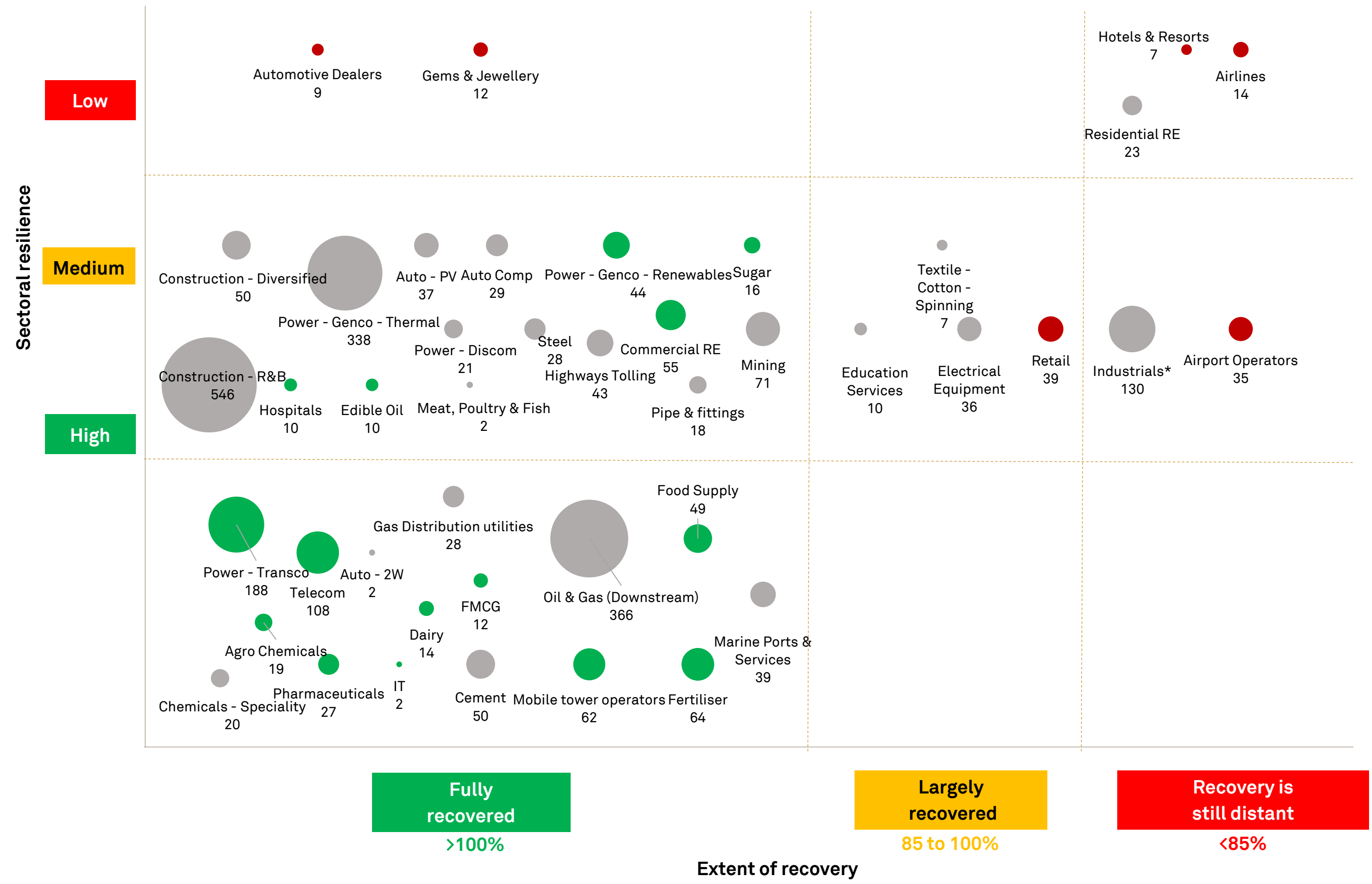
Extent of recovery: Indicates the level of recovery to the pre-pandemic level. It is calculated by comparing estimated revenue for the fourth quarter of fiscal 2021 with revenue for the corresponding period of the previous fiscal.

Sectoral resilience: Measures ability to withstand future disruptions/shocks. It is based on category of goods (essential/ non-essential); nature of demand (discretionary or non-discretionary); balance sheet strength in terms of leverage and liquidity available for entities in the sector; and the level of government/ regulatory support to the sector.

Sensitivity to Covid-19 resurgence: Gauges sensitivity to the risk of a second wave of the pandemic, including containment measures such as night curfews/ limited public mobility. Businesses with high direct consumer interactions are more sensitive.

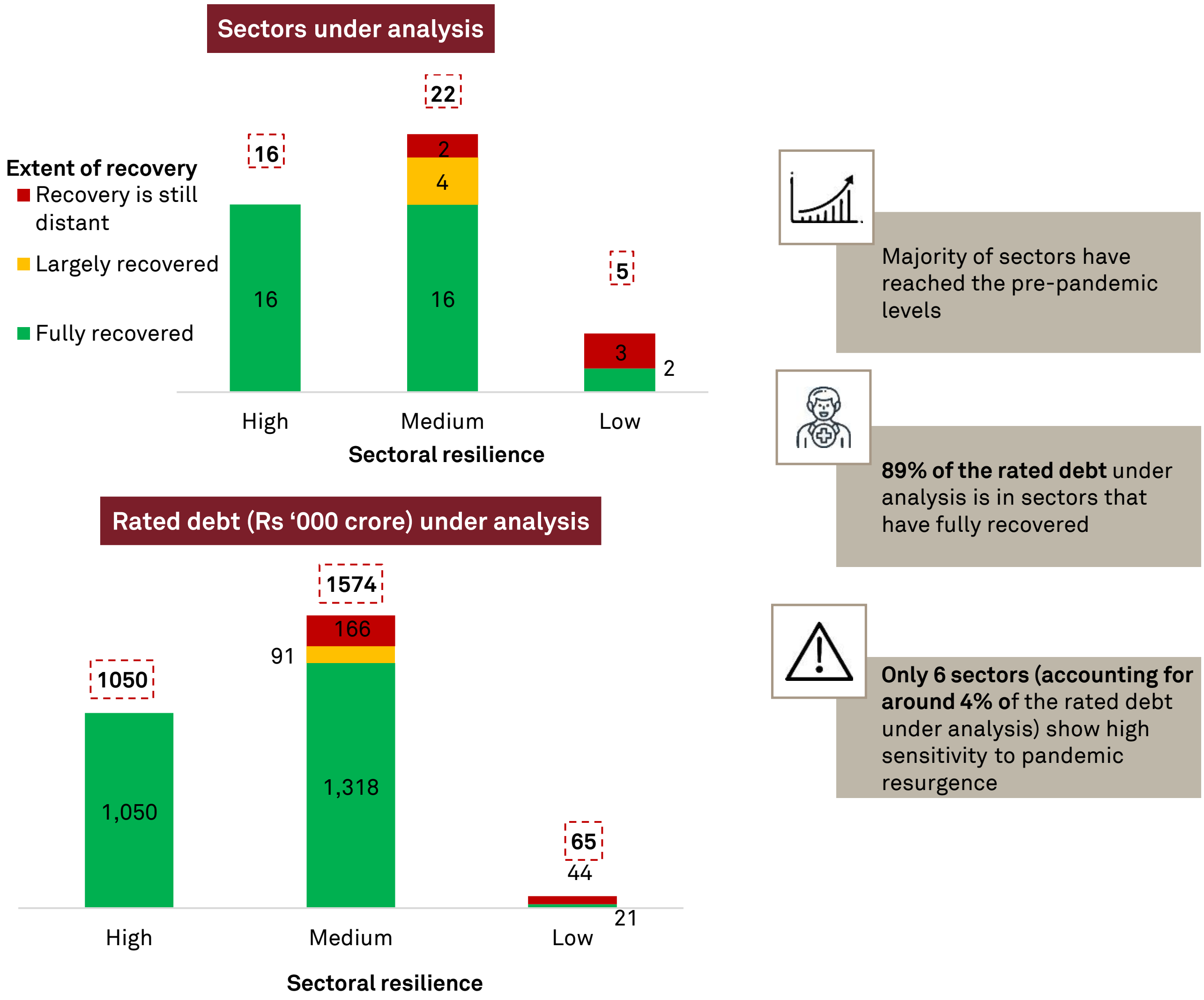
[3] One sector (Real estate) has been bifurcated into two sub-sectors (Real estate – Commercial and Real estate – Residential) for the purpose of this edition of study, given the divergent credit quality trends witnessed therein.

Chart 7: Sectoral resilience and extent of recovery



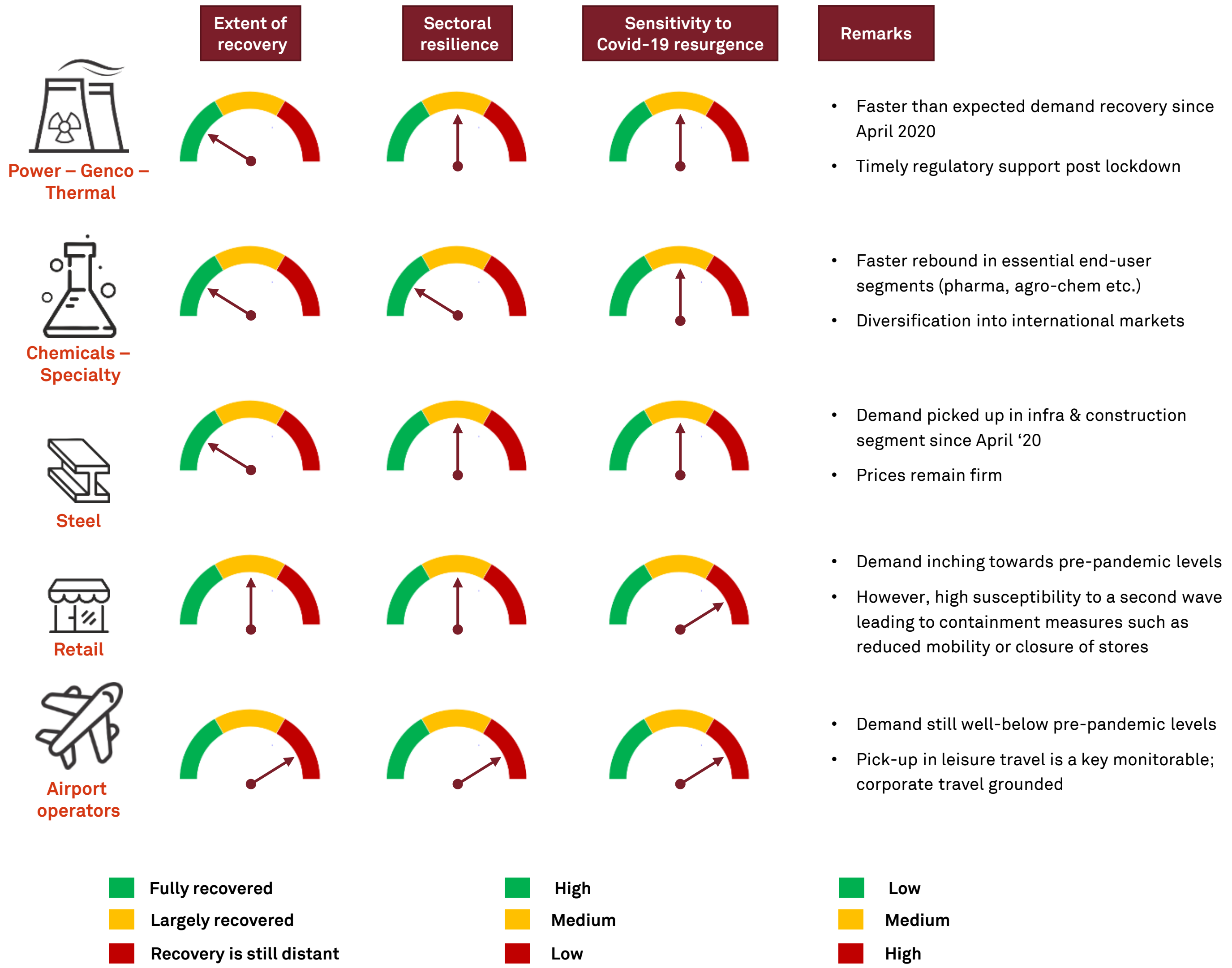
Size of the bubble indicates rated debt quantum (figures in Rs ' 000 crore)
Colour of the bubble indicates sensitivity to Covid-19 resurgence (Green=Low, Grey=Medium & Red=High)
Q4FY21E sales vs. Q4 FY20 sales
*Industrials comprise engineering and capital goods, industrial machinery and consumables and heavy electrical equipment

Chart 8: Key takeaways of sectoral resilience study



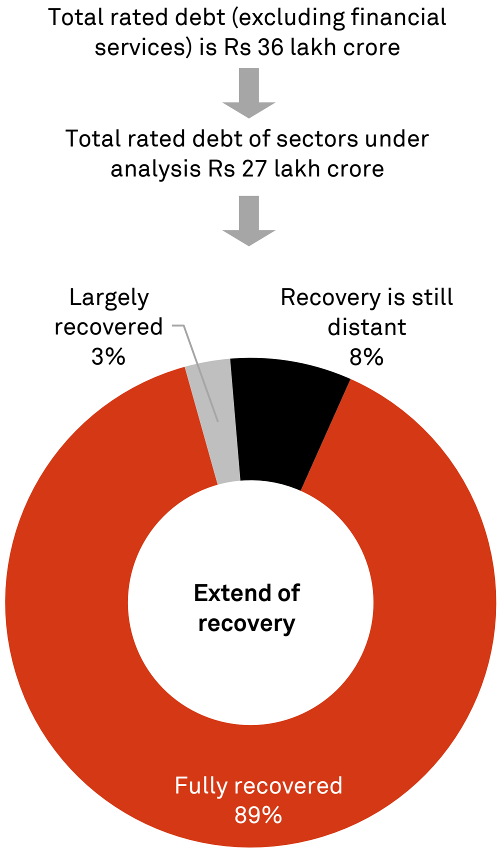
- **Though most sectors have already reached or are close to the pre-pandemic levels, the sustenance of recovery is crucial.**
- **Resurgence of Covid-19 cases or hiccups in the vaccination drive could trip up recovery.**

Chart 9: How to interpret COVID-19 impact analysis table



- The big picture: Majority of India Inc has adapted to the new normal, a small proportion still bogged down by Covid-19 impact The 'fully recovered' sectors include essentials such as FMCG, pharmaceuticals and telecom along with discretionary sectors such as auto and auto ancillaries and infra-linked sectors such as roads and construction, cement and steel.
- The 'largely recovered' category includes education, retail and textiles.
- The 'recovery is still distant' category includes airlines, gems & jewellery and hotels.

Chart 10: Break up of debt under study



- Sectors in this category have displayed healthy demand growth with month-on-month improvement since the unlock measures were initiated
- Broad-based recovery in sectors ranging from infra-linked (steel, cement, construction) to essentials (dairy, FMCG, pharma and telecom)

Table 5: Fully recovered sectors and drivers of recovery

Sector	Major driver of recovery
Telecom	Part of essential product/services
Fertiliser	
Mobile tower operators	
Food supply	
Pharmaceuticals	
Agro chemicals	
Dairy	
FMCG	
IT	
Power generation – thermal	
Power generation – renewables	
Power transmission	
Power distribution	
Sugar	
Hospitals	
Edible oil	
Meat, poultry & fish	
Oil & gas (downstream)	Improved business activity/mobility
Gas distribution utilities	
Chemicals - speciality	
Commercial RE	
Highways tolling	
Cement	Uptick in infra & construction activities led by government push
Steel	
Mining	
Construction - R&B	
Construction - diversified	
Pipe & fittings	
Marine ports & services	Revival of discretionary spending led by mix of pent up & festive demand
Auto - 2W	
Auto – PV	
Auto components	
Auto dealers	
Gems & jewellery	

'Fully recovered' category – 89% of rated debt

- Sectors in this category have displayed steady demand pickup, albeit at a subdued pace

Table 6: Largely recovered sectors and drivers of recovery

Sector	Major driver of recovery
Retail	Return of consumer discretionary spending/pent-up demand/festive cheer
Textile - cotton spinning	
Electrical equipment	Uptick in infra & construction activities led by government push
Education services	Improved business activity/mobility

'Largely recovered' category – 3% of rated debt

- Sectors in this category continue to see challenges to uninterrupted demand pickup
- This is mainly because of the highly discretionary nature of their products or services
- Recovery is dependent on arresting the spread of infections, improving mobility and increase in consumer spending power

Table 7: Sectors with distant recovery and impediments to recovery

Sector	Major impediment to recovery
Industrials	Uneven/slow demand recovery
Residential RE	
Airlines	Restricted mobility on account of containment measures
Airport operators	

'Recovery is still distant' category – 8% of rated debt

Conclusion

Over the past year, Indian corporates have adapted pretty quickly to the turbulence caused by the pandemic and majority of the businesses are expected to have recovered fully by the end of fiscal 2021. Demand recovery has been gathering steam since the second half of the fiscal, but fears of a second wave of the pandemic have cast doubt over its sustainability.

The absence of incremental regulatory support (after the extension of moratorium on debt servicing, one-time debt restructuring window and extension of IBC suspension in fiscal 2021) can increase pressure on corporates which have fundamentally weakened because of the pandemic.

Efficient and fast vaccination will be critical to avoid further Covid-19 related disruptions and provide stability to the corporate credit outlook.

Credit quality outlook for the financial sector

Banks to rebound, supported by tailwinds from economic recovery

Bank credit is seen growing 400-500 basis points (bps) at 9-10% this fiscal as the Indian economy recovers supported by budgetary stimulants and measures announced by the RBI. CRISIL forecasts GDP growth of 11%, for the fiscal, driven by faster-than-expected uptick in economic activity, pent-up and festive season demand, and government measures including the Rs 3 lakh crore ECLGS. Bank credit grew ~5% last fiscal despite the sharpest contraction in the Indian economy since Independence.

Corporate credit, which forms almost 49% of overall bank credit, had contracted last fiscal as companies put capex on the backburner. Also, sizeable incremental funding for banks had happened through the investment book because of the availability of low-cost funds under TLTRO and PCG, which added to the downward pressure. Nevertheless, the government's infrastructure push and a likely revival in demand will help increase credit to this segment by 5-6%.

The retail segment growth slowed to 9-10% last fiscal and is expected to return to the mid-teens this fiscal. Banks will benefit from lower competition as non-banks, grappling with multiple challenges, see tepid growth. With deposit growth outstripping credit growth last fiscal, banks can use the surplus liquidity to wrench market share in some of the largest product segments of non-banks such as mortgages and new vehicle finance.

Micro, small and medium enterprise (MSME) finance was among the fastest-growing areas for banks last fiscal, supported by ECLGS.

Overall, the expected economic recovery, along with pick-up in private investment and capex, will drive credit growth this fiscal. However, a sub-normal monsoon and another surge in Covid-19 cases leading to localised or partial lockdowns pose downside risks.

On the asset quality front, the economic trajectory last fiscal pointed to a sharp rise in non-performing assets (NPAs) but reported numbers reveal this fear did not come true on account of supportive regulatory and legal pronouncements including the six-month debt moratorium, restructuring measures as well as the Supreme Court standstill on NPA recognition. NPAs are expected to rise from 8.2% in March 2020 to 10.5-11.0% in fiscal 2022 because of slippages from restructured assets as well as removal of the standstill on NPA recognition.

However, the current asset quality stress cycle is expected to be different than that witnessed a few years back. NPAs then came primarily from bigger, chunkier accounts. This time, smaller accounts, especially the MSME and retail segments, are expected to be more vulnerable than large corporates which have consolidated and deleveraged their balance sheets.

Profitability of the banking sector is set to improve over the medium term. PSBs turned profitable after five fiscals of losses. Provisioning coverage ratios have improved significantly, thereby strengthening balance sheets.

In terms of capital levels for absorbing asset-side risks, leading private sector banks continue to be well placed. For PSBs, too, there has been a significant uptick in capital ratios supported by capital infusion by the government as well as issuance of hybrid bonds.

Overall, banks should exhibit reasonable stability in credit quality. For private sector banks, this will be driven by strong capitalisation, while PSBs will continue to benefit from government support. However, privatisation of two PSBs in announced in the Union Budget for next fiscal will be a monitorable.

NBFCs to see growth return, but at a lower level; stressed assets a key monitorable

Since the onset of the pandemic and in line with the subdued macroeconomic environment, disbursements by NBFCs slowed in the first half of fiscal 2021. While disbursements have picked up since, they haven't returned to the pre-pandemic levels. Consequently, assets under management (AUM) of NBFCs are estimated to have remained flat or declined marginally in the fiscal. Lower repayments during the loan moratorium period (March 1 to August 31, 2020) and potential capitalisation of interest accumulated helped limit the de-growth.

On the asset quality front, stressed assets (Pro-forma GNPA + potential stress in loan book (including restructuring)) of NBFCs are projected to have reached Rs 1.5-1.8 lakh crore or 6.0-7.5% of AUM by the end of the last fiscal. The one-time Covid-19 restructuring window and the MSME restructuring scheme offered by the RBI are envisaged to have limited reported gross NPAs. Unlike previous crises, the pandemic impacted almost all NBFC asset segments. Operations were curbed the most in the April-June quarter, when disbursements and collections were severely affected by the hard-braking of economic activity. Collection efficiency has improved since then, but is still some way off the pre-pandemic levels in the MSME, unsecured and wholesale segments, given the volatility in cash flows of borrowers.

Home loans, the largest segment for NBFCs, may have seen marginally positive growth in fiscal 2021, primarily because the moratorium led to a lower rundown in the portfolio even as underlying asset sales dropped in the first half. On the asset quality side, home loans are expected to continue to fare better than the other segments given that more than two-thirds of the portfolio constitute loans to the salaried segment, where the impact of Covid-19 on cash flow has been low. Still, delinquencies are expected to inch up.

Vehicle finance, the second-largest asset class, is estimated to have grown marginally in fiscal 2021 as disbursements dropped substantially in the first half amid reduction in underlying asset sales and intensifying competition from banks. Concerns over increasing delinquencies in this segment translated into tighter underwriting standards for NBFCs, which too hampered growth. The impact on asset quality is likely to be transitory and collection efficiency is expected to continue to rise over the next few quarters as economic activity improves. The LCV segment has seen collection efficiency rise steadily, while the MHCV segment is lagging. The stress in this portfolio is likely to be driven by segments such as tourist bus, school bus and commercial car loans. Amid the challenging, albeit improving, macroeconomic environment, delinquencies are expected to increase at a higher rate in this asset class.

The MSME and unsecured loan sector is expected to be among the most impacted. Growth will be marred amid concerns regarding asset quality as the cascading impact of the lockdown on the operations of borrowers and lenders and weak economic activity weighed on the delinquency metrics in the first half of last fiscal.

For the microfinance segment, collection efficiency started reviving in the second quarter of fiscal 2021 and was at 93-94% in the fourth quarter. While the recovery has been faster than envisaged, ability to improve to the pre-pandemic level of 98-99% on a steady state basis needs to be monitored. With steady improvement in collections and pickup in economic activity, disbursements restarted in August 2020 and had reached the pre-pandemic level by the end of the third quarter of fiscal 2021. Given the gap between current and pre-Covid collection levels, the credit loss is expected to increase. Also, a few MFIs have availed the one-time restructuring scheme announced by the RBI. Asset quality remained constrained due to the pandemic and the 90+ days past due (dpd) were higher than expected as of December 2020. While the delinquencies are expected to have reduced since then, they will remain higher than before the pandemic. Hence, the ability of MFIs to manage asset quality and maintain healthy collections will remain a key monitorable.

Easing of funding access for NBFCs remains key to their credit profiles. Over the past two years, non-convertible debenture/commercial paper issuances have dropped substantially. Even securitisation, which had become a substantial source of funding since September 2018, fell steeply from March 2020 amid heightened concerns regarding asset quality. There have been some green shoots in the past few months, with NBFCs raising more funds from banks because of the long-term repo operations window opened by the RBI, the partial credit guarantee scheme and the special liquidity scheme. As capital markets remain confidence-sensitive, continued funding support from banks will remain important. Banks have provided significant support to NBFCs in the past two years, with bank credit growth to NBFCs being higher than the system credit growth.

Green shoots for securitisation with recovery in collection efficiency and issuance volume

The collection efficiency across the securitised pools of retail loan receivables has improved from the low seen in April 2020. The median monthly collection ratio[4] has risen to above 80% across major asset classes after falling to near zero in some pools in April 2020 and is now closer to the pre-Covid-19 level of about 99% in pools backed by CVs and two-wheelers. However, the recovery in collection efficiency could be threatened by localised lockdowns, if any, to contain the rise in Covid-19 infections in states such as Maharashtra and Kerala.

Collection efficiencies in securitised transactions were impacted at the beginning of last fiscal by the nationwide lockdown and the moratorium on loan repayment from March to August 2020. Because of pressure on collection efficiencies, a few transactions saw restructuring of the promised principal repayment terms from timely repayment to ultimate repayment, supporting the regular servicing of the pass through certificates (PTCs) despite lower collections. Moratorium was also allowed in a number of securitisation transactions, post approval from investors, with approved amendments in the transaction payout supporting the credit quality of the securitised transactions. Consequently, only a few transactions logged increased stress manifesting in adverse rating actions.

Across asset classes, 10 transactions were either downgraded or placed on rating watch in the past year due to the increased stress.

Securitisation issuance volume saw an uptick in the second half of fiscal 2021 as collection efficiencies improved across asset classes resulting in higher investor confidence.

Strengthening collection efficiencies

Securitisation transactions have recorded strengthened collections after deterioration for a few months from April 2020 because of the pandemic. CRISIL Ratings consistently tracks the monthly collection ratio (MCR: collections excluding prepayments as a percentage of estimated pre-moratorium billing for the month) for all transactions rated by it. The median MCR had decreased to near zero in a number of pools, especially for MFIs, for the May 2020 payout[5]. The MCR for pools backed by two-wheelers and CV loans crossed 99% by January-February 2021, while mortgage-backed securitisation (MBS) pools recorded 100% MCR for the January 2021 payout. For SME[6] and microfinance pools, the median MCR crossed 87% and 82%, respectively, for the November 2020 payout.

The improvement in collections is largely attributable to broad-based economic recovery following the unlock measures and increased efforts by lenders spurred by the return of their on-ground collections and recovery teams.

[4] Collections excluding prepayments as a percentage of estimated pre-moratorium billing for the month
[5] Payouts in a month correspond to collections in the previous month. For example, May 2020 payout corresponds to collections in April 2020.
[6] Small and medium enterprises

Cash collateral utilisation

Moratorium was allowed in some transactions which resulted in intermittent liquidity concerns. A few transactions, thus, had to use cash collateral to continue regular servicing of the outstanding PTCs and the most impacted asset classes were as follows:

Table 9: Median CC utilisation for key asset classes

Sr no	Asset class[1] backing PTCs	Total transactions	Transactions where CC was utilised in last 1 year	Median of peak CC Utilisation#
1	HL	39	17	3.2%
2	CV/CE	80	45	7.6%

Among transactions that utilised cash collateral
Source: CRISIL Ratings

Vital monitorables for securitised pools

Collection efficiency is on its way to the pre-Covid level across asset classes based on the trends seen over the past two quarters. Key monitorables for the continued performance of securitisation transactions would be the extent of the rise in fresh Covid-19 infections and the speed of vaccination. Some states, such as Maharashtra and Kerala, are witnessing a relatively higher increase in infections. Localised lockdowns, if any, will dent future collections in the affected geographies, specifically for asset classes and entities having a large proportion of on-ground staff for cash collections and recoveries, and may necessitate the utilisation of credit enhancement. CRISIL Ratings will continue to closely monitor the collection performance of all securitised pools under its surveillance and will take the appropriate rating actions.

Uptick in issuance volume

Issuance volume rose to Rs 26,000 crore in the third quarter of fiscal 2021 from Rs 22,000 crore in the first half as more originators entered and mutual funds returned to the market after largely staying away in the first half. Stabilising collection efficiency also helped bolster investor confidence in securitisation transactions, with mutual funds returning as investors. A gradual return of investors is also indicated by the issuance of innovative structured products, such as covered bonds and replenishing structures. The total securitisation volume for the first nine months of fiscal 2021, at Rs 48,000 crore, however, was lower than that in fiscals 2018 (~Rs 60,000 crore), 2019 (~Rs 145,000 crore) and 2020 (~Rs 152,000 crore).

RBI's TLTRO 2.0 facility provided sufficient liquidity to NBFCs for cautious disbursements from the second quarter of fiscal 2021. NBFCs may now shift to raising funds through securitisation as they gradually increase disbursements for portfolio growth.

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[1] CV – commercial vehicle loans; CE – construction equipment; HL – home loans

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Outlook on asset quality of securitisation transactions

Collection ratios in a few asset classes have almost improved to pre-Covid levels. The impact of any localised lockdown on collections will have the strongest impact on credit assessment. Until vaccinations reach a critical mass and economic activity returns to normal on a sustainable basis, collection ratios may be susceptible to a rise in infections. In this regard, CRISIL Ratings is cognisant of divergences in borrower behaviour across asset classes, business profiles and geographies.

The adequacy of internal and external credit enhancement will depend on the trend in collection efficiencies, and will be a crucial input for rating actions on securitisation transactions.

Conclusion

The credit quality outlook for securitisation transactions for fiscal 2022 is cautiously positive given the improvement in collection efficiency and gradual revival of economic activity, and issuance volume is expected to increase over the previous fiscal. NBFCs are envisaged to increase fund raising through securitisation due to low interest rates as they cautiously refocus on portfolio growth.

Epilogue

The credit quality for India Inc improved considerably in the second half of fiscal 2021 with upgrades outnumbering downgrades. A slew of policy and regulatory measures provided relief in the first half, while ECLGS and one-time debt restructuring provided much-needed liquidity support to jump-start business activity in the second.

But the biggest boost came from the unlock measures, which released demand across sectors, thereby getting the economy going and cash flows from operations flowing for India Inc.

As the impact of Covid-19 settles, credit profiles will gradually return to being driven by business fundamentals – demand growth, profitability, balance sheet strength and liquidity. The credit quality outlook is one of cautious optimism, even as the government impetus on economic growth, infrastructure development and domestic manufacturing is expected to drive demand growth across sectors.

While the financial sector also rebounded in the second half of fiscal 2021, efficacy in collections, notably for vulnerable segments such as MSME and unsecured retail loans, and fund raising ability (especially for NBFCs), remain key monitorables this fiscal.

The resurgence of Covid-19 virus is the key threat to the optimistic outlook, even as a study of 42 corporate sectors indicates that only 6 (accounting for 4% of rated debt under study) are highly sensitive to a resurgence, while 20 are moderately sensitive.

The pace of inoculation, ability to control the affliction rate, mutations in the virus, the severity of lockdown, if any, and a sub-normal monsoon are the caveats to the cautious optimism. The pace of economic growth and therefore improvement in credit quality of India Inc hinges on these factors.

Notes

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