

## CARE OUTLOOK FOR FY18

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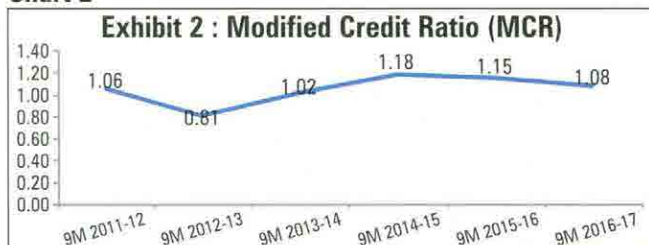
**F**Y17 was fairly volatile for the economy as well as the financial sector with two events sparking considerable turmoil. The first was demonetisation, which was introduced at a time when the economy seemed to be in the takeoff phase on the back of a good monsoon, which in turn subsequently upset the growth path. The second pertains to the NPA problem afflicting the PSBs and private banks alike though varying in intensity. The coming year would hopefully be less impacted by these two phenomena.

From a rating agency perspective, the overall quality of credit has remained fairly stable as depicted by the CARE Debt Quality Index (CDQI) in Chart 1 (an index which tracks the credit quality of a select sample of companies since 2011-12). While there have been blips along the way the path is almost flat which is assuring. Further, for the first 9 months of the year, the Modified Credit Ratio (defined as the sum of upgrades and retentions to sum of downgrades and retentions) continues to be above 1. This may be considered to be a positive development as they do indicate a large modicum of stability in the credit quality environment.

**Chart 1: CARE Debt Quality Index (2011-12=100)**



**Chart 2**



There would be several factors that would influence the credit environment in the coming year. The first is the overall growth prospects where there are expectations that the economy will definitely be on the upward path with almost all parameters that matter being in the right direction. Growth would be in the region of 7.5% with an upward bias that will help to regain the momentum that was lost in the second half of FY17. Second, inflation appears to be well under control and if these conditions last, which is largely expected, RBI could be lowering rates further during the course of the year. While the RBI has taken a neutral stance in its latest policy, it is based more on developments on the crude oil front. Presently, while higher prices are possible, it is not expected to cross the \$ 65/barrel mark this year, which will keep inflation down provided the monsoon is favourable. The monsoon will play an important role here.

Financing growth will always be a challenge for our economy and as demand for investment funds picks up all options need to fire at the same time given the changing environment. The economy will progressively see greater reliance on the corporate debt market for two reasons.

Third, investment will hold the clue for future growth prospects. Presently the government has been very active in infrastructure especially in the areas of railways, roads and urban development. The allocations made in the Budget this time are also higher and it is hoped that this will help to bring in a comparable level of private investment too which will set in

motion the virtuous cycle of investment which is missing today. The investment rate in the country has been coming down over the years with the cog being set 3-4 years back when several projects got stalled for various administrative reasons.

Fourth, on the back of a good monsoon one can hope for the resurrection in consumer demand. In 2016 it may be recollected, there was an upsurge in consumer demand just prior to November which is the middle of the festival season. This was expected to also bring about the usual increase in investment demand leading to higher credit offtake. A good monsoon, coupled with the regular festival habits relating to consumption and pent-up demand caused by demonetisation will help to revive the consumer goods production.

Hence, the clue to growth will be the simultaneous running of the engines of consumer demand picking up, investment getting more aggressive and inflation running stable which will help to spur growth to a new level that can be taken forward subsequently.

Better growth prospects are going to get reflected in several industries as demand picks up and the other bottlenecks get cleared. On the consumer goods front, automobiles in particular along with consumer durable goods would be the ones to watch for as the first signs of household spending manifest in these areas. The positive impetus to the infra sector by the government would help industries such as cement, steel, machinery and electrical goods which will be furthered by the thrust provided to the housing sector. This should also help in the revival of the real estate segment, which was one sector that was impacted quite sharply by the demonetisation move of the government. Therefore, one can expect a gradual turnaround in most of these sectors.

Interestingly the overall corporate performance for the third quarter of the year has been stable with there being only pockets of disappointment in industries that are linked with consumer spending. The other segments have done fairly satisfactorily. There could be some further correction in Q4-FY17 after which it would be reasonable to expect a change in direction in FY18 with the second quarter being the turning point.

Financing growth will always be a challenge for our economy and as demand for investment funds picks up all options need to fire at the same time given the changing environment. The economy will progressively see greater reliance on the corporate debt market for two reasons. The first is that the interest rate transmission is faster here and hence the interest rates are always lower than that charged by banks. Second, there are several measures being implemented to wean companies away from banks and to the debt market. The large exposures norms for instance is one such move where it is realized that banks are having not just an ALM problem but also taking on concentrated risk which has to be lowered. Therefore, this will be a propellant for the corporate debt market which will be accessed more by manufacturing and infrastructure companies for funding investment requirements.

Banks will continue to tread carefully this year, at least in the first couple of quarters as they simultaneously try and address the NPA problem with business compulsions. The major challenge is capital for banks as while NPA resolution in terms of recognition and provisioning would go through the regular processes, the raising of capital by PSBs to fund further lending will be critical. The government is to provide Rs 10,000 cr for the year, which may not be adequate in case there is a sudden upsurge in demand for credit. Disinvestment presently is a way out such that the government brings down the stake to 51%, though the present valuation may not make it viable.

The foreign route is always open but the future direction of interest rates in the USA is only upwards and hence companies may just not find it competitive especially so as the rupee depreciation possibility still lingers. The RBI has been reiterating constantly the need to hedge such exposures and with the cost being relatively high, companies may not quite use this route. However, there has been some interest shown in the issuance of Masala bonds which does have potential to add effectively to the borrowing bouquet for companies. Once again the interest rate differential between India and the hosting country will play an important role in turning the scales besides the appetite of investors for taking on the forex currency risk.

The coming year hence will be exciting for the country as conditions seem to be favourable for a favourable takeoff which in turn can take the economy back to the high growth path that was in evidence in the earlier part of this decade. The financial sector surely does face challenges, especially the banking system. The expected growth in demand for funds would perforce compel the system to evolve to ensure that it is satiated.

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He has over 30 years' experience and worked with Otis Elevator Company India Ltd, DSP Financial Consultants Ltd. and Kotak Mahindra Finance Ltd before joining CARE. He has worked in diverse areas in ratings such as rating operations, criteria development, business development, disinvestment advisory services, international ventures, regulatory compliance, human resources management, information technology etc. He was involved in several strategic initiatives including the IPO of CARE.

He was earlier elevated to the Board of CARE on August 22, 2009 as a Deputy Managing Director and has served on the Board for nearly seven years. Mr. Mokashi also serves on the Board of CARE's subsidiary companies viz. CARE Kalypto Risk Technologies and Advisory Services Pvt. Ltd and CARE Ratings (Africa) Pvt. Ltd.

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