



CARE RATINGS OUTLOOK FOR FY19

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2017-18 has been a very important one for the financial sector because a major move was undertaken to resolve the NPA issue and its accompanying challenges. The overall economic conditions appear to be positive presently and with the right external conditions could move towards a smart recovery in FY19 where growth reaches 7.5% and gets poised to scale higher levels subsequently when the psychological mark of 8% is crossed. Besides the banking sector, financial markets are also set for a sea change especially on the debt markets front. The RBI will probably remain watchful and the present inflationary conditions signal towards a possible increase in interest rates in case inflation remains above the 5% mark for a sustained period of time.

The economy definitely appears to have recovered from the two major reforms that were introduced in 2016 and 2017 and it is expected that by March 2018, the shadow of demonetization would have worn off while the entire production sectors adjusted to GST. It would hence be fairly straight play for these sectors. What can we expect in FY19?

First, growth will be of a higher level though still in the takeoff stage. GDP

growth has been in the lower range of sub-7% this year and should move to a higher number in FY19.

The investment cycle should look better. The overall investment rate has been declining in the last 3 years and the direction needs to change. Two drivers would be higher investment in infra which will be led again by the government, especially central government followed by private investment.

Second, assuming a normal monsoon in 2018, industrial growth should be picking up pace which is already evident in Q3-FY18. In particular consumer goods sector and capital goods would be the key drivers of path. So far, growth has emanated more from the infra industries with the government playing a leading role. This time a revival in consumer demand is

necessary. The new MSP formula should address the issue of farmer distress in 2017 due to prices falling sharply due to oversupply conditions. Higher growth in consumer goods should trigger a virtuous backward linkage chain to other sectors.

In this context, the sectors to watch out for would be automobiles, consumer durable goods, cement, steel and other metals, engineering and power. Real estate would still be in the uncertain mode as the slowdown in new projects especially in urban areas is not likely to reverse soon. The Budget's proposal to increase customs duty on various goods especially in the electronics segments would provide a further fillip to the concerned industries.

Third, the investment cycle should look better. The overall investment rate has been declining in the last 3 years and the direction needs to change. Two drivers would be higher investment in infra which will be led again by the government, especially central government followed by private investment. The thrust provided through various reforms in roads, railways, FDI, power etc. would help to gradually step up investment. The other stimulus would come

differentially from sectors in manufacturing where the capacity utilization rates improve as there is pick-up in demand for various goods. This will be concentrated and not pervasive, but would be a good start for the revival of investment.

Fourth, the banking sector would continue to be under observation with the focus being on PSBs. The NPA resolution process through the NCLT should see the final judgment on companies which have been referred to the IBC. Further, the capital infusion by the government both through the recap bonds and direct infusion of capital should alleviate the provisioning requirements and put the banks on a stronger footing. It is expected also that the growth in bank credit should gradually return to the trend growth rate of 15-20% in the next 3-4 years. But for FY19, growth of around 10% would be ideal (after excluding retail loans).

The important decisions to look out from the point of view of ideology and policy would be the disinvestment in PSBs. This has been on the agenda for quite some time and a decision on the same has to be taken this year as future viability will hinge on this factor. More subdued stock markets could be the only impediment in this exercise where the goal would be to get the best possible valuation after recapitalization.

Alternatively the decision to merge banks would have to be considered which will be the other option. The progress of the merger of the SBI associate banks with the SBI would be the model template that would be used when reckoning such decisions. Therefore, the banking sector can see more action in the coming year.

Fifth, the corporate debt market is expected to blossom in a bigger

manner with a number of steps being put in place by the government and the RBI. The latest decision to allow provident funds and insurance companies to invest in 'A' rated bonds will bring in more borrowers in this market. This is timely as the new NPA resolution norms of the RBI puts more pressure on the borrowers to service their debt and some may prefer to explore other options. Also the large exposure norms imposed on banks will encourage large companies to partly raise funds from the bond market. The CP market has already shown it is a viable substitute to bank credit and a similar change may be expected here.

The clue of course will be the revival in investment which will necessitate greater demand for long term funds. Presently the bond market is dominated by issuances from finance companies and banks and as the other manufacturing and infra based companies enter the investment stream would actively consider this market.

Sixth, the corporate sector is expected to perform better than in FY18. The third quarter results have been encouraging and indicate that companies have in general adjusted almost fully to the new GST regime. Therefore, growth in sales should be back to the trend rate of 15% this year which augurs well for shareholders too as profitability is maintained or improves. With global recovery already taking place exports oriented industries would tend to benefit from this growth.

Sixth, as a corollary these conditions would translate to better credit quality from a rating perspective. The MCR ratio, which is the ratio of number of upgrades plus retentions to number of downgrades plus retentions, which is presently stable at around 1, will move northwards if the corporate performance is better.

The government has already placed a realistic Budget which would ensure that the targets are realized to a large extent. With a normal monsoon, food inflation should be under check and as long as oil prices do not spike, the RBI should hold rates or increase the repo rate by a maximum of 25 bps, if the need arises. The rupee would be stable under these conditions as foreign flows should continue to be stable even as the current account deficit widens but remains within the 2% range. Therefore, FY19 promises to be a better year than FY18, with the qualification that movement in the upward direction will be gradual.

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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 Ratings. 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 Ratings.

He was a member of the Working Group formed by National Housing Bank (NHB) for promoting RMBS and other Alternate Capital Market Instruments - covered Bonds [October 2012].

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He has a Masters Degree in Management from NMIMS. Mr Mokashi is a Graduate in Mechanical engineering from VJTI, Mumbai University.

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