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Corporate Default Prospect at 2011 Low on Recovery: India Credit

By Anoop Agrawal September 14, 2014

The risk of Indian companies reneging on their debt in the coming 12 months has fallen to a three-year low as stocks rallied to a record on the prospect of an economic revival, Bloomberg's default risk model shows.

The median probability of nonpayment has dropped to about 0.45 percent from last year's peak of 0.75 percent and as much as 1.3 percent during the 2008 credit crisis, according to the gauge, which is based on factors including share performance and debt metrics. The average yield on five-year AAA company bonds dropped 30 basis points this year to 9.33 percent as inflation slowed. A similar rate in China is 5.21 percent.

Corporate debt-rating upgrades are exceeding downgrades in India for the first time since 2011, after Asia's third-largest economy expanded at the fastest pace in more than two years last quarter. Bad loans at local banks have declined from an eight-year high and the S&P BSE Sensex (SENSEX) index of local shares surged 28 percent so far in 2014.

"The credit profile of companies has been improving in line with the recovery taking place in the economy," D.R. Dogra, managing director in Mumbai at CARE Ratings, said in an e-mail interview on Sept. 10. "A gradual pick-up in sales and recovery in profit margins has also helped to alleviate the situation. In fact, a direct indicator of the above is that the non-performing assets of banks have been stable."

Corporate default probability is inversely correlated to economic growth and equity-market capitalization, according to a Sept. 10 Bloomberg report on corporate credit risk in India. That means this year's drop in the gauge reflects the pickup in the economy and the stocks rally that has made it easier for businesses to access capital.

Economic Outlook

Prime Minister Narendra Modi, who took office after a landslide election victory in May, has pledged to boost the economy. His government plans to cut the budget deficit to a seven-year low, spur infrastructure development and allow more foreign investment in industries from defense to railways.

The finance ministry sees annual growth quickening to as much as 5.9 percent in the year through March 2015, after the previous period's 4.7 percent that was near the slowest in a decade. The first improvement in local corporate debt ratings since 2011 is supporting that forecast.

Rankings for 231 firms were raised this year at Crisil Ltd., the local unit of Standard & Poor's, data compiled by Bloomberg show. That outnumbered the 195 downgrades.

'Bottoming Out'

"Clearly, we have seen a bottoming out of the credit risk profile," Deep Narayan Mukherjee, a Mumbai-based director at India Ratings & Research, the local unit of Fitch Ratings, said in a phone interview on Sept. 10. "In the next six to 12 months we should see stronger signs of recovery."

Non-performing debt as a proportion of total advances fell to 4 percent as of March 31 from 4.2 percent in September, which was the highest since 2005-2006, the RBI said in a report last month. Loan recoveries at State Bank of India, the biggest lender, more than doubled in the first quarter and tripled at Bank of Baroda, ranked second by assets.

ICRA Ltd., the local unit of Moody's Investors Service, sees more improvement in Indian lenders' asset quality should the new government deliver on its pledge to revive growth. The rally in local stocks has made it easier for companies to sell shares and replace their debt with equity capital, reducing the risk of defaults, according to ICRA.

Public, Private

Credit risk for India's state-owned enterprises has declined less than for private companies, according to the Bloomberg report.

"Among non-financials, leverage and median default risk for public sector firms seem higher than for private sector firms, but both sectors have declined slowly over the past two years," according to the report. "The higher leverage and default probability for public non-financials are not just a size effect, but potentially performance-related."

Credit-default swaps also signal a drop in bond risk for Indian firms. The average cost of contracts protecting the debt of eight Indian issuers has slumped 121 basis points in 2014 to 216, according to data provider CMA.

Bond yields in India have dropped this year on speculation cooling inflation will add room for the central bank to lower interest rates, helping companies rein in borrowing costs. Ten-year (GIND10YR) government bond rates declined 33 basis points, or 0.33 percentage point, in 2014 to 8.50 percent, while the rupee appreciated 1.9 percent to 60.66 per dollar, according to data compiled by Bloomberg.

"Policy makers have taken a tough and consistent stance to bring down inflation, which is clearly the biggest concern for the economy," said Rupa Nitsure, an economist in Mumbai at state-owned Bank of Baroda. "The credit profile of the economy should look better in the short and medium term."

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