Economy on the mend; further measures needed
January 2, 2020

Brickwork Ratings expects more measures to reverse the economic slowdown

While slow-down is a global phenomenon, India has remained insulated from such events in the past due to its burgeoning consumer demand at the back of its demographic dividend. The Indian economy was expected to grow at a much faster pace encouraging the nation to set a goal of a $5 trillion Economy in next 5 years thereby targeting a CAGR of 15%. However, the Indian economy is suddenly witnessing a sharp deceleration marked by low demand and production. The Government has undertaken a series of steps in the recent past to reverse the economic downturn. The document analyses the trends in key parameters of the economy, the initiatives hitherto taken and gives the agency’s opinion on what more is required.

The major issues faced by banks were stress assets in the books, liquidity and cost of funds was a terrible pain to NBFCs and MSMEs. The real estate sector post demonetisation also faced a lot of stress while bond market saw a major downside due to lack of demand from investors after the slew of defaults started last year.

The Government of India (GoI), Reserve Bank of India (RBI), Securities Exchange Board of India (SEBI) and other regulators have had taken several measures to boost the consumption and investment activities and to alleviate stress, in a bid to revive the declining Indian economy.

Reforms like cutting key policy rates, pushing banks to lend to Non-Banking Financial Companies (NBFCs), mandating them to link their lending rates to repo rate were implemented to push banking sector. In addition, Foreign Direct Investments (FDIs) reliefs and cuts in corporate tax rates were announced to help growth in investment activities.

Further, approving realty fund for aiding stalled housing projects and granting subsidies to affordable housing were the initiatives towards supporting the flagging real estate sector. To deepen the debt market, government introduced debt exchange traded funds, special Open Market operations to improve liquidity conditions of the debt market. Meanwhile, Finance Minister has recently announced a major push towards Infrastructure spending, which is in the right direction.

In BWR’s opinion, these initiatives will help revive the economy in the next fiscal but more steps maybe required to drive a meaningful reversal in the economic cycle. The measures could include enforcing a higher transmission of rates by banks in Q4, liquidity reaching the sectors facing cash-crunch, incentives towards uplifting consumption and investment activities. BWR is of the opinion that it is right time to invoke John Maynard Keynes and the Govt may go in for fiscal expansion for productive purpose.
The key Economic Parameters:

Gross Domestic Product (GDP) growth fell for the sixth quarter in a row to 4.55% in Q2 FY20. The full year GDP estimates stand sharply revised downwards to ~5% levels as against earlier ~7% forecast in the last Budget. The Index of Industrial Production (IIP) and core sectors also continued with negative performances. Further, the credit environment and corporate profits during H1 continued to remain depressed. However, tax revenues of the Government has seen an improvement in the last quarter and exports have shown a moderate uptick. Also, the Stock markets are trading at all time high and the bond yields have come down substantially in the last one year.

Note: Data compiled by BWR Research sourced from RBI, FBIL, FIMMDA and CMIE, RHS indicates Right hand side
The Reforms taken by Government of India to push up the economy:

Starting with Demonetisation as a measure to stifle parallel black money economy and improve tax compliance taken in the past, the Government has recently initiated many reforms to promote growth and also revive consumption and investment activities along with the development of the Indian capital market –

Infusion of Capital to support Banks: The Finance Minister announced capital infusion of INR 700 billion into public sector banks with a aim of boosting lending and improving liquidity in the market. The capital infusion helped banks clean-up the stressed assets on their books and free-up resources for additional lending.

Banking and Credit Growth: Besides capitalising the Banks, the GOI announced consolidation of 10 state-run banks into four large-scale lenders. These mergers were conceived with the aim to strengthen the financial system in the country, reduce their infrastructure cost, bring in economies of scale, professionalise the management and improve corporate governance. The GOI is instilling confidence among bankers for taking lending decisions and has advised the bankers not to fear the three Cs (CBI, CVC and CAG) and clear pending vigilance cases against officials.

Insolvency and Bankruptcy Code (IBC): NPA curtailment and recovery influence economic growth. The SARFAESI Act helped the banks during the last 2 decades in recovery from specific asset sale but not the industry’s revival. The IBC came into force thereafter in a bid to consolidate and amend laws relating to re-organisation and insolvency in a time-bound manner at the first sign of financial stress, providing timely solutions for viable projects through change in ownership and management or initiating winding-up processes where required. IBC resolutions in some large stressed assets have helped in reduction of NPAs on the banks’ books and also provided confidence to the investor community. More fast track resolution of the stressed assets is expected in future.

Slashing Key policy rates by 135 basis points: The Reserve Bank of India has cut repo rate by 135 bps starting from February 2019 to revive the growth and the transmission has been similar in the money and debt market. Further rate cut to the extent of 15-25 bps is expected once the food inflation subsides.

Repo linked bank loans: To facilitate better transmission of rates by banks and to enhance credit supply, on direction from RBI, banks linked their retail lending interest rates to external benchmarks (currently Repo) to benefit the borrowers in declining interest rate scenario.

Partial Credit guarantee scheme for NBFC-HFC: Government announced Partial Credit Guarantee Scheme for purchasing high-rated pooled assets from Non-Banking Financial Companies (NBFCs) / Housing Finance Companies (HFCs), with the amount of overall guarantee being limited to first loss of up to 10% of assets being purchased by the banks under the Scheme, or INR 100 billion, whichever is lower. This measure will substantially reduce the credit enhancement required and also lower the cost of borrowings for issuers.

MSME Bill Discounting: Banks were asked by government to provide bill discounting facility to the MSME sector against payments due from the large corporates in a bid to boost the sector. However, the sector growth is still not picking up, which calls for some helpful guidelines from the regulator.

Disinvestment: The Cabinet Committee on Economic Affairs, has accorded 'in-principle' approval for enabling reduction of GOI’s holding below 51% in select CPSEs while retaining the management control on a case to case basis. This will provide a much needed support to the government in maintaining the fiscal deficit targets while undertaking the necessary reforms to boost the economy.

Subsidies to Real Estate and Affordable housing: The Real Estate segment which has been under stress for a while needs to be revived to achieve economic growth and employment as it directly influences the core sectors such as steel and cement and is also a large employment generator. The government has implemented scheme for interest subsidy for affordable housing and enhanced tax exemption on interest expenditure for such housing loan besides RERA and REIT. Further the government announced formation of an Alternate Investment Fund (AIF) to provide priority debt financing for the completion of stalled housing projects that are in the Affordable and Middle-Income Housing sector. The government shall act as the Sponsor with a total commitment to infuse ~INR 100 billion. This can provided much needed funds for completion of stalled projects. However, more measures are needed to incentivise demand to reduce the high unsold inventory in the residential property segment.

Bond Market-ETF (Exchanged traded Fund): A vibrant bond market is essential for the economy. The GOI recently launched an ETF. BWR had opined that it was a three in one’ step. Firstly, it will help the healthy PSUs including banks in raising cheaper funds, secondly, it will give an opportunity to investors to invest in safer instruments with tax advantage and thirdly, it will help the hitherto lagging bond market to develop and deepen. The maiden issue under
the fund was heavily oversubscribed. **More such measures to deepen the bond market such as starting bond indices are expected.**

**Special OMOs:** To contain rising bond yields, the RBI strategically arranged this debt to money market swap wherein they sucked out government bonds of long duration (10 years) and pump in short duration (about 6 months) worth INR 100 billion through special Open market Operations (OMOs) to improve both liquidity and bond yields.

**Measures considered to be the potential steps:**

❖ Government/Reserve Bank of India may **incentivise banks to pass on the full transmission of interest rates** – leading to credit blooming. Credit to Non-Banking Financial Companies (NBFCs) will also result in conducive climate for reversal of the economic slowdown.

❖ Further **rate cut** to the extent of 15-25 bps is expected once the food inflation subsides.

❖ Government may **incentivise investments as the restoration of investor confidence** is vital in current situation in order to support the economic activities of nation as investments is an integral part of economic and financial stability cycle.

❖ The government may announce **some relief in personal taxation** in a format which will encourage spending such as tax exemption for expenditure on specific items such as travel, interest for 2nd house etc apart from announcing enhanced tax rebates to individual which are the need of the hour for private expenditure.

❖ The Government is expected to **revamp GST and rationalise number of slabs.**

❖ Measures for **improving the farmers income**, provide them fair price of their produce besides the Governments procurement, streamline logistics to prevent natural and distribution losses, strengthening the cooperative system and measures to make farmers independent rather than depend on loan waivers.

❖ The overhang projects need some push on a **faster approach to accelerate the real estate, infrastructure activities** leading to growth in various associate sectors and thus boosting the overall sentiments of the market. While tax incentives to the industry have already been provided, some more incentives for pushing the investment activities by industry are expected.

❖ More steps particularly on faster and adequate lending for **MSME needs** and lowering the lending rates for their cost competitiveness are expected. However, banks need to be alert regarding asset quality of MSME and Consumer Finance Sectors.

❖ More measures for **increasing availability of resources to performing NBFCs** is expected with a view to support a sector which has served sections not adequately catered to by the banks.

❖ **Introduction of bond indices** to deepen the bond market.

❖ More of **special OMOs** are expected during Q4 to stabilize the bond yields.

**Contacts:**

**BK Piparaiya**  
Senior Director- Ratings  
piparaiya.bk@brickworkratings.com  
022-28311439 Ext-614

**Ria Matwani**  
Research Editor  
+91 22 67456675  
Ria.m@brickworkratings.com

Investors & Media Contact  
+91 22 67456668  
liena.t@brickworkratings.com

www.brickworkratings.com  
January 2020
About Brickwork Ratings

Brickwork Ratings is India’s home-grown credit rating agency built with superior analytical prowess from industry’s most experienced credit analysts, bankers and regulators. Established in 2007, brickwork ratings aims to provide reliable credit ratings by creating new standards for assessing risk and by offering accurate and transparent ratings. Brickwork ratings provides investors and lenders timely and in-depth research across the structured finance, public finance, financial institutions, project finance and corporate sectors. Brickwork ratings has employed over 350 credit analysts and credit market professionals across 8 offices in India. Our experienced analysts have published over 12,000 ratings across asset classes. Brickwork Ratings is committed to provide the investment community with the products and services needed to make informed investment decisions. Brickwork ratings is a registered credit rating agency by securities and exchange board of India (SEBI) and a recognised external credit assessment agency (ECAI) by reserve bank of India (RBI) to carry out credit ratings in India. Brickwork ratings is promoted by Canara bank, India’s leading public sector bank. more on Canara bank available at www.canarabank.co.in

BWR Rating criteria is available at https://www.brickworkratings.com/ratingscriteria.aspx

Brickwork Ratings (BWR), a SEBI registered Credit Rating Agency, has also been accredited by RBI and empaneled by NSIC, offers Bank Loan, NCD, Commercial Paper, MSME ratings and grading services. NABARD has empaneled Brickwork for MFI and NGO grading. BWR is accredited by IREDA & the Ministry of New and Renewable Energy (MNRE), Government of India. Brickwork Ratings has Canara Bank, a Nationalized Bank, as its promoter and strategic partner.

BWR has its corporate office in Bengaluru and a country-wide presence with its offices in Ahmedabad, Chandigarh, Chennai, Guwahati, Hyderabad, Kolkata, Mumbai and New Delhi along with representatives in 150+ locations. BWR has rated debt instruments/bonds/bank loans, securitized paper of over ₹ 10,00,000 Cr. In addition, BWR has rated over 6300 MSMEs. Also, Fixed Deposits and Commercial Papers etc. worth over ₹24,440 Cr have been rated.

DISCLAIMER

The Information in this Report is provided "as is" without any representation or warranty of any kind. A Brickwork Ratings rating is an opinion as to the creditworthiness of a security. This opinion is based on established criteria and methodologies that Brickwork Ratings is continuously evaluating and updating. Therefore, ratings are the collective work product of Brickwork Ratings and no individual, or group of individuals, is solely responsible for a rating. The rating does not address the risk of loss due to risks other than credit risk, unless such risk is specifically mentioned. Brickwork Ratings is not engaged in the offer or sale of any security. All Brickwork Ratings reports have shared authorship. Individuals identified in a Brickwork Ratings report were involved in, but are not solely responsible for, the opinions stated therein. The individuals are named for contact purposes only. A report providing a Brickwork Ratings rating is neither a prospectus nor a substitute for the information assembled, verified and presented to investors by the issuer and its agents in connection with the sale of the securities. Ratings may be changed or withdrawn at anytime, for any reason in the sole discretion of Brickwork Ratings. Brickwork Ratings does not provide investment advice of any sort. Ratings are not a recommendation to buy, sell, or hold any security. Ratings do not comment on the adequacy of market price, the suitability of any security for a particular investor, or the tax-exempt nature or taxability of payments made in respect to any security. Neither Brickwork Ratings nor its affiliates, third party providers, as well as their directors, officers, shareholders, employees or agents (collectively, “BWR Reps”) guarantee the accuracy, completeness or adequacy of the Report, and no BWR Reps shall have any liability for any errors, omissions, or interruptions made or committed, whatsoever.
therein, regardless of the cause, or for the results obtained from the use of any part of this publication. In no event shall any BWR Reps be liable to any party for any direct, indirect, incidental, exemplary, compensatory, punitive, special or consequential damages, costs, expenses, legal fees, or losses (including, without limitation, lost income or lost profits and opportunity costs) in connection with any use of any part of the Report even if advised of the possibility of such damages. Brickwork Ratings receives fees from issuers, insurers, guarantors, other obligors, and underwriters for rating securities.