



## GUEST COLUMN

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# Geopolitics could shape FY23 asset quality

India Inc’s credit quality rebounded in FY22 after two years of economic slowdown. As a result, the downgrade rate of ICRA-assigned ratings was 6 per cent in FY22 (of 184 entities) — much lower than the 13 per cent in FY20 and the decadal average of 9 per cent.

In contrast, FY22’s upgrade rate of 19 per cent (of 561 entities), stood at a multi-year high relative to the decadal average of 11 per cent. Sectors that witnessed relatively high upgrades in the just-concluded fiscal include real estate, power, ferrous metals, textiles, and pharmaceuticals. A majority of the upgrades were driven by entity-specific factors rather than sectoral tailwinds.

Many sectors are on a path to recovery. There are enticing opportunities in steel, agricultural produce, textiles, and electronics goods to boost exports. The Production-Linked Incentive scheme promises to enhance supply-chain resilience, support import substitution, and create positive externalities. Banks as well as non-banking financial companies are well capitalised and face largely manageable asset-quality pressures. With both the real and the financial sectors in relatively good health, FY23 could well turn out to be a year of moving beyond “rebound” growth.

However, just as the economy was recovering from the impact of the third wave of the pandemic, the Russia-Ukraine conflict has renewed uncertainties. The associated spike in commodity prices is expected to aggravate inflation and compress disposable incomes as well as producers’ margins. Following elevated commodity prices and fresh supply-chain issues

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emanating both from the conflict, as well as renewed lockdowns in parts of China, we now forecast India’s

real GDP growth to moderate to 7.2 per cent in FY23, from 8.5 per cent in FY22.

Higher prices of fuel and edible oils are likely to compress disposable incomes in the mid-to-lower income segments, constraining demand revival in FY23. In the mid-to-upper income segments, normalisation after the third wave is set to shift consumption towards contact-intensive services.

Even though exports of some items will rise to meet global demand amid the supply crunch, ICRA only expects a gradual rise in capacity utilisation to 74-75 per cent in Q3FY23, from 71-72 per cent in Q4FY22, leading to a potential modest delay in the broad-basing of capacity expansion by the private sector.

An early kick-off of the government’s capex programme is crucial to boost investment activity in H1FY23. However, the execution risk is shifting to the states, with a considerable portion of the step-up in budgeted capital spending coming through the enlargement in the interest-free capex loan to the state governments to ₹1 trillion in FY23.

Therefore, the associated pickup in projects and further enhancement in the pipeline for construction entities remains to be seen. Healthy reservoir levels offer insurance against potentially below-normal rainfall this monsoon. As economic activity normalises, there could be a shift in availability of agricultural labour across different regions, affecting acreage in some states, which has been the key driver of agri-output during FY21 and FY22.

Besides, inadequate availability and high prices of fertilisers poses some concern. Growth of crop output may be modest at best in FY23. Agri-incomes may see a tempered improvement in the months ahead.

Looking ahead, ICRA has a “positive” outlook on the metals, oil and gas (upstream), roads (toll), and textiles (cotton spinning) sectors. Simultaneously, it has a “negative” outlook on airlines, airport infrastructure, media (exhibitors), and power (thermal and distribution).

If the Ukraine conflict is protracted or escalates, business will continue to grapple with rising input and energy costs, shipping and other logistics costs, besides potential supply disruptions. On an ominous note, this could quickly translate into asset-quality pressures for the financial sector — a risk we must contend with in FY23.