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Weekly Credit Brief Apr 20 - Apr 26 2021

Surging COVID-19 cases may derail improvement in Indian companies' credit quality

by NUS-CRI Market Monitoring Team

- **NUS-CRI Forward PD indicates a deteriorating credit outlook for India domiciled corporates as a new wave of infections threatens to derail economic recovery domestically**
- **India faced the largest spike in credit risk over the last month when compared to other key emerging markets**

With weekly COVID-19 cases and deaths increasing by 47% and 90% between the last two weeks of Apr 2021 respectively, India has been in the trenches against its war with the ongoing pandemic. As such, our focus this week shifts to India domiciled listed corporates (Indian companies). The holistic credit quality of Indian companies has been improving since the start of the year, with the NUS-CRI Aggregate (median) 1-year Probability of Default (Agg PD) improving from 80bps to 44bps by the end of Mar 2021 on a YTD basis. However, ever since the end of Mar 2021, the country has seen an uptick in its credit risk with Agg PD increasing by 20bps to 64bps in one month, in tandem with the drastic increase in the number of total COVID-19 cases.

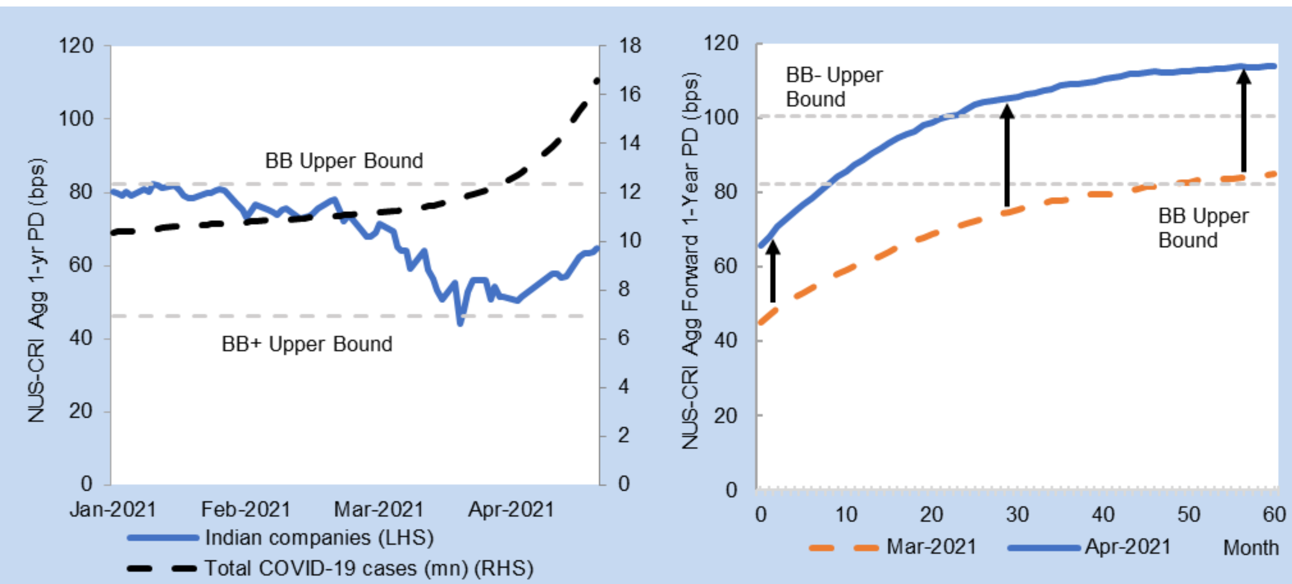

Figure 1a (LHS): NUS-CRI Agg PD for Indian Companies on a YTD basis with reference to PDiR2.0[1] bounds. India total COVID-19 cases. Figure 1b (RHS): NUS-CRI Agg Forward PD for Indian companies based on data feed as of Mar 2021 and Apr 2021. Source: *NUS-CRI, Oxford University*

Accompanying the worsening credit profile of Indian companies, credit outlook also deteriorated as showcased by the NUS-CRI Aggregate Forward 1-year Probability of Default (Forward PD[2]) in Figure 1b. The deteriorating credit outlook over the last month may be driven by the onset of lockdowns in major metropolises across the country. The onset of such lockdowns not only affects the ability of companies to manage operations, but also carries potential hindrances for companies to service their upcoming debt obligations. NUS-CRI Database has already recorded 32 default events for Indian companies so far in 2021, amounting to close to a record total of INR 52bn in defaulted bonds. These default events make up around 30% of total defaults seen by globally listed companies over the same period. As of 23 April 2021, the cumulative probability that more than 27 additional defaults occur by Indian companies over the next 6 months lies at 65%, compared to 16% a month ago,

[1] The Probability of Default implied rating version 2.0 (PDiR2.0) provides a more familiar interpretation through mapping the NUS-CRI 1-year PDs to the S&P letter grades. The method targets S&P's historical credit rating migration experience exhibited by its global corporate rating pool instead of relying solely on the reported default rates.

[2] The Forward PD estimates the credit risk of a company in a future period, which can be interpreted similarly to a forward interest rate. For example, the 6-month Forward 1-year PD is the probability that the firm defaults during the period from 6 months onwards to 18 months – this is conditional on the firm's survival in the next 6 months.

indicating that Indian companies are facing possible significant headwinds in managing their credit risk moving forward.

From a policy standpoint, India's regulatory watchdog, Securities and Exchange Board of India (SEBI), has tightened due diligence standards for the issuance of debt securities that took effect from the beginning of Apr 2021. These new rules require debt trustees to carry out regular independent due diligence checks for the assets backing newly issued debt instruments. The main purpose of this policy is to protect investors by ensuring that debt guarantors readily check that issuers have the necessary assets to discharge interest and principal payments for the securities issued. The impact of the new regulation has slowed down the pace of new issuances with issuances falling drastically over the first two weeks of Apr 2021. Bond issuances over this period fell to a 13-year low of INR 33bn in 2021.

As a result, Indian companies face increasing difficulties in accessing the debt capital markets. With close to 25% of the outstanding debt maturing over the next 2 years, Indian companies that want to refinance in the current environment may face difficulty, not excluding due to the introduction of the above-mentioned regulation. With the social effects of the pandemic worsening drastically on a daily basis over the past three weeks, investor's 'flight to safety' out of India poses a concern for domestic companies that aim to tap into both the equity and the debt markets. Furthermore, for companies that want to tap the low borrowing costs of foreign capital markets, the depreciation of INR has made it more expensive for Indian companies to borrow in USD. The cumulative impact of reduced accessibility of Indian companies to domestic and foreign markets poses a challenge and may negatively contribute to the heightened credit risk in the future.

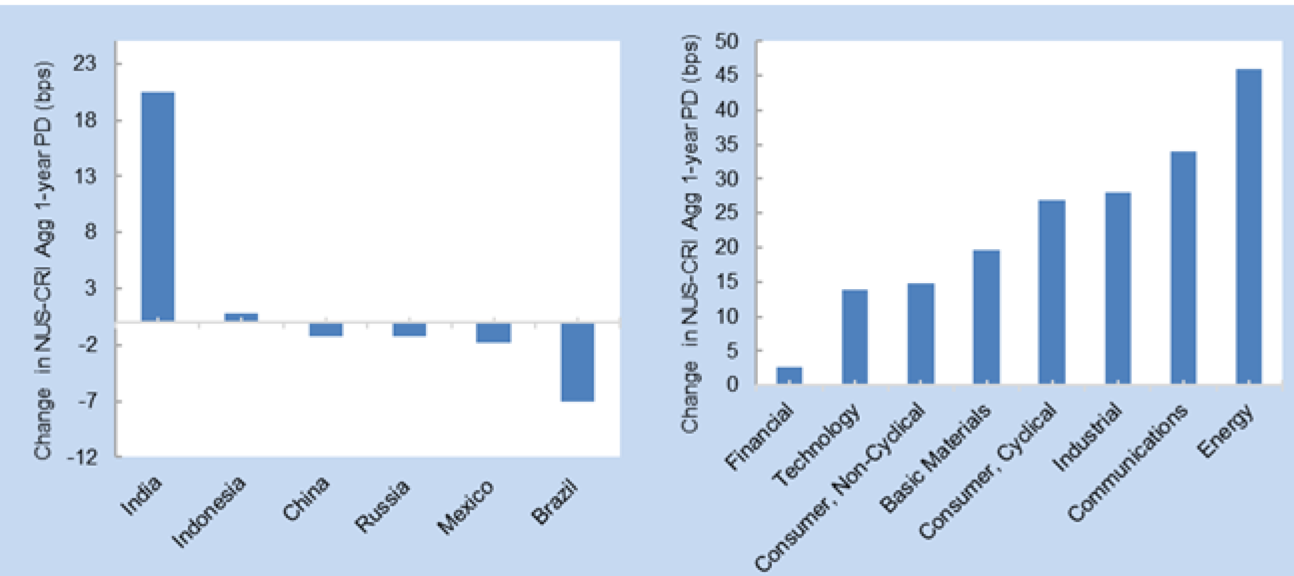

Figure 2a (LHS): Change in Agg PD of corporates in key emerging markets from Mar 2021 to Apr 2021. Figure 2b (RHS): Change in Agg PD for Indian corporates broken down by sectors. Source: *NUS-CRI*

To contextualize the worsening credit quality of Indian companies over the past month, Figure 2a above demonstrates the change in Agg PD from Mar-2021 to Apr-2021 for key emerging markets around the globe. The magnitude of India's credit quality deterioration was larger when compared to the change in credit quality seen in some of the leading emerging economies such as China, Russia, Mexico, Indonesia and Brazil. The impact of the second wave of the COVID-19 pandemic on Indian firms' credit quality is also disproportional for different sectors. Corporates in the energy sector have experienced the largest change in PD, as seen from Figure 2b. With renewed restrictions imposed by Indian authorities, the demand for diesel and gasoline is forecasted to fall by almost 20% at the end of the month. At the same time, operations in these companies have slowed or stalled completely, with employees evacuating from factories as the virus spreads rapidly across the country. In contrast, India's financial sector faced a muted increase in credit risk. While the operating environment for India's financial sector remains weak, state-sanctioned support for Micro, Small, and Medium Enterprise loans provides breathing room for the asset quality for banks, at least in the short term.

In light of the country's dire situation, international support for India's recovery plan has been strong, with the US pledging to provide supplies to help boost India's vaccination efforts. However, continued supply chain disruptions may slow down the rebound for the Indian economy in the near term. On the other hand, as prospects of further lockdowns emerge under worsening COVID-19 conditions, pressure is mounting on the Reserve Bank of India (RBI) to extend its loan relief programs. As economic activity slows down and as potential socioeconomic costs increase in the near future, further schemes set forth by RBI can aid in relieving the possible future repayment pinch felt by borrowers in a weak operating environment.

Credit News

UBS tightens lending criteria to coal, Arctic drilling, oil sands

Apr 23. UBS has announced measures to reduce lending to corporates in the coal power industry, as it joins a global movement in the financial sector to decarbonize the economy. The bank stated that it would only lend to companies that used coal for 20% of their energy needs, or potentially if they had a strategy to fall in line with the Paris Agreement guidelines. They also stated that they might lend to these corporates if the proceeds were for renewable energy initiatives. They imposed similar strict guidelines for thermal coal miners as well as Arctic oil and oil sands users. The bank hopes to achieve net-zero emissions for the businesses it partners with by 2050. (Reuters)

CLO, securitized-debt sales are on fire as investors hunt for yield

Apr 23. The demand for securitized debt has increased dramatically this year, with sales of Collateralized Loan Obligations (CLOs) increasing by 152% as compared to the same time point in 2020. This increase was brought out by refinancing demand, with the spreads for AAA-rated CLO liabilities at their narrowest levels in the post-crisis period. Investor demand for asset-backed securities (ABSs) has risen as well. Sales for ABSs have surged by 45% as compared to the same time last year. Overall, these assets provide opportunities for investors to find returns in a low-yield credit market. The interest in CLOs has also been spurred by expectations of rising interest rates, with investors trying to increase their exposure in floating-rate bonds. The overall tightening of spreads may be healthy for the CLO market, as capital inflows are likely to increase. (Bloomberg)

SPAC surge pumps up junk-bond market

Apr 23. Special Purpose Acquisition Companies (SPACs) are now aiming to acquire companies that issue high-yield bonds. They hope to use their large cash balances to pay down the debt of these firms in hopes of improving their prospects. The overall activity for equity issuances surged in 2021, with total funds raised by SPACs and IPOs reaching USD 250bn as of Apr 2021, exceeding the total amount raised in all of 2020 and the total issuance of high-yield bonds in 2021. Investors are now worried about an overheating in the SPAC market, mirroring the real estate industry during the mortgage crisis. While credit health has seemingly improved with over half of high-yield issuers being rated BB, the increasing trend of SPACs acquiring highly leveraged companies could pose trouble in future economic downturns. (WSJ)

Investors plough money into US inflation-protected bond funds

Apr 23. To prepare for the rise in inflation amid signs of economic recovery, investors are putting their money into inflation-protected bonds. US Treasury Inflation-protected Securities (Tips) saw an inflow of USD 1.2bn in last week ended Wednesday. Prospects of the global coronavirus vaccination campaign, combined with the Biden administration's USD 1.9tn fiscal stimulus program raised concerns over inflation in the market. The Federal Reserve will maintain the current ultra-accommodative monetary policy unless the Core PCE averages 2%. Furthermore, the Fed chair Jay Powell has argued that any increase in price pressure will be "transitory". Both 2-year and 5-year break-even rates, popular market indicators for inflation expectations derived from Tips, are now at 2.63% and 2.57% respectively, higher than in December. Meanwhile. the 10-year break-even rate is at 2.3%. As transitory inflation may move the market and lead to higher inflation expectations, investors could employ Tips to protect them against inflation. (FT)

Bond investors on edge as China grapples with Huarong restructuring

Apr 22. After bad loan giant China Huarong Asset Management Co Ltd saw its dollar bonds plummeted a week ago, uncertainties remain over its restructuring plan. Bids on a EUR 500mn December 2022 bond issued by subsidiary Huarong Universe Investment Holding Ltd dropped from 97 cents quoted on Apr 14 to 70 cents on Apr 22, but higher than 65 cents quoted a week ago. The possibility of the People's Bank of China (PBOC) buying Huarong assets via onshore vehicle to back up the state enterprises' offshore debt will help calm the market nerves and could lead to rerating and repricing of China's bond market. Investors, however, remain wary about it with no concrete information. (Reuters)

US corporates ready USD 30bn of bond sales after earnings (Bloomberg)

Qatar Petroleum plans USD 10bn bond sale for gas expansion (Bloomberg)

Global bond, money market funds attract inflows on rising virus concerns (Reuters)

Regulatory Updates

China tightens credit conditions in bid to balance growth and debt

Apr 25. To prevent the Chinese credit market from overheating, policymakers hope to slow down credit growth through various policy measures. They are reining in the highly leveraged property market through the "three-red lines" policy, while total social financing has fallen to 12%. The government aims to lower its debt burden, with the debt-to-GDP ratio of the country rising to 281%, a record high. With the Chinese economy slowing down after the rebound last year, policymakers monitor credit growth on a sector-specific level instead of adjusting rates, which would affect its outlook on an aggregate level. By monitoring credit health in this way, they hope to manage troubling sectors such as real estate without detrimentally affecting the credit-starved SME sector. (FT)

Canada scales back bond purchases and raises growth forecast

Apr 22. Canada became the first among G7 countries to cut down its monetary policy support measures introduced during the onset of the pandemic last year. Aside from the reduction in bond-buying by 25%, the Bank of Canada will scale back the net purchases of government debt by CAD 1bn per week to CAD 3bn, as the economic recovery both in Canada and around the world is making progress. The bank revised the projections for GDP growth to 6.5%, up by 2.5% from Jan's estimates. It also brought forward the date when it will meet the inflation target to H2 2022 from 2023 in the January projection. The Canadian 10-year-bonds yields rose to 1.54% and the Canadian dollar appreciated against the US dollar after the announcement. This move of the central bank, which marked the start of an exit strategy, however, is surprising as COVID-19 cases are still surging in Canada. (FT)

Hong Kong plans expand bond connect in July, HKEJ reports (Bloomberg)

Hawks press ECB to scale back bond buying despite rising Covid wave (FT)

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