

Country risk: India's Covid-19 hit may turn it to junk

Jeremy Weltman Thursday, May 21, 2020

Risk analysts have south Asian borrowers in their sights, after Sri Lanka's downgraded credit rating from S&P this week.



India's investor prospects deteriorated more than any other Asian country in the first quarter of 2020, according to Euromoney's country risk survey.



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It shed 3.22 points from its risk score tally, extending a trend 10-year decline to 7.75 points, resulting in a rapid fall of eight places since December, to 67th out of 174 countries in the global risk rankings.

Importantly, India has fallen almost to the bottom of the third of five tiers into which Euromoney divides all countries based on their comparative risk metrics, to a level that is often associated with a country moving from investment grade to junk status.

Contributors to Euromoney's country risk survey attribute India's fall to the coronavirus crisis causing recession and elevated fiscal and financial sector vulnerabilities.

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- Shihar Aneez

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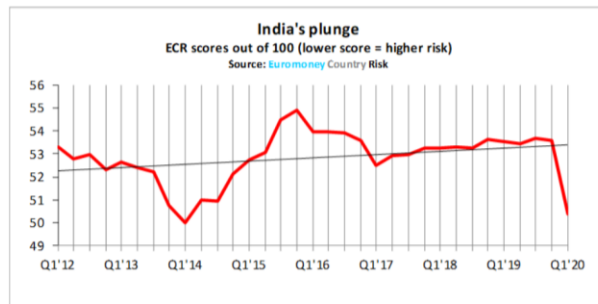


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Sher Mehta, head of macroeconomic research and country risk analysis at Virtuoso Economics, says India lacks fiscal buffers. He expects a marked rise in the public debt-to-GDP ratio – already at 70% – for the current fiscal year that began on April 1 and runs through to the end of March next year.

The prospect of a V-shaped economic recovery is diminishing, he believes, despite the \$267 billion economic stimulus package India's government introduced to address the country's mounting economic and humanitarian crisis.

"Much of this stimulus focuses on liquidity measures, rebooting the supply side of the economy, and structural reforms," Mehta says, "rather than a strong fiscal stimulus to shore up plummeting demand."



Survey contributor Owais Zaheer agrees the stimulus package will have a limited impact at best and says India's fiscal position is increasing the likelihood of a credit rating downgrade.

"It is worth only 1.5% to 1.8% of GDP, and much of it comprises pre-budgeted items that have been reclassified as relief. Consequently, a follow-on package may be required which could see India's fiscal standing deteriorate, weighing on its rating."

Independent economic analyst Shihar Aneez says that under the current lingering lockdown there is uncertainty over the extent of the fiscal stimulus package required to ride out the post Covid-19 phase.

"Though the government wants to limit fiscal stimulus, it will be difficult to trigger economic growth, amid rising unemployment with millions of job losses," Aneez says.

On top of that "India is also facing difficulties with tax collections and a privatization programme planned for this fiscal year, so there is limited scope for the government to spend."

This puts the prospect of reforms under the spotlight, says Joy Rankothge of Country Acuity Advisors, who ponders if this will spur the bold strategy that investors have been hoping for from prime minister Narendra Modi since he took office in 2014.

One area that India must reform is the banking sector, where around 70% of assets are controlled by the public sector. Bank stability is one of the economic factors downgraded in Euromoney's survey; it is now scoring less than half the available points, indicating heightened risk.

"Banks are sitting on very high non-performing loans, and several rounds of reforms and recapitalizations haven't really fundamentally addressed the issues," says Rankothge, who adds that India must address this issue if the country is to grow at close to potential.

Regional problem

India is not the only country struggling. The entire south Asia region is suffering, thanks to a combination of concentrated economic activity, demographics and urbanization, says freelance country risk analyst and ECR survey contributor Dr Shahid Malik.

Remittances in particular are a big threat to foreign exchange reserves, he points out. They have fallen sharply, notably in India and Sri Lanka.

More than half of Bangladeshi, Indian and Pakistani exports comprise manufactured goods. Bangladesh, one of the biggest textile exporters in the region, faced its worst hit in April.

India, Sri Lanka and the Maldives have also been affected by the sudden drop in tourism.

As if to flag such heightened risk, Sri Lanka's risk score, like India's, fell sharply in Euromoney's first-quarter survey, causing the country to fall five places in the global rankings. It is now 87th, roughly on a par with Turkey.

This week S&P downgraded Sri Lanka's sovereign borrower credit rating from B to B-, citing the country's worsening fiscal position.

Many analysts, including Aneez, saw this coming.

Before the S&P downgrade, he said that Sri Lanka "will face a tough challenge maintaining its credit ratings, given the pandemic will exacerbate the already rising public and external debt sustainability challenges, following tax cuts and an associated shift in fiscal policy late last year".

Tier-five Bangladesh (at 141st in the survey) and tier-four Pakistan (125th) were already-risky options that have dropped further in Euromoney's global risk rankings.

On Bangladesh, Aneez notes the weak revenue-generation capacity that constrains improvements in debt affordability and limits fiscal flexibility, putting its rating under threat.

As for Pakistan, he says the government's commitment to fiscal reforms under the IMF programme (to 2022) is a "crucial anchor for the continued expansion of its revenue base when economic activity gradually normalises". But, he notes, the coronavirus is a shock that can have an adverse impact on the country's rating.

For a region with such enormous political and social problems, mostly linked to high levels of poverty, under-employment and ethnic tensions, the crisis is nothing short of a nightmare for its politicians.

For the region's investors, it looks like delivering much riskier returns.

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