COUNTRY RISK CATEGORY

3

OF 7

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India

COUNTRY ANALYST

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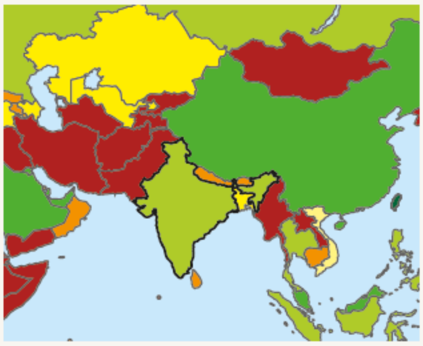
Basic facts (2020)

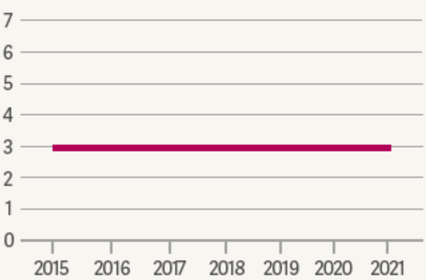
Population: 1 397 million
GDP, nominal: USD 2 709 billion
GDP/capita: USD 1 965



0	1	2	3	4	5	6	7

The country risk categories are arranged on a scale from 0 to 7. The lower the figure, the better the country's creditworthiness

Country classification history



Source: EKN

Strengths

- Diversified economy with a large domestic market
- Limited external debt and considerable international reserves
- Strong growth potential

Weaknesses

- Weak public finances, with persistently large deficits and high debt.
- Weaknesses in the banking and financial sector
- Unpredictability in the regulatory environment, business climate deficiencies, and mixed payment experience

The pandemic was preceded by slowing growth

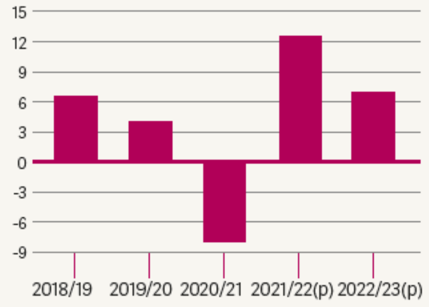
India is the world's 6th largest economy (3rd in terms of purchasing power parity). With a growing population of over 1.3 billion, 44% of whom are under the age of 25, India is on its way to overtaking China as the world's most populous country. The growth of the economy is primarily driven by domestic demand. Private consumption accounts for 60% of GDP. Private sector-dominated investment is around 30% of GDP. The economy is relatively diversified and with good global market positions in areas such as ICT, pharmaceuticals and steel. However, integration into global trade and production flows is relatively limited, and in terms of the size of the economy, manufacturing and the export sector are small (16% and 11% of GDP, respectively). Combined with limited natural resources, this causes structural trade deficits. Growing service exports and remittance inflows contribute to moderate a current account deficit, which is financed to a large degree by foreign direct investment (FDI). International reserves have gradually strengthened to levels covering over 80% of the country's limited foreign debt (about 20% of GDP). The large diversified economy and robust external balances provide resilience to external shocks.

The landslide victory in the 2019 elections for Prime Minister Modi and his Bharatiya Janata Party (BJP) gave the BJP a second five-year term with its own majority in the lower house of Parliament. The victory suggests a deeper shift in India's political landscape, from decades of fragile coalition governments led by the secular Congress Party to today's dominance of the BJP with its Hindu-nationalist and slightly more market-oriented agenda. The pace of reform has increased under Modi. However, the reform processes inevitably take time given India's history of state intervention in the form of a large state sector, regulations, and subsidies, not the least in the agricultural and energy sectors and also given a complex political system with 35 states and territories. With the vision to modernise India, growth-promoting reforms have been initiated since 2014. This includes a national system of taxing goods and services, known as GST, which will strengthen the tax base. Energy subsidies have been reduced in favour of infrastructure investment and. Corporate taxes have been reduced. Inflation targets have been introduced as an anchor in monetary policy. Liberalisation of permitting processes,of restrictions on foreign ownership and capital inflows are intended to attract capital to infrastructure and the manufacturing industry. Reforms in the banking system and the insolvency framework have been initiated. Despite the reform policies, growth started to slow even before the coronavirus outbreak. GDP growth fell from an annual average of 7.4% in the financial years (FY) in 2014-18 to 4% FY19 (the financial year runs from the beginning of April to the end of March). Factors such as increasing weaknesses in the financial sector combined with subpar growth in investment, private consumption and employment may indicate that sluggish implementation is hampering the impact of the reform policies.

Recovery with expansionary macro policy

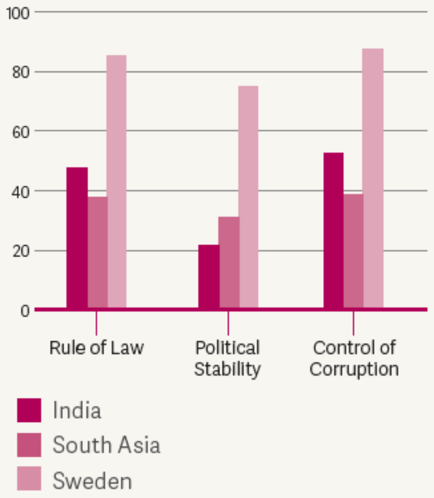
India suffered one of Asia's deepest declines in GDP during the pandemic (-7.3% FY20). This was contributed to the extensive lockdown in the first quarter of FY20, as well as the wave of infections in autumn 2020 that led to the

GDP growth (fixed prices, % per annum)



Source: IMF WEO april 2021 (Indian fiscal year, April-March)

Business environment



Ranking from 0 (worst) to 100 (best)

Source: The World Bank

reintroduction of restrictions in the country's economically most important regions. A gradual recovery has been underway since late autumn 2020, but then a second, larger wave of infection in spring 2021 has dampened the recovery. A growth rebound of 8-10% is nevertheless considered likely FY21 before a normalisation next year. It is likely to be until spring 2022 before the vaccination cover in the population approaches levels that might yield some form of herd immunity. The coronavirus pandemic and vaccination trends are thus the primary uncertainties in the coming year.

The pandemic has reinforced India's macroeconomic weaknesses: public finances and the financial sector. While strong GDP growth has previously helped to stabilize government debt relative to GDP, the debt ratio has increased sharply since 2017, reaching 90% of GDP in FY20. The risks are mitigated by the fact that most of the debt is denominated in domestic currency. Nevertheless, there is a need to strengthen public finances. The State is also exposed to financial sector weaknesses. Prmimarily in the state-owned banks, which account for 60 per cent of the banking system's assets, but also in some private banks and Non-bank Financial Institutions, whose importance for theprovision of credit has grown. In 2020, the Indian government has taken several emergency measures in support of companies and banks. This includes the emergency suspension of insolvency proceedings against companies and the banks to book new non-performing loans. As these measures expired in March 2021 there is a risk of rising bankruptcies and credit losses going forward. The situation risks exacerbating the weaknesses in the financial sector. Therefore, the government has announced a continued expansionary fiscal and monetary policy for the coming years. Governmental efforts to kick-start the it's ambitious infrastructure plans are combined with the central bank holding down interest rates by means of the purchase of government bonds. In addition, state banks continue to be the focus of further banking sector reforms. Their non-performing loans are to be partly taken over by a new asset management company followed by recapitalisations and privatisations. The key challenge is to avoid long-term damage to the economy's growth potential and to bring about a return to a sustainably higher growth path driven by the private sector.

Business environment

Over the past decade, a number of reform processes with a focus on strengthening the business climate have been commenced. The national system for tax on goods and services (GST 2017) can facilitate intra-state sales. A major reduction in corporate tax rates was implemented in 2019. Infrastructure investments continue to contribute to reducing costs for energy, logistics, etc. Regulatory relief for foreign investment has been introduced in several areas, such as the construction, pharmaceutical, insurance and retail sectors. The implementation may have shortcomings, but the reforms leave an imprint on indices that measure the business and investment climate. In the World Bank's Worldwide Governance Indicators (WGI), India's performance in terms of economic institutions has improved and is now sligthly above the average for Asian Emerging and developing countries. India climbs the World Bank's Business Climate Ranking (Ease of Doing Business Index, DBI) and in 2020 reached rank 63 out of 190 countries (134, 2015), or rank 7 in the region. India ranks 68 in terms of time and costs associated with import and export procedures and logistics. However significant red tape remains, and in terms of

Swedish export to India

	MSEK
2020	9 674
2019	12 787
2018	12 600
2017	11 432
2016	8 921

Source: SCB

EKN:s exposure

	MSEK
Guarantees	3 478
Offers	1 431

starting up a company, India ranks in 136th place.

From EKN's credit risk perspective, important aspects of the business environment are related to the degree of predictability, stability and quality both in regulations that affect our obligors' business operations and, in the country's, legal and institutional environment that affect the position of lenders and creditors. According to the WGI, the quality of the regulatory environment is just below the average for the region. Examples of sweeping reforms that are enforced with little warning include the demonetisation of high-denomination notes in 2016, or the retroactive revaluations of tax charges in the telecoms sector. Corruption is another challenge. In Transparency International's Corruption Perceptions Index, India ranks 86 out of 180 countries, a deterioration since 2016 (rank 79). The legal framework follows the British model and the judiciary is regarded as being independent. One important reform is the modernisation of the framework for insolvency and bankruptcy. A new law (IBC, 2016) is intended to facilitate corporate restructuring/business reorganisations, manage non-performing loans, and strengthen the payment culture. A time-limited insolvency procedure, the outcome of which is reviewed in specialised courts, should lead to faster proceedings and higher levels of recovery. In the DBI, the estimated average recovery rate for corporate bankruptcies (in transactions with security provided) has increased from 26 per cent in 2019 to 72 per cent in 2020. This is far better than the regional average (40%). In practice, the insolvency process has often proved to take considerably more time than the stipulated deadlines, as the courts are reported to be overburdened and many court rulings are appealed. However, case law and practice in the courts is still evolving as the legislation undergoes changes. A 1-year ban on insolvency proceedings was introduced during the coronavirus pandemic until March 2021. EKN's experience is that it takes a very long for a court case to wind its way through the judiciary, the outcome is uncertain and unpredictable, and the risk remains that the recovery rate is very low. Thus, the improved performance in DBI is assessed to point to a positive trend but may not yet fully reflect the realities of foreign creditors.

A relatively complex and changing regulatory framework surrounding foreign capital flows and currency is another challenge, although liberalisation has taken place in recent years. In the quest to stimulate domestic manufacturing, there are also signs of increasing protectionism and tariffs, which may hamper export opportunities. Delays in payment are relatively common in EKN guarantee transactions. It is likely advisable to include a provision in the contract concerning interest on past due amounts. EKN's experience has been the payment of supplier credits with low or no interest due tends to be given lower priority.

EKN:s policy

EKN has placed India in country risk category 3 (of 0 to 7) for more than a decade. Normal risk assessment applies to all debtor categories. This means that there are no pre-given restrictions in the guarantee and that the transactions are assessed on their own merits without special requirements or terms and conditions. As the macroeconomic preconditions for credit risks to companies are deemed to have deteriorated in the wake of the coronavirus pandemic, increased premiums for commercial risks have been applied since April 2020.

EKN:s commitment and experience

EKN's guarantee commitment amounts to SEK 4.9 billion, of which SEK 3.6 billion are outstanding guarantees. The power and telecom industries dominate For the period 2016-20, EKN issued guarantees in 187 transactions for 32 exporting companies, amounting to a total equivalent to SEK 2.6 billion. The largest sectors in terms of amounts in the flow were telecoms and vehicles, construction, and mining equipment. Approximately 100 transactions with SME exporters accounted for about 15 per cent of the guarantees. After a few weak years, demand picked up in 2018-19, but the trend was broken during the pandemic in 2020. Delays in payment are relatively common. Of the guarantees issued during the period 2016-20, more than 20 per cent of the transactions were late in payment (as per May 2021). The delay in payment is 70-80 days on average. However, the claims rate in this cohort is low and until May 2021, claims have been made in only 2 cases. EKN's historical payment experience is mixed. In guarantees issued prior to 2016, EKN has settled claims in during the period 2016-21 for an amount of approximately SEK 360 million, in a handful of transactions. In these transactions, the recovery rate has been very low.