COUNTRY RISK CATEGORY

3

OF 7

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India

COUNTRY ANALYST

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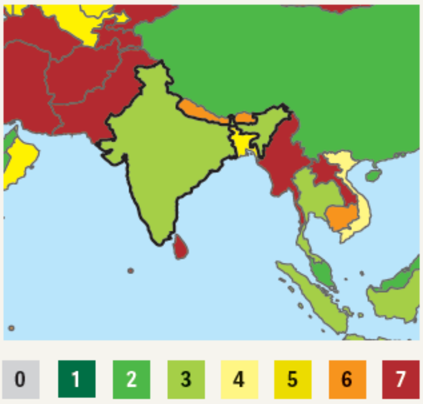
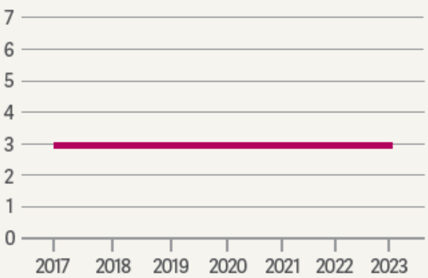
Basic facts (2022)

Population: 1 423 million
GDP, nominal: USD 3 386 billion
GDP/capita: USD 2 379



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

+ Good growth potential and growth-oriented reform policy
+ Diversified economy with a large domestic market
+ Limited external debt and considerable international reserves
+ Government debt is primarily domestic

Weaknesses

– Weak public finances with persistent deficits and high debt ratios
– Weaknesses in the financial sector.
– Unpredictability in the regulatory environment, and mixed payment experiences
– Exposure to climate change and transition risks

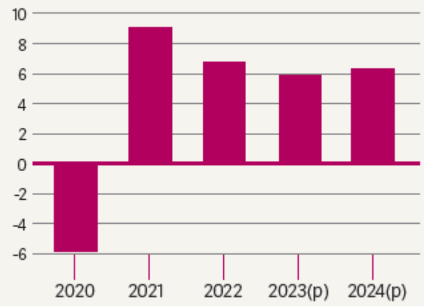
Continued reforms lay foundations for growth

With a population of 1.4 billion, of which 43 per cent are under the age of 25, India will become the world's most populous country this year. The economy is expected to climb from the world's 6th to 3rd largest within 5-6 years. Growth is primarily driven by domestic demand. Private consumption accounts for just over 60 per cent of GDP. Investment, dominated by the private sector, amounts to about 30 per cent of GDP. On the production side, the services sector dominates (just under 55 per cent of GDP). The informal sector accounts for a large share of employment, and agriculture alone (about 18 per cent of GDP) employs over 40 per cent of the workforce. With increasing income inequality and a growing workforce, a key challenge is to create more formal jobs. The economy is relatively diversified with strong global positions in areas such as ICT, pharmaceuticals, steel and petrochemicals. The integration into global supply chains is more limited, as is the size of the manufacturing industry and goods exports (15 per cent and 13 per cent of GDP respectively). In combination with limited natural resources, this contributes to structural trade deficits. Growing, and increasingly advanced service exports and remittance inflows (approx. 9 per cent and 3 per cent of GDP respectively) contribute to a dampening of current account deficits. They remain moderate and can be partially financed by foreign direct investment (FDI). International reserves are therefore robust and cover about 80 per cent of the country's limited external debt (about 20 per cent of GDP). Although persistent budget and current account deficits present some vulnerability, a large, diversified economy and external buffers provide resilience to external shocks. The importance of agriculture, the challenges of population pressure regarding, for example, water availability and a fossil-heavy energy mix contribute to India being one of the more exposed middle-income countries in Asia, in terms of long-term climate change and transition risks.

Ahead of the elections in spring 2024, there are many indications that Prime Minister Modi and his Bharatiya Janata Party (BJP) are heading for a third five-year term. This would imply continuity in policies based on the BJP's Hindu nationalist agenda, but also on the vision of modernising India through growth-oriented reforms with a focus on the supply side of the economy. A macro-policy framework has been established with inflation targets, flexible currency, and deficit ceilings for federal and state budgets, although compliance occasionally slips. A national system for tax on goods and services has been introduced. This promotes trade between states and strengthens the tax base. The fiscal policy prioritises much-needed investments in infrastructure. The rapid digitalisation of recent years and an increasingly expanded digital infrastructure, not least public systems, are central to modernising and formalising India's economy. Reforms of the banking system and insolvency framework have contributed to reducing problem loans in the banks and debt levels in the corporate sector. Liberalisation of FDI, capital inflows and the labour market are intended to attract investment in the manufacturing industry. Green transition with investments in renewable energy and green technology is another growth area on the reform agenda. Attitudes towards bilateral free trade agreements have become more open and negotiations have resumed with the EU and others after a prolonged break. The reform processes take time given the country's large public sector and a complex federal political system, where reforms may struggle to make a nationwide impact. The trend in the years before

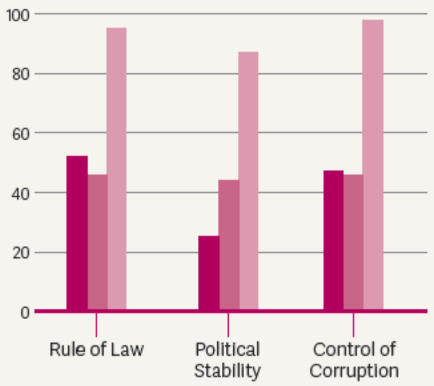
India

Real GDP growth (constant prices, % per annum)



Source: IMF WEO, Macrobond

Business environment



Ranking from 0 (worst) to 100 (best)

Source: The World Bank, Macrobond

Swedish export to India

	MSEK
2022	17 244
2021	11 522
2020	9 667
2019	12 787
2018	12 600

Source: SCB

EKN:s exposure

	MSEK
Guarantees	2 521
Offers	45 874

the pandemic, namely of weak growth in private investment and in new jobs in the formal sector, may indicate that the impact of the reforms is being slowed by implementation issues. Together with the lingering effects of the pandemic on the economy, this contributed to the IMF lowering its estimate of India's medium-term potential growth rate from 7 to about 6 per cent in 2021. Nevertheless, it suggests that India remains one of the faster growing countries in Asia and with scope for an up-side with continued reform policies.

Striving for fiscal consolidation in the long term

The strong GDP growth, which as been driven by pent-up consumption and public investment after the pandemic, is slowing down. Successive interest rate hikes to curb inflation and signs of weaker external demand are also contributing to this. However, growth remains robust, as a large domestic market cushions the impact of a weak global economy. For FY22 (ending in March 2023), GDP growth landed at a strong 7.2 per cent. For FY23, a gradual slowdown to ± 6.0 per cent is expected. On the external side, the current account deficit is expected to decrease slightly in FY23-FY24 on the back of lower commodity prices and domestic demand, as well as the growth trend in service exports.

The pandemic years amplified India's main macroeconomic weakness: government finances. After strong GDP growth helped stabilise the debt-to-GDP ratio for a long time, the ratio has risen sharply since 2017. Rising interest expenditure, the often-weak state finances and the cost of subsidy programmes imply that public deficits are expected to remain above pre-pandemic levels in the coming years. This also affects the private sector, as public financing needs tend to raise interest rates. The government's plan is to gradually reduce the deficit over time but continue to prioritise infrastructure in order to strengthen growth. However, the 2024 election carries some risk of fiscal populism. Public debt will therefore remain high over the next 3-4 years, around 80-85 per cent of GDP. The risks of this are reduced by the fact that over 90 per cent of the debt is domestic, in local currency and relatively long-term. A prerequisite for strengthening government finances is a return to a sustainably higher growth trajectory driven by the private sector. The continuity in the reform policies gives reason for cautious optimism that the foundations for a stronger growth trajectory are in place.

Business environment

A series of reform processes have been initiated over the past decade to strengthen the country's competitiveness and business environment. Regulatory relief for FDI has been introduced in several sectors. Incentive programmes, Production Linked Incentives, have been expanded to more sectors to attract investments to more advanced manufacturing industries (mobile telephony, semiconductors, electric vehicles, etc.), and Samsung's and Apple's establishments are among the successes. In 2019, corporate tax rates were reduced to levels more in line with competitor countries in Asia. Investments in infrastructure and logistics networks are designed to reduce still high energy and logistics costs. Increasing digitalisation is now being used to support the reform processes. This may, for example, apply to efficiency-enhancing initiatives to reduce lead times in trade and logistics, but also in public transfers, tax administration and for increased government coordination of investment projects that has historically been weak. The implementation may have flaws and take time, but the reform processes are beginning to make their mark in indexes that measure the business and investment climate. In the World Bank's Governance Indicators (WBGI), India's performance in terms of economic institutions has improved somewhat and is slightly above the average for emerging and developing countries in Asia. The fact that the results are improving in the World Bank's Logistics Performance Index indicates that the investments in infrastructure and digitisation are also beginning to bear fruit.

From EKN's credit risk perspective, important aspects of the business environment are predictability and quality, partly in regulations that affect debtors' business operations, and partly in the country's legal and institutional environment, as these affect the position of creditors. For the regulatory environment, India's performance in the WBGI is slightly above the average for the region. However, the regulatory environment is considered to be complex with extensive bureaucracy at many levels. In the future, progressively tighter regulations related to climate policy are expected. Furthermore, there is no shortage of examples of sweeping reforms implemented with little warning, such as the invalidation of high-denomination banknotes in 2016 or retroactive revaluations of taxes in the telecoms sector in 2020. Corruption remains another serious challenge. In Transparency International's Corruption Index 2022, India ranks 85th out of 180 countries, in line with the regional average. For the legal environment, the results in the WBGI are slightly above the average for the region. A major 2016 reform modernises the insolvency and bankruptcy framework via new legislation (IBC). The focus is on restructuring rather than the liquidation of companies. The law will facilitate the restructuring of companies, the management of 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 practice, the process has often proved to take significantly longer than the law prescribes. Judicial practice is evolving as the legislation is gradually undergoing adjustments. The framework seems more favourable for financial creditors than for suppliers who, for example, may not be included in the creditors' committees that are established in the event of insolvency. Furthermore, rules from the central bank seem to give domestic financial creditors some initial advantage in restructuring negotiations. One challenge is that the market for non-performing assets is undeveloped, which makes asset valuations difficult. EKN's experience is that it takes a long time to pursue a legal process, that the outcome is uncertain and that the recovery rate risks being low – especially for foreign creditors or where there is a lack of collateral. Although the effects of the reforms are limited, there are signs that the recovery rate in bankruptcies has begun to increase and the time period is shortening, which indicates a positive trend.

The weak and non-transparent finances of states and their companies make the risk assessment of such counterparties difficult. A relatively complex and changing regulatory framework surrounding foreign capital flows and currency is another challenge, despite liberalisations that have taken place in recent years. In an attempt to stimulate domestic manufacturing, there is also evidence of increasing protectionism in the form of local standards, overly complex import regulations and customs tariffs, which may hamper the possibilities for exports and integration into international supply chains.

EKN:s policy

EKN has classified India in country risk class 3 (on a scale of 0 to 7) for more than two decades. Normal risk assessment applies to all debtor categories. This means that there are no predetermined limitations in the issuance of guarantees and that the transactions are assessed on their own merits without any specific requirements or preconditions.

EKN:s commitment and experience

EKN's exposure amounts to SEK 48.4 billion, of which SEK 2.5 billion is in issued guarantees. This is predominately within telecoms but also the power sector, construction machinery and medical technology. During the period 2018-2022, EKN issued guarantees in more than 200 transactions for approximately 25 exporters amounting to SEK 3.4 billion. Some 100 SMEs accounted for 15 per cent of the guarantee volume. EKN's payment experience is mixed. Payment delays are common. It is an advantage to have interest on late payment in the contract, as EKN's experience is that payment of supplier credits with low or no interest on late payment tends to be given lower priority. Of the guarantees issued in 2018-2022, delays have been reported in approximately 25 per cent of transactions. The delays lasted 70-80 days on average. However, the claims rate is low in this cohort. Only 5 transactions out of just over 200 resulted in a claim. In guarantees issued before 2018, approximately SEK 588 million in claims were settled during 2018-2022. In these transactions, the recovery rate has so far been very low.