Higher interest rates, increasing risk aversion by state-run banks and volatile external environment are key drives for credit quality of corporates in the current financial, says a report.

The rising risk aversion indicates that sourcing credit for issuers who are rated below 'A' is increasingly becoming difficult, an India Ratings report said.

"The adverse conditions in the interest rate market, increasing risk aversion by state-run banks, volatile external environment and limited access to alternative financing options as critical drivers for corporate credit quality in FY19, especially for weak entities," the report said.

It said recent analysis of the top 500 corporate borrowers which comprise about 78 per cent of the overall banking system's corporate exposure, indicates that around Rs 7.60 trillion debt is on the books of the non-public sector entities rated 'BBB' and below or have no rating outstanding.

Government's substantial cash infusion of Rs 1.53 trillion into state-run banks in FY19 would be adequate to cover credit costs emanating from stressed assets.

Baring three to four healthy state-run banks, the FY20 CET1 may be below the current regulatory requirements, it said and warned that "this could increase banks' risk aversion and skew incremental lending towards better-rated corporates, leaving lesser space for small and weaker credits."
The report further said excess system level liquidity has become necessary to absorb the short-term financing challenges without stoking an irrational credit culture in the near term.

While recapitalisation will partially restore state-run lenders' ability to normal lending, frontloading and early infusion can address credit tightening to a certain extent, the report said.