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Theme 256

INDIA'S CREDIT RATING OUTLOOK

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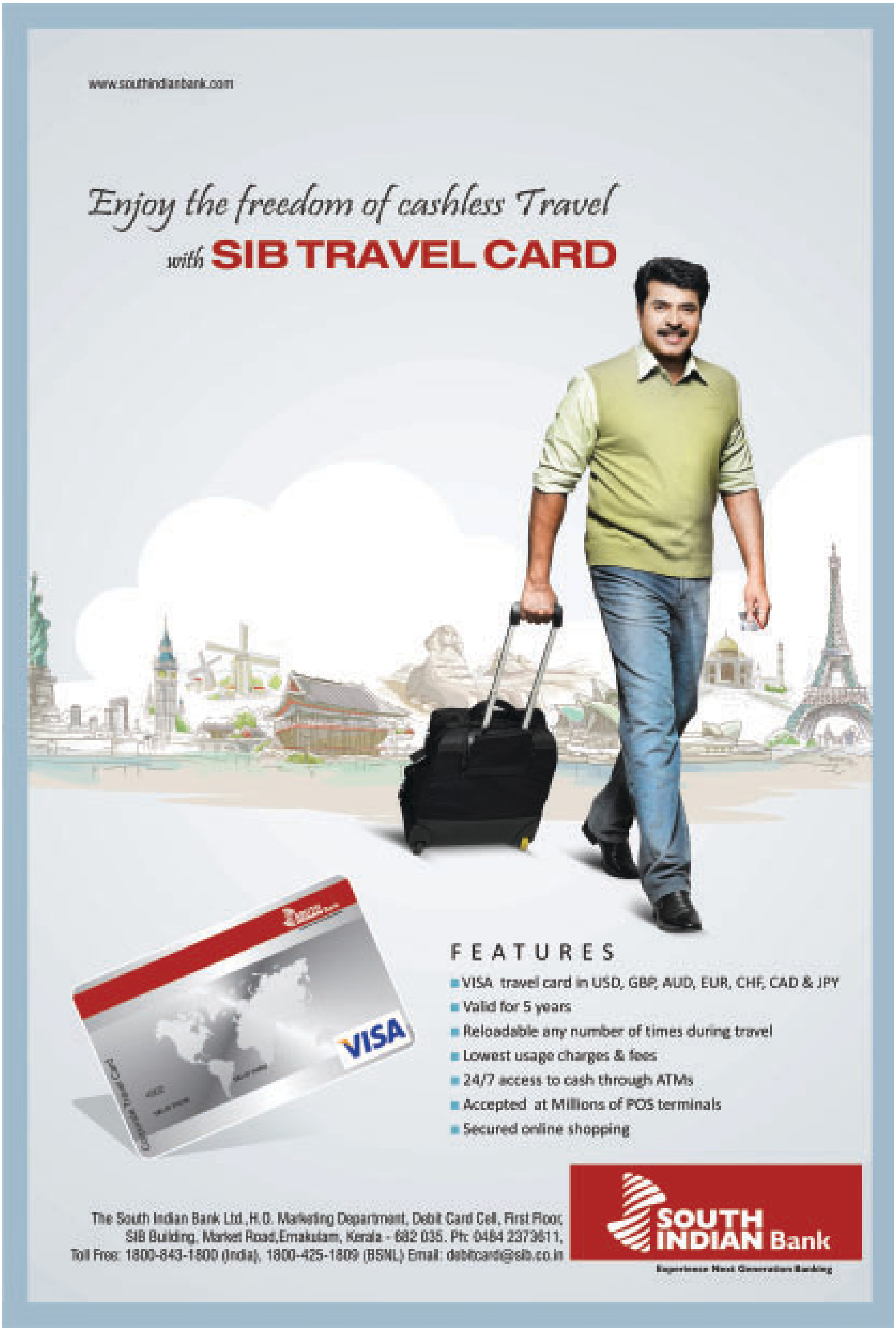
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Theme No. 256 : INDIA'S CREDIT RATING OUTLOOK

A well informed customer will make the policy makers as well as organisations which produce goods and services more responsive to the customer needs. This will also result in healthy competition among organisations and improve the quality of goods and services produced.
The "SIB Students' Economic Forum" is designed to kindle interest in economic affairs in the minds of our younger generation. We highlight one theme in every monthly meeting of the "Forum". The sovereign rating agencies, S&P(Standard & Poor's) and Fitch have cut India's credit rating outlook. We discuss, this month, on the implications of this downgrade.

What do you mean by sovereign rating?
A credit rating evaluates the credit worthiness of a debtor, especially a business (company) or a government. It is an evaluation made by a credit rating agency of the debtor's ability to pay back the debt and the likelihood of default. A sovereign credit rating means the rating of the Government of a country indicating the risk involved in investing in that country by International investors. The largest credit rating agencies, operating worldwide are Dun & Bradstreet, Moody's, Standard & Poor's and Fitch Ratings.

What do you know about S&P?
Standard & Poor's (S&P) is an American financial services company. It is a division of The McGraw-Hill Companies that publish financial research and analysis on stocks and bonds. It is well known for its stock market indices, the U.S. based S&P 500, the Australian S&P/ASX 200, the Canadian S&P/TSX, the Italian S&P/MIB and India's S&P CNX Nifty. The company is one among the big three credit rating agencies, which also include Moody's Investor Service and Fitch Ratings.

What was the action by S&P?
S&P cut India's outlook from stable to negative , assigning one in a three chance of a downgrade to below investment grade over the next two years. The agency warned the Government of a downgrade in two years, if it fails to improve the fiscal position and take steps to better the political climate in the country. The rating agency also lowered the GDP growth forecast from 7.5% to 6.5% and again to 5.5% .
The major reasons cited by the agency were

1. Low GDP growth of 6.9% in 2011-12.
2. High fiscal deficit at 5.9% of GDP in 2011-12

3. High current account deficit at 3.6% of GDP in 2011-12
4. High inflation
5. High Interest rates.
6. Heavy debt burden
7. Political paralysis & corruption threatening fiscal reforms.

Within three months of Standard & Poor's action in April 2012, and its follow-up threat, Fitch scaled down India's sovereign credit outlook to 'negative' from 'stable' while citing much the same reasons as S&P — corruption and the absence of or inadequate reforms.

What was the response of the Government?

The Government says that the rating agencies' observations are based on old data and do not reflect the recent developments. The Government statement, pointed out that the revision in rating outlook by Fitch to the lowest investment grade notch was because it had ignored the recent positive economic trends. While the markets had already anticipated that Fitch would revise the outlook and so there is no surprise in the announcement, it must be pointed out that Fitch has primarily relied on older data, and has ignored the recent positive trends in the Indian economy.

What was the observation made by Fitch?

Fitch went on to point out that the revision in outlook reflected the "heightened risks" that India's medium-to-long-term growth potential would gradually deteriorate if further structural reforms are not hastened, including measures to enhance the effectiveness of the government and create a more positive operational environment for business and private investments. It, however, retained India's sovereign rating a notch above the speculative grade. Alongside, the rating agency also downgraded the credit outlook of seven PSUs. The Indian government, Fitch said, had repeatedly delayed tax and subsidy reforms and thus the confluence of weaker economic growth and a large subsidy bill "means India will likely miss its 5.1 per cent of deficit target for 2012-13". The rating agency also lowered the GDP growth forecast to 5.5 per cent in 2012-13 from its earlier projections of 6 percent and 6.5 per cent.

What was the immediate reaction in the stock market?

Most of the indices closed on a negative note subsequent to the release of S&P report. Both NSE and BSE indices were down by almost 6 % and 5% respectively. Even though the IT stocks were up by 2%, realty and even power stocks suffered huge setbacks.

What are the major initiatives taken by the Government?

Our country does not have any sovereign global bond issues, and as such there is no direct impact on the Government by the downgrade. But the investors in our companies will seek more risk premium resulting in an increase in the cost of funds.

There will be a negative impact on foreign investment, both FDI and FII. The slowdown in inflow of foreign exchange may weaken the rupee. In a string of bold initiatives the government, accused of a "policy paralysis", first announced Rs 5 per litre increase in the regulated diesel prices and a cap on subsidized cooking gas usage. It followed up these measures with a liberalisation of foreign holding caps in the aviation, multi-brand retail, non-news broadcast media and power exchanges. It also announced a plan to divest its stake in five companies.

What is the response of S&P to the recent reform measures by the Government?
Ratings agency Standard & Poor's, welcomed big-ticket reform measures by the government, saying these steps would serve as a medium-to-long term positive steps for the macroeconomic conditions. If the measures proposed by the government are implemented, the agency expects a medium-to-long-term positive impact on the macro-economy. S&P earlier viewed that the slow GDP growth and political road blocks in policy decisions may put the country at the risk of losing its investment grade rating. The government's recent announcement on foreign direct investments is viewed as an encouraging development..

What are the major reform steps suggested to overcome the present crisis?

1. The Government has to take tough decisions on subsidies
2. The Government has to fix the oil prices in tune with markets to bring down the consumption and import of oil.
3. Gold imports to be checked by increasing duty
4. Liberalisation of FDI norms in retail, insurance and banking sectors.
5. Fast track implementation of GST(Goods and Services Tax)
6. Reforms in DTC (Direct Tax Code)

What was the credit rating outlook by Moody's?
Moody's retained India's credit rating outlook at "stable". The agency is of the view that the current slowdown is unlikely to be a permanent feature of the country's economy. Unlike S&P and Fitch, who have threatened to downgrade the sovereign rating to "speculative" from "investment" grade, Moody's took a different view and chose to maintain its stable outlook on India's current "Baa_3" rating. The Indian economy, for decades, has been characterised by various challenges such as weak fiscal performance, inflationary trends and uncertain policy environment. But certain recent negative trends such as lower growth, slow investment and low business sentiment are unlikely to pose any permanent or even medium term threat to the economy.

What is the Government's view on the recent threat?
The Finance Minister reiterated that the country does not face any immediate or serious threat of a credit rating downgrade by S&P or Fitch. The S&P report points out that the country still risks a rating downgrade in the next 24 months despite the

recent spate of policy changes. The Government assures a lot of reforms, change and strengthening of the economy. The Finance Minister views the report seriously and has plans to convince the rating agencies that the country does not deserve a downgrade and that in terms of growth and potential of growth, India is way above most of the countries. During the last few months, the country has taken bold steps by increasing the price of diesel, limiting the supply of subsidized cooking gas, relaxing foreign investment rules governing retail, airlines, insurance and pension sectors.

What is the recent forecast by economists and international organisations on our growth prospects?

During the first quarter of this fiscal, the GDP growth slowed down to 5.5% and then to 5.3% during second and third quarter. Based on the initial trends, in both agriculture and manufacturing sectors, many economists have lowered our growth estimate to less than 6% during the fiscal. Both IMF and World Bank have reduced India's growth forecasts to 4.9% and 6% respectively. In a latest report, Standard & Poor's expects India to grow by 5% during 2013, amidst the possibility of global economic recovery continuing during the year. For China, S&P expects the growth rate to move back to the 8% level in 2013, after it slipped to 7.4 % in the third quarter of 2012.

What is the latest stand taken by S&P & Moody's?

S&P says the possibility of India losing its investment –grade credit rating has receded somewhat as a result of the economic reforms undertaken by the government since last September. This is a clear indication of a softening of the stand by the rating agency just a few weeks after it reiterated a warning about cutting India's rating to junk, citing a wide fiscal deficit and a heavy debt burden. India's GDP growth dropped to 5.3% in July-September 2012 quarter, a 14-quarter low, suggesting that the full year expansion could be a decade low of around 5%. The S&P expects India's current account deficit to remain elevated at 4% of GDP in FY 2013, just short of the record high 4.1% of GDP in the previous fiscal.

Moody's had a more upbeat assessment of the economy, making its assessment on recent reforms measures, with growth prospects and a flurry of pro-business reforms designed to lift the economy from its funk. The rating agency further said that near-term risks around India's fiscal and external deficits have receded.

Long-term	Short-term	Long-term	Short-term	Long-term	Short-term	
Aaa	P-1	AAA	A-1+	AAA	F1+	Prime
Aa1		AA+		AA+		High grade
Aa2		AA		AA		
Aa3		AA-		AA-		
A1		A+	A-1	A+	F1	Upper medium grade
A2		A		A		
A3	P-2	A-	A-2	A-	F2	
Baa1		BBB+		BBB+		Lower medium grade
Baa2	P-3	BBB	A-3	BBB	F3	
Baa3		BBB-		BBB-		
Ba1	Not prime	BB+	B	BB+	B	Non-investment grade speculative
Ba2		BB		BB		
Ba3		BB-		BB-		
B1		B+		B+		Highly speculative
B2		B		B		
Moody's		S&P		Fitch		*source: Wikipedia*

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