Syllabus subtopic: Indian Economy and issues relating to planning, mobilization of resources, growth, development and employment.

News: Global ratings agency Moody’s Investors Service has cut its outlook on the Government of India’s ratings to negative from stable, but affirmed the Baa2 foreign-currency and local-currency long-term issuer ratings.

Prelims focus: About sovereign ratings

Mains focus: What does the downgrade mean for India? Implications and what needs to be done?

- Moody’s also affirmed India’s Baa2 local-currency senior unsecured rating and its P-2 other short-term local-currency rating.

Implications for India

1. The decision to change the outlook to negative reflects increasing risks that economic growth will remain materially lower than in the past, partly reflecting lower government and policy effectiveness at addressing long-standing economic and institutional weaknesses than Moody’s had previously estimated, leading to a gradual rise in the debt burden from already high levels.

2. Reduction in outlook is the first step towards an investment downgrade, as India is now just a notch above the investment grade country rating. An actual downgrade in country ratings can lead to massive foreign fund outflows.

Why did Moody’s cut India’s rating?

1. Moody’s projected fiscal deficit of 3.7 per cent of gross domestic product (GDP) in the year through March 2020, a breach of the government’s target of 3.3 per cent, as slower growth and a surprise corporate-tax cut curbs revenue.

2. India’s growth outlook has deteriorated sharply this year, with a crunch that started out in the non-banking financial institutions (NBFIs) spreading to retail businesses, car makers, home sales and heavy industries.

3. Moody’s said the outlook partly reflects government and policy ineffectiveness in addressing economic weakness, which led to an increase in debt burden which is already at high levels.

4. India’s economy grew by 5 per cent between April and June, its weakest pace since 2013, as consumer demand and government spending slowed amid global trade frictions.
Indian government arguments:

Noting Moody’s concerns, the Finance Ministry said that India continues to be among the fastest growing major economies in the world, and India’s relative standing remains unaffected.

The Government said it has undertaken series of financial sector and other reforms to strengthen the economy as a whole.

It has also proactively taken policy decisions in response to the global slowdown. These measures would lead to a positive outlook on India and would attract capital flows and stimulate investments.

The fundamentals of the economy remain quite robust with inflation under check and bond yields low. India continues to offer strong prospects of growth in near and medium term.

About different general credit ratings?

AAA: Highest credit quality that denotes the lowest expectations of default risk.

AA+/AA/AA-: Very high credit quality. ‘AA’ ratings denote expectations of very low default risk. They indicate very strong capacity for payment of financial commitments.

A+/A/A-: High credit quality that denotes expectations of low default risk. The capacity for payment of financial commitments is considered strong, however, vulnerability to adverse business or economic conditions exists.

BBB+/BBB/BBB-: Good credit quality that indicates that expectations of default risk are currently low. The capacity for payment of financial commitments is considered adequate, but adverse business or economic conditions are more likely to impair this capacity.

BB+/BB/BB-: This rating indicates an elevated vulnerability to default risk, particularly in the event of adverse changes in business or economic conditions over time; however, business or financial flexibility exists that supports the servicing of financial commitments.

B+/B/B-: This rating indicates that material default risk is present, but a limited margin of safety remains. Financial commitments are currently being met; however, capacity for continued payment is vulnerable to deterioration in the business and economic environment.

CCC+/CCC/CCC-: Substantial credit risk exists in this rating, where the default is a real possibility.

CC: This rating shows a very high level of credit risk with a possibility of defaults.

C: This rating shows that a default or default-like process has begun, or the issuer is in a standstill.

DDD/RD/SD/DD/D: This indicates that the issuer has entered into bankruptcy filings, administration, receivership, liquidation or other formal winding-up procedure or has ceased
business.