Credit rating agency S&P revises India economic outlook to negative

Credit rating agency Standard & Poor has revised India's outlook to negative. The agency has reaffirmed sovereign credit rating at investment grade but suggested that the probability of a downgrade is now higher than before.

The agency sees little progress on economic reforms and believes that the GDP growth could fall to 5.3 per cent in 2012-13. The Indian government expects GDP growth of over 7 per cent.

"The outlook revision reflects our view of at least a one-in-three likelihood of a downgrade if the external position continues to deteriorate, growth prospects diminish, or progress on fiscal reforms remains slow in a weakened political setting," said Standard & Poor's credit analyst Takahira Ogawa.

Indian stock markets fell on news of the negative grade. The Sensex slipped nearly 200 points to 17,019 while the broader Nifty index slumped over 60 points to 5,160.

A lower rating will make money dearer for Indian corporates, particularly in foreign currencies. State-run companies will be the hardest hit, since their finances are more directly linked to the government.

The downgrade could also impact treasury bonds and rupee movement, both of which are linked to government finances. Bond yields rise since a lowered sovereign outlook makes the bonds riskier and the market will demand better yields for holding them.

India's 10-year bond yield rose 4 basis points or 0,04 per cent, to 8.63%, while the rupee fell to 52.64 against the dollar from 52.48 before the action.

The rupee has been under pressure despite central bank intervention earlier in the year. Given the government's high fiscal deficit, and a liquidity crunch in the system, it will be harder for the Reserve Bank of India to intervene to break its fall.

India's favorable long-term growth prospects and high level of foreign exchange reserves support the ratings, but they are restrained by large fiscal deficits and debt, as well as its lower middle-income economy, the ratings agency said.

"S&P downgrade is largely due to the fiscal deficit situation. It is a concern for the country but India will continue to attract flow of investments but might be in moderation," said Suresh Senapaty, executive director and chief financial officer of Wipro.

S&P is not confident about the government achieving control over fiscal deficit. The fiscal deficit – or the difference between the government receipts and spending – is expected to be 5.1 per cent of the gross domestic product or GDP for the year ended 2012-13. S&P does not think these targets could be achieved.

“High fiscal deficits and a heavy debt burden remain the most significant constraints on the sovereign ratings on India. We expect only modest progress in fiscal and public sector reforms, given the political cycle--with the next elections to be held by May 2014--and the current political gridlock,” Ogawa wrote.

“Such reforms include reducing fuel and fertilizer subsidies, introducing a nationwide goods and services tax, and easing of restrictions on foreign ownership of various sectors such as banking, insurance, and retail sectors.”

In February 2012, the agency warned that the balance of risk factors for the current sovereign credit rating on India may be shifting to negative.

The rating agency, which hit the headlines earlier this year for downgrading the Untied States’ credit rating for the first ever to below AAA, said India’s risk factors included high inflation, a weak government fiscal position, and a slower rate of economic growth.

India currently enjoys a stable rating of BBB- on it sovereign debt. However, it has been grappling with political gridlock and the government’s ability to implement measures to improve economic growth and fiscal prudence will be vital to boosting confidence, Ogawa had said.

(NDTV)