

Poor by all Standards--India should pull up its socks.

Wondered what S&P's downgrading India's sovereign rating is all about?

S&P on 25th April, 2012 lowered outlook of India's sovereign rating from stable to negative. This is 'raising the flag' or a kind of advance notice viz if the position does not improve in the short term, S&P may downgrade India's sovereign rating. Presently India's investment grade is 'BBB-'. This is the lowest level of investment grade. Any further downgrade will result in "junk" status from investment grade of 'BBB-' which will have serious impact on foreign investment to India.

Let us look at the 5 macro parameters that S&P looks at when fixing the sovereign credit rating;

1. Political score:

Obviously coalition politics has not helped, with major policy decisions in limbo.

Every day brings out a new scam and the nation and the media keep talking about it.

Corruption is rampant even at the grass root - try getting your driving license or the mutation of your property done without hassles! Ask the man on the street or the poor villager-he will give you a litany of woes.

2.Economic structure and growth prospects:

GDP growth over some quarters is slowly creeping down indicating a gradual slowdown in the economy while NPAs of banks are showing worrying sign of growing. The IIP is also exhibiting negative growth.

3.External liquidity:

This is an area where India still appears to have her head above water,because of our so called forex reserves. But if the confidence of investors is shaken as has happened recently,FDI will stop and FIIs will continue to take money out of the stock market.

'Forex Reserves' is a misnomer because we include FII inflows which is 'hot money'.Strictly speaking FE reserves are FDI, exports minus imports, and invisibles such as FE earnings thru tourism etc.

4.Fiscal performance:

The parlous state of our fiscal position in the face of excessive govt expenditure is becoming evident.

Taxes are being raised not so much thru income tax but thru indirect taxes such as service tax etc .There is a limit which the Indian taxpayer is willing to cough up specially when there is no delivery on the ground.

5.Monetary flexibility:

This involves the RBI and to check if the central bank is willing to compromise in lowering interest rates to spur growth while trying to control inflation and also trying to keep the exchange rate from getting volatile.

The RBI has done something but is it too late? And has the lowering of interest rates been passed thru to borrowers in large measure? May be not.

In short on all 5 factors there are serious infirmities. Not surprising therefore that S&P lowered India's outlook. However, rating agencies are taking a conservative position with all other countries as well. The criticism the rating agencies received for not forecasting the 2008-2009 private/banking debt crisis is making them conservative, now that a global sovereign debt crisis seems to be looming on the horizon.

And when the sovereign credit rating goes down, it takes down with it the credit rating of private debt instruments as well, including that of the entire banking system.

So what should India do?.

At the Federal and State level:

1. Practice bi-partisan politics. Keep national interests paramount.
2. Demand moral rectitude in public life.
3. Have stable policies.
4. Speed up judicial processes.
5. Give up populism and stop doles over a period of time while ensuring that the underprivileged are not neglected.
6. Instead create jobs and set up vocational skill development centres for the less educated.
7. Encourage savings and a balanced outlook on spending to avoid profligacy.
8. Citizens of India should engage with elected representatives like MPs, MLAs, Councillors, and the Administration and demand action.
9. Chart a path for a sustainable 8% GDP growth and avoid aiming for higher growth rates. This is to prevent sudden shocks of demand-supply mismatch and over investment.
10. Agriculture, storage and food processing is a key area which should not be neglected.

Too much to ask? Not really. We can do it. Roti, Kapda aur Makaan is a slogan which can become a reality for the 1.2b people of India. In the nineties we succeeded in managing "continuity with change". In this decade can we manage "austerity with growth"? If we don't act now we will have plenty of time to repent later.

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