THE HINDU BusinessLine

Why are India’s sovereign ratings poor?

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The strange ways of rating agencies

How India fares vis-à-vis the rest

	India	China	Indonesia	Italy	Spain
Sovereign ratings & outlook					
Fitch	BBB-/Stable	A+/Stable	BBB-/Positive	BBB/Stable	BBB+/Stable
Moody's	Baa3/Positive	Aa3/Negative	Baa3/Positive	Baa2/Negative	Baa2/Stable
S&P	BBB-/Stable	AA-/Negative	BBB-/Stable	BBB-/Stable	BBB+/Positive
Macroeconomic indicators					
2016-17 Nominal GDP ($ billion)	2,259	11,125	927	1,851	1,233
GDP per capita, PPP ($)	6,105	14,451	11,058	37,217	34,727
2017-18 Projected Real GDP growth (%)	7.30	6.40	5.20	0.90	2.50
Inflation (%)	2.99	1.20	4.17	1.90	2.60
General government revenues/GDP (%)	21.40	27.80	14.00	47.10	38.10
General government balance/GDP (%)	-6.70	-3.00	-2.70	-2.40	-3.30
Current account balance/GDP (%)	-1.40	1.60	-2.60	2.60	2.00
Net FDI/GDP (%)	1.00	0.30	1.30	0.30	-1.90
Usable reserves/Current account payments*	4.7	17.8	6.4	2.7	1.4
Government Debt/GDP (%)	68.90	40.30	27.40	130.50	97.60
Non financial sector Debt / GDP (%)	128.20	255.60	68.20	273.10	282.90
Household debt/GDP (%)	10.50	43.20	16.70	41.70	65.20
Bank NPLs/Total gross loans (%)	7.57	1.75	2.98	17.97	6.09
Ease of doing business - Rank	130	78	91	50	32
Quality of infrastructure - Logistics performance index ranking	35	27	63	21	23
Corruption index rank	79	79	90	60	41

*months

Sources: IMF, BIS Statistical Bulletin March 2017, Fitch, Moody's, and S&P

Rating agencies are fixated with per capita income. Hence, India’s ratings are lower than countries with higher deficits

In *Economic Survey 2016-17*, Chief Economic Advisor Arvind Subramanian has highlighted what he terms the “poor standards” of the rating agencies. He feels that India’s sovereign ratings don’t reflect the country’s fundamentals and prospects, and have been stagnant for too long.

Puzzling assessment

The sovereign credit ratings assigned by the three international rating agencies — Fitch, Moody’s and Standard & Poor’s (S&P) — are on a par at ‘BBB-’, the lowest investment grade rating. Fitch and S&P have assigned a stable outlook for India, while Moody’s has assigned a more optimistic positive outlook. Moody’s upgraded India to ‘Baa3’ in January 2004, while Fitch and S&P upgraded India’s sovereign rating to ‘BBB+’ in August 2006 and January 2007 respectively.

India’s stagnant sovereign ratings is a puzzle given its nominal GDP, the sixth largest in the world, grew by 36 per cent since 2010-11 to $2.26 trillion in 2016-17 with the general government deficit moderating to 6.7 per cent in 2016-17 from a seven-year peak of 8.3 per cent in 2011-12.

Large image: The strange ways of rating agencies

The current account deficit has also improved significantly to 1.4 per cent in 2016-17 from a seven-year peak of 7.8 per cent in 2012-13. Forex reserves, among the ten highest in the world, are adequate to meet 4.7 months of current account payments. The ratios of the non-financial sector and household debt to GDP are moderate.

The Government’s reform initiatives including FDI liberalisation, bankruptcy code, monetary policy framework agreement, GST and the Aadhaar Bill are expected to spur investments, eliminate tax inefficiencies and improve government revenues and governance.

The impediment to the rating agencies upgrading India’s sovereign ratings lies in their methodologies. The sovereign rating methodology factors economic strength, institutional strength, fiscal performance, and susceptibility to event risk to assign ratings. The rating agencies categorise countries into buckets based on their size (GDP), growth, volatility of growth and per capita income, among other factors. The emphasis on per capita income is because countries with higher per capita incomes are better equipped to withstand cyclical volatility and are endowed with higher debt servicing ability. India’s low per capita income has resulted in its sovereign rating being lower than countries with higher deficits and indebtedness and lower growth prospects.

But does India’s low per capita income contribute to socio-economic and political instability? The answer is clearly, no. The Gini index/co-efficient, a number ranging from 0 to 100, measures a country’s income distribution. Zero represents perfect equality and 100, perfect inequality. India’s Gini co-efficient at 33.6 compares favourably with those of China (46.9), Spain (35.9), and Indonesia (36.8). Italy’s Gini co-efficient is better than India’s at 31.9.

On a comparative scale

The *Survey* benchmarked India’s growth rate and credit to GDP ratio with those of China’s and made a case for higher ratings.

The GDPs of Italy and Spain are projected to grow at much lower rates than India’s and Indonesia’s. The level of government, corporate and household indebtedness is significantly higher than India’s and Indonesia’s. Italy and Spain share India’s problem of a high level of bank non-performing loans (NPLs). The one metric in which the two countries outperform India and Indonesia is GDP per capita.

Yet Fitch and S&P rate Spain two notches higher than India and Indonesia, while Moody’s has assigned a rating that is one notch higher.

Further, S&P has assigned a positive outlook on Spain’s rating but a stable outlook on India’s rating. Similarly, Fitch and Moody’s have assigned ratings to Italy that are a notch higher than India’s sovereign rating, while S&P rates India and Italy on a par. This is despite Italy’s ratio of bank NPLs to total gross loans being more than twice India’s NPL ratio!

The ratios of China’s non-financial sector debt and household debt to GDP are among the highest in the world. Yet Moody’s Credit Opinion dated January 26, 2017 lists “a relatively moderate level of government debt, which is financed at low cost” as a credit strength. The agency narrowly focusing on government debt and ignoring the systemic risks stemming from high levels of non-financial sector and household debt is baffling.

True rating

The International Monetary Fund’s Article IV consultation report dated August 2016 estimates China’s 2016 “augmented fiscal balance” as a percentage of GDP, to be 10.1 per cent. China includes net land sales proceeds as a government revenue, whereas IMF treats net land sales proceeds as a financing cash inflow. IMF’s Article IV India consultation report dated February 2017 estimates India’s 2016-17 general government balance as a percentage of GDP at -6.7 per cent; which is equal to India’s official estimates. If this higher deficit is juxtaposed with China’s non-financial sector and household debt, what would its “true” rating be?

In conclusion, a ‘BBB-’ sovereign credit rating for India does seem low in the context of its significance to the global economy, strong macroeconomic performance, improving governance and regulation, and robust growth prospects. A five to six notch differential between India’s and China’s sovereign ratings is excessive.

Whether China’s sovereign credit rating is representative of its macroeconomic profile and debt servicing ability is a question rating agencies ought to address expeditiously. The differentials between India’s, Italy’s and Spain’s sovereign ratings are farcical. It is high time rating agencies rid their portfolios of such inconsistencies to enable investors assess and price sovereign risks accurately.

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