RATING ACTION

02 June 2020

Moody's downgrades India

Moody's downgraded India's sovereign rating to Baa3 from Baa2 with negative outlook on the back of rising fiscal deficits, growth contraction and higher debt levels (30% more than Baa median). The agency believes that India's long-term growth is likely to be 6% instead of 8% earlier. This is on the back of subdued private sector capex cycle, stress in the financial sector and reforms not yielding results. Notably, Moody's had upgraded India in Nov'17. This raises the risk of other agencies revising outlook to negative from stable.

Sameer Narang
Jahnavi | Dipanwita Mazumdar
chief.economist@bankofbaroda.com

KEY HIGHLIGHTS

- Moody's downgrades India's credit rating to Baa3.
- Public debt-GDP ratio estimated to shoot up to 84% from 72%.
- Weaker revenue growth a cause of concern.

Moody's downgrades India: Moody's has downgraded India's credit rating to Baa3 from Baa2 earlier. Central government's fiscal deficit (% of GDP) in FY20 slipped to 4.6% from revised estimate of 3.8%. In addition, general government's public debt which is estimated at 72% in FY21, is expected to go up to 84% in FY22 as per Moody's estimates. Brazil and Argentina are the only ones with higher debt than India. However, India's general government fiscal deficit is estimated at 11% in FY21 is amongst the highest.

Outlook is negative: Moody's now expects India's real GDP to contract by 4%. Growth will rebound to 8.7% in FY22 after which it will revert to 6%. Thus, Moody's believes that growth in the future will be lower than earlier levels of 8% because of subdued private capex cycle. In addition, persistent stress in non-bank financials implies economy will be constrained for consumption and investment credit. Accordingly, Moody's has maintained negative outlook which reflects mutually reinforcing stress in the economy and financial sector.

Other agencies may revise outlook: While Moody's has aligned its rating with other rating agencies (Fitch and S&P), its outlook is negative. The other rating agencies have a stable outlook on India. This raises the risk of change in outlook by other agencies. Given India's low reliance on external debt, this will not in any way impinge on India's domestic borrowing market. In addition, India stands to benefit from low oil prices. We believe the lower growth and higher fiscal deficit outlook made the agency change its ratings. With growth bottoming out in Q1FY21 and given government's reform and privatisation agenda, outlook on India will improve from H2FY21.

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For further details about this publication, please contact:

Economics Research Department

Bank of Baroda

chief.economist@bankofbaroda.com