India's Rating Downgraded

Why in News

Recently, **ratings agency Moody's Investors Service** downgraded India's sovereign ratings from Baa2 to Baa3.

Key Points

- **Reason:**
  - The ratings agency cited **slow reform momentum, constrained policy effectiveness and slower growth** compared to India's potential among the reasons for the downgrade.
  - Covid-19 pandemic has only amplified the vulnerabilities in India's credit profile that were **present and building prior to the shock.**
  - The rating has been downgraded in the context of the coronavirus pandemic, it was **not driven by the impact of the pandemic.**
- **Lowest Grade:**
  - Baa3 is the **lowest investment grade** in Moody's rating ladder.
  - This means, India is just one notch above the non-investment grade or junk grade.
  - Moody's had upgraded the country's rating to Baa2 in November 2017.
- **Lowers Growth Forecast:**

  According to Moody, India's real GDP growth rate will contract by 4% in 2020-21 due to the shock from the coronavirus pandemic and related lockdown measures.
    - It expects the economy to grow 8.7% next financial year and closer to 6% in the subsequent year.
    - India's GDP growth slipped to an 11-year low of 4.2% in 2019-20. The fiscal deficit also expanded to 4.6% of the GDP as against the revised estimate of 3.8% of GDP in the previous financial year.

- **Other Economic Issues:**
  - **Credit Crunch:** The rating agency did not expect the credit crunch in the country's under-capitalised financial sector to be resolved quickly.
  - **High Debt Burden:** The fiscal constraints point to a **higher debt burden** for a longer period of time.

    The lower GDP growth over the medium term will diminish the government's ability to reduce its debt burden after a significant rise due to the coronavirus economic shock.
  - **Lower Tax Revenue:** India's **large low-income population** will limit the government's tax revenue base.
- **Government effort not adequate for sustainable growth:**

  The government response to the growth slowdown prior to the coronavirus outbreak as well as the recent support package for vulnerable households and small businesses is **not enough to restore the sustainable GDP growth.**

Credit Rating

- A credit rating is a quantified assessment of the **creditworthiness of a borrower** in general terms or with respect to a particular debt or financial obligation.
- A credit rating can be assigned to **any entity that seeks to borrow money—** an individual, corporation, state or provincial authority, or sovereign government.
- A **sovereign credit rating** is an independent assessment of the creditworthiness of a country or sovereign entity.
  - Sovereign credit ratings can give **investors insights into the level of risk associated** with investing in the debt of a particular country, including any political risk.
  - Investors use sovereign credit ratings as a way to assess the riskiness of a particular country's bonds.
  - Obtaining good sovereign credit rating is usually essential for developing countries in order to access funding in international bond markets.
- A **rating agency** is a company that assesses the financial strength of companies and government entities, especially their ability to meet principal and interest payments on their debts.
- **The Big Three Credit Rating Agencies:** Fitch Ratings, Moody's Investors Service and Standard & Poor's (S&P) are the big three international credit rating agencies controlling approximately 95% of global ratings business.
- In India, there are six credit rating agencies registered under **Securities and Exchange Board of India (SEBI)** namely, CRISIL, ICRA, CARE, SMERA, Fitch India and Brickwork Ratings.

Source: IE