# Indian agencies should get into sovereign ratings

## Rating wrangle. The three major global ratings agencies have rated India just above investment grade, despite its impressive macrofundamentals

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A credit rating tells us about the probability of default in servicing debt by any entity. The issue becomes nebulous when it comes to rating a sovereign as it is necessary to distinguish between debt which is in domestic currency and the part which is in forex. The former technically can never happen as countries can print notes to repay debt even if it is at the cost of inflation.

For the latter there is a potential risk which is posed to the global community. The Indian government has only domestic debt (negligible external debt) and yet has a low sovereign rating. Hence, a sovereign credit rating is based on subjective views.

Currently the most accepted sovereign ratings are those given by S&P, Moody's and Fitch. There has been a tendency for convergence in their ratings with the difference never going beyond one notch. This oligopolistic structure has also meant that India tends to get a rating just about the investment grade. There are several gaps in their rationale.

There is a strong case for India's rating to be much higher than the current BBB (minus). First when it comes to foreign investment, India has been a preferred destination both from the point of view of FDI and FPI. This is the strongest case for upgrade because those investing money (FDI ranges between $70-80 billion on annual basis and FPI around $20-40 billion depending on market conditions), India has been on top of the charts. Hence if investors are keen to channel their funds here, evidently they see potential and safety which makes it more than just investment-grade.

## India's resilience

Second, for quite some time, India has been the fastest growing economy — both in terms of GDP and per capita income. The projections by the IMF for India has also validated this view. Post-Covid, India has bounced back with resilience faster than other nations. This can be judged by the fact that the RBI has been able to raise interest rates from a low of 4 per cent to a normal range of 6-6.5 per cent (which has been the average in normal times).

Third, the current account balance is a good indicator of the strength of external balance. This was at 1.2 per cent last year and better than that of the US and UK, which have higher ratings in the AA category. The strong growth in export of services is testimony to India's power in the IT domain. India weathered the Ukraine crisis well, thanks to the Reserve Bank of India and regulatory systems in place.

Fourth, there needs to be serious reflection on public debt. For how long can the so called anchor currency countries continue to have blown-up debt-GDP ratios? For the US it was 122 per cent in 2023 and 101 per cent for UK. Italy and France have above 100 per cent with the latter having a rating in AA bracket. Japan has a ratio of 252 per cent with an A bracket rating.

Clearly, something is amiss here with India having just 83 per cent being rated low. The rating agencies are constantly exhorting the government to lower the debt levels, but the same does not hold for the US which has been on the verge of a technical default on more than one occasion.

Hence looking at the important parameters that go into these subjective ratings, India should definitely be in the A category given the consistent performance over the year. This has been supported by proactive policies of the government in terms of attracting investment. India's financial system can be compared with the best with robust capital markets and sound banking system.

India has implemented labour reforms and the sector public sector has also performed well. So how does one break out of this impasse?

## Corporate impact

These are challenges which several emerging markets have to contend with. While the government is not affected by such ratings except for 'reputation' issues, Indian companies borrowing overseas would be at a disadvantage due to the rating as they have to pay a premium when borrowing in the euro markets. There needs to be more competition in the ratings market.

In fact, domestic rating companies should start giving sovereign ratings. Given that the three major global credit rating companies do have their associate rating agencies in India, CARE Ratings' recent move to establish its sovereign ratings business in GIFT city is significant. In other words, it can assess the sovereign ratings of other countries.

Ratings given by the domestic rating agency need to be accepted by others. Here the government and the RBI have a role to play. To begin with, these ratings should be permitted for use when reckoning capital weights of banks for overseas assets (includes claims on foreign sovereigns, foreign PSEs, foreign banks, etc.).

Presently the RBI accepts those given by S&P, Fitch and Moody's. This should change once recognition is given to any domestic agency which does sovereign ratings. Domestic recognition is key to making a pitch for acceptance in other jurisdictions.

Second, there needs to be more advocacy of these ratings in global forums like G20, BRICS, SAARC, ASEAN etc. In fact, Hong Kong had given recognition to such domestic agencies for bank loan ratings in the past. This needs to be discussed more at the government level.

Third, as we take steps to internationalise the rupee, the concept of a 'fourth party' (in addition to the big three rating agencies) sovereign rating can also be pushed. Given India's economic strength, this is an opportune time for the government to do so. There would be a long way to go, but the start is what is most important.

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