

Research Update:

India Outlook Revised To Stable From Negative On Our Expectation Of An Improvement In The Country's Fiscal Position

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India Outlook Revised To Stable From Negative On Our Expectation Of An Improvement In The Country's Fiscal Position

Overview

- We expect India's fiscal position to improve over the next few years and its economy to maintain strong growth momentum.
- We revised the outlook on India to stable from negative.
- We affirmed the 'BBB-' long-term and 'A-3' short-term sovereign credit ratings on India.

Rating Action

On March 18, 2010, Standard & Poor's Ratings Services revised the outlook on the Republic of India to stable from negative. At the same time, we affirmed the 'BBB-' long-term and 'A-3' short-term sovereign credit ratings on India.

Rationale

The revision in outlook reflects our view that India's fiscal position could now begin to recover and that its economy will remain on a strong growth path.

The government budget targets a general government (including central and state governments) deficit of 8.3% in the fiscal year ending March 31, 2011, from 9.8% in the previous fiscal year. The government intends to follow the medium-term fiscal consolidation plan outlined by the 13th Finance Commission. The Commission recommended that general government deficit be reduced to 5.4% of GDP and the ratio of general government debt to GDP be lowered to 68% of GDP by the fiscal year ending 2015. The government's decision, in February 2010, to change its fertilizer policy to implement a nutrient-based pricing policy and to raise urea prices by 10% from April 2010 is a step forward for the reduction of subsidies. The budget also announced an average increase in the prices of domestic petroleum and diesel of 6.0% and 7.8% respectively.

We expect India's GDP growth to be 8.0% in fiscal year ending March 31, 2011, which is higher than many other countries' and exceeds our previous expectation. In addition, we view India's external position as resilient. We expect the country's ratio of gross external financing need to current account receipts plus international reserves to remain stable at 77% in fiscal 2010. The Indian financial sector's net external debt is projected to reach 26% of current account receipts at the end of the current fiscal year on March 31, 2010. Despite uncertainty in the global capital markets, confidence in India is bolstered by the country's international reserves, which are 374% of its

short-term external debt.

However, the ratings continue to be constrained by the high government debt burden and deficit, and India's weak fiscal profile. The consolidated debt of India's central and state (general) governments is estimated at 80% of GDP (by our definition) in the current fiscal year, while interest payments are likely to consume about 27% of general government revenue. India's contingent liabilities are also high. The country's state-owned enterprises (SOEs), particularly those with state governments, are generally not very efficient, and are significantly dependent on the government for financial support.

In our opinion, the recent high inflation rate could also derail the stable macroeconomic and interest rate environments. The Wholesale Price Index (WPI), India's most widely used inflation index, increased by 10% in February 2010, mainly because of the rise in food prices. We think the Reserve Bank of India (RBI, India's central bank) and the government need to achieve a fine balance between their monetary and macroeconomic policies to contain inflation while maintaining the growth momentum of the economy.

The transfer and convertibility assessment for India-based non-sovereign issuers ('BBB+') remains two notches above the long-term 'BBB-' foreign currency sovereign credit rating on India.

Outlook

The stable outlook reflects our view that India's fiscal consolidation at the central, state, and public enterprise levels over the next several years will likely restore the government's policy flexibility, and keep credit fundamentals commensurate with the 'BBB-' rating. Standard & Poor's will continue to monitor the government's measures to rein in public finances.

As such, the sovereign ratings on India could be raised, if the government continues to reduce the public sector's deficits materially. For example, future government initiatives to reduce subsidies for fertilizers, foods, and fuels would be a significant factor in improving the expenditure structure of the budget and reducing the negative influence of potential external shocks on India's fiscal position. Strong commitment of the central and state governments to the medium-term fiscal consolidation plan set out by the next Fiscal Responsibility and Budget Management Act is key to India's fiscal consolidation. Early implementation of the goods and service tax (GST) could help stabilize and potentially increase government revenues in the medium term and become a further positive factor for sovereign ratings.

Conversely, if the government continues its loose fiscal policy or there are policy setbacks on monetary, financial, and economic fronts that lower India's medium-term growth prospects could result in a downward pressure on the ratings.

Related Criteria And Research

"Bulletin: India's Budget Could Signal A Turning Point For Fiscal Consolidation," published Feb. 26, 2010.

"India (Republic of)," published Dec. 30, 2009.

"Sovereign Credit Rating: A Primer," published May 29, 2008.

Ratings List

Ratings Affirmed; CreditWatch/Outlook Action

	To	From
India (Republic of) Sovereign Credit Rating	BBB-/Stable/A-3	BBB-/Negative/A-3
India (Republic of) Transfer & Convertibility Assessment Local Currency	BBB+	

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