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RESEARCH ARTICLE

WHAT REFORMS LED TO THE CHANGE IN THE MOODY RATING FOR INDIA AND HOW HAS THE CHANGE IMPACTED THE INDIAN ECONOMY

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Abstract

The reformative regime by the Government of India has upgraded our stance on Moody's index. Transformative policies have initiated a wave of positive sentiment with respect to nation credit worthiness and growth prospects; which has lead the US based Moody's Investor services to promote India from Baa3 to Baa2 (Deepshikha Sikarwar 2017). Basis the in-depth content analysis of the existent literature, the present study reviews and delineates the curative impact of the recent economic reforms lead by the Indian government. It has been observed that the reforms of GST, Demonetization, Fiscal consolidation and Aadhar and DBT have led to higher growth in terms of GDP, improved business climate and stable financing for government debt and for India as an investment opportunity country.

Introduction:

The Moody's rating that measures the credit worthiness of a country or an organization is usually changed on the basis of the reforms or the actions taken by a government. These have impacts on various aspects of the society such as business decision-making and economies attractiveness. The paper explores how due to the regimes led by the Modi government have helped India upgrade their credit rating and what impacts is it likely to cause in the times to come.

Literature Review:

The Moody rating is a system to give an insight to the investors based on gradations relating to the future credit worthiness of a country or an organization. This credit worthiness gradation system, was started by, Sir John Moody in 1909. (Moody's 2018)

It has several grading levels ranging from Aaa to C, the former being the most trust worthy credit system, i.e. with the lowest level of credit risk while the latter being the most risky and typically in default (Moody's 1998). The numbers {1, 2, 3} in front of the generic rating gives a more specific indication of the generic rating category. The number 1 in front of any rating depicts that the particular rating is at highest level in that particular category, while the number 3 indicates a lower end or position in a generic rating category.

The Moody investor services review its applicants time to time and upgrade a particular nation for instance if changes have been favorable, i.e. they help in improving the credit worthiness of a nation, making it more reliable for foreign investors. In India's case, this upgrade has been the first since January 2004. Moving to "2" in the Baa category was a positive indicator and a recognition of the government reforms and policies.

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There are instances when the credit rating is not assigned or taken back when and if assigned. Few of the possible reasons include that there is lack of potential data relating to the issue or the issuer. Secondly, an application may not be received to grade, or the grading must have been done someplace else and not under Moody's publication.

Although this rating system has been beneficial for a lot of countries in terms of attracting investors and assuring their credibility, it has some drawbacks and loopholes as well. First and foremost, if two obligations carry the same generic category rating it doesn't absolutely define the fact that these are alike in credit quality. In a broader perspective, there are only a limited rating categories for thousands of bonds, so a rating cannot define an actual standing of a risk. Additionally, these ratings should not be used alone as a factor while looking for investment opportunities as there are several other factors as well to be kept in mind. Lastly, as the decision of the rating is made based on the future rather than the past and the current scenario, the investors should not expect to find a reflection of statistical factors alone.

Research Methodology:-

The data collected has been from secondary sources that include newspaper articles, articles from the web such as from the Economic Times, expert opinions from interviews and press conferences as well as from a published research paper. A few of the resources are listed below:

Serial Number	Article Source	Author	Type
1.	Moody's Backs Modi Government's economic Reforms, justifies India's credit rating upgrade	Business Today Online	Online News article
2.	Impact of GST on the Indian Economy	Clear Tax	Online News article
3.	Arun Jaitley welcomes Moody's rating upgarde says Narendra Modi's reforms universally acknowledged	FP Staff	Expert Opinion
4.	Moody's upgarde a fitting reply to govt's critics; Bull market has just begun: Jhunjhunwala	Money control	Interview
5.	Financial Architecture of India's economy after Demonetisation of the currency	Yash Agarwal	Online Research paper

Finding and Analysis:-

As per the Research Methodology, the results that were obtained were in form of the causes and the results of the upgrade, which shall be explained in detail as follows in the paper.

Causes for the upgrade:-

Introduction of Goods and Services Tax:-

PM Vajpayee in 2000 set up a committee to draft Goods and Services Tax (GST). (Clear Tax 2018) Now, after 17 years on 1st July, the bill for this indirect tax was passed. This is essentially replaced with many of India's indirect taxes. It is a multi-stage tax: means tax will be added at each point of sale. The GST bill has three sub parts namely the Central GST (CGST), Inter-State GST (IGST) and the State GST (SGST). All in all it is an indirect tax levied on the supply of direct and indirect goods in India.

Some may claim that it will hamper the growth in the short run, however this step had been taken keeping the long run in mind where the benefits seem to outnumber the drawbacks. This is evident as the GDP growth % indicated by the yellow line has dipped to 6.7%, the lowest in the last 3 years. The implementation of GST is a major reason for the fall of the GDP growth %. However, the favorable part can be seen in the long run when the growth % rises to an all time high of 8.2 in the year 2022. This forecasted growth % is what probably Moody's have predicted and analyzed, thus the GST being one of the reasons for this upgrade.

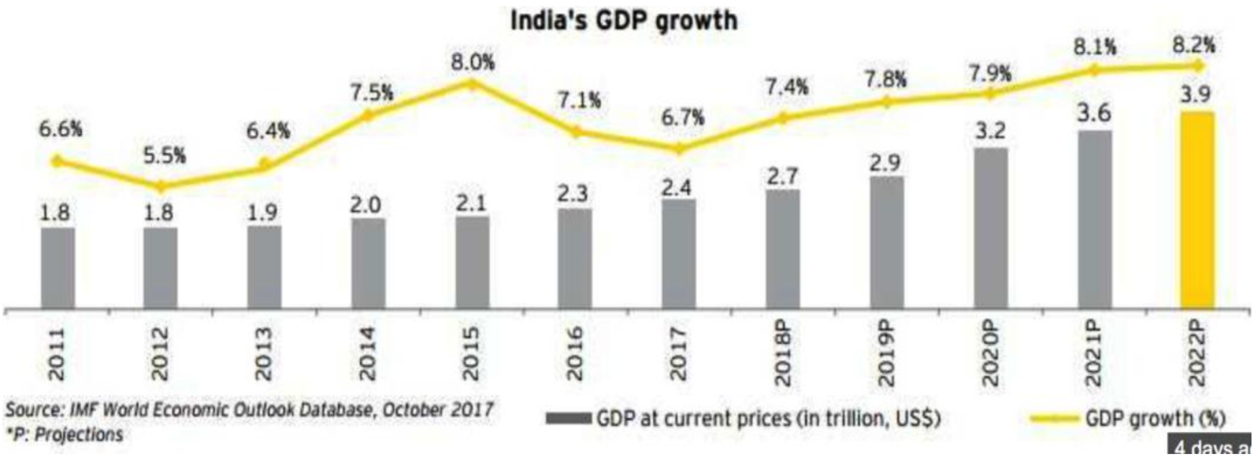


Figure 1:-India's GDP Growth from 2011 to 2022
Source: The figure has been adopted in original form IMF World Economic Database published in October 2017

Not only the growth %, but also the constant rise in the GDP price can be a contributing factor to the upgrade.

Another positive aspect of this indirect tax in the short and long run both is that the imposition of this tax has helped overcome the cascading effect of tax. (Clear Tax 2018) This means that the tax on tax that previously existed will now be removed. It has several advantages, one of them being that now the entire system gets less complicated and additionally as the tax is added on to one stage the cost of production for the supplier decreases. The fall in cost means that for the suppliers it will give them more confidence to increase their supply. This increases the GDP of the economy. It can thus be said that these effects after the introduction of GST might have given the Indian economy an edge for their rating to improve.

Adoption of the strategy Demonetization:-
8th November 2016 was a historic day in the Indian economy with the demonetisation of two high value currency notes: Rs.500 & Rs.1000. As a result, these bank notes will not be used as a medium of exchange and/or store of wealth for future use. The elimination of these notes was an effort to fight corruption, counterfeiting & tax evasion in the country. 30th December 2016 was set as the deadline for people to exchange the notes they have in their possession.

The demontization paved way for a new financial architecture. A day after, □500 and □1000 notes ceased to be a legal tender, the National 50 stock exchange [NIFTY] closed down to 1.31%, while the Bank NIFTY closed higher by 0.09% which is a clear indicator of the growth of the banks in the coming months. Furthermore, the CASA ratio [the ratio of deposits in current and savings accounts to total deposits] will increase which will further increase the net interest income and the net earnings of the banks as the people now in order to save the currency will deposit more of their money into the banks. And now the people would opt or digital channels of payments, rather than transitioning to the new currency notes. But on the contrary, there are several infrastructural issues even in the digital system such as obsolete banking technology as well as the not the com- pletely advanced telecommunication industry which are like the backbones for digital transactions.

Changes in Fiscal consolidation framework:-
Through the adoption of a new Fiscal Responsibility and Budget Management [FBRM] Act, the government aimed to improve the fiscal consolidation of the Indian economy, which would mean that in the long term the fiscal deficit of the country will fall. Former revenue secretary's report forecasted that the fiscal deficit be aimed at being bought down from 3.2% to 2.5% of the GDP by the year 2023. More to this was the formation of the MPC or the Monetary Policy Committee that aimed to improve the transparency and efficiency in India. Moody investors appreciated this step as it would fix the credit leakage in the country and probably is one of the causes of the upgrade.

Introduction of Aadhaar and DBT:-

DBT or the Direct Benefit Transfer launched on 1st January 2013 is the reform that revolutionized the transfers from the government to the people. Earlier the transforms be it subsidies or the wage payments were done via the government offices; however, with the introduction of DBT the transfers are being made directly into peoples bank accounts (Toje Jose 2016). This helps in removing leakages in the system and thus enhancing the financial inclusion. A total of 74 schemes and 17 ministries are under the DBT. The two major programmes are the LPG subsuidy scheme PAHAL and the wage payment under MGNREGS. What DBT does is to ensure that the right beneficiary reciecves the payment in his account, and this is done by the use of the Aadhaar Card which is a universal ID. As the right people get the money the economy will start moving away from the path of corruption and for a country like India where the population is 1.3 billion and counting it will mean that the people now have more and more spending and saving power. Higher spending power means it will help them improve their living standards and on the other hand higher savings will mean there are less likely chances of default payments and thus more credibility while lending loans.

Impacts:-

Higher Growth:-

Rakesh Jhunjunwala, founder Rare Enterprises and the ace investor in India said, “The upgarde has multifold financial implications. Firstly with the upgarde to Baa2 now, it will allow India as a government to borrow at lower interest rates.”(Moneycontrol 2017) Higher borrowings at lower interst rates will mean that the country can look at higher development prospects as now they would have to pay comparatively less for the loan amount. Higher borrowings may also be used to alllevate poverty in terms of launching of newer scheems as well as funding money for upliftment of the poor. All this will help the economy achieve equality as well as lead to higher GDP and economic growth. From Fig.2 a rising trend is observed in the GDP per captia and as well as the private consumption. This very well explains that people in the Indian economy are doing well for themselves and thus signify growth.

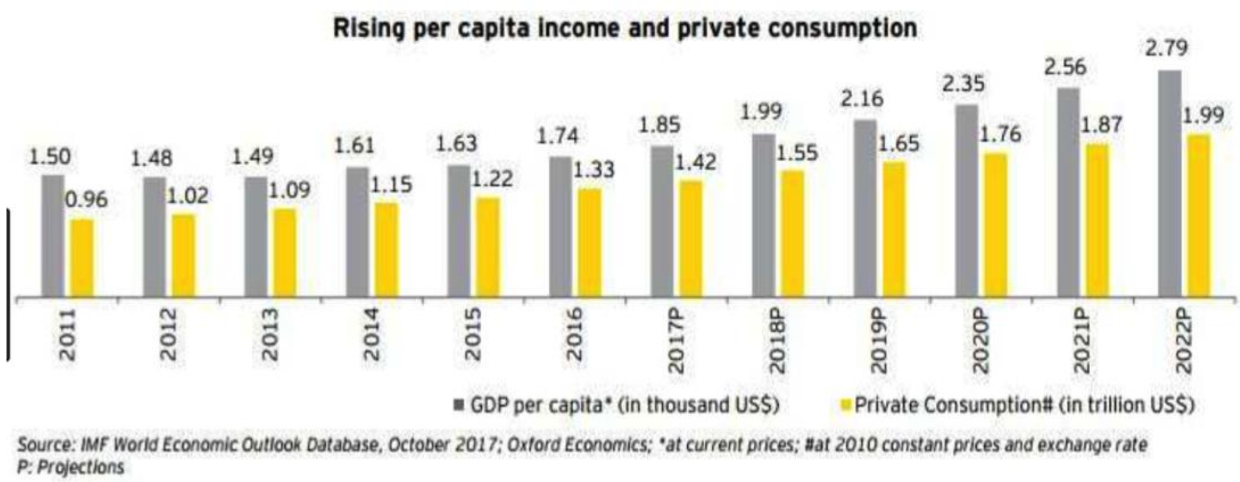


Figure 2:-Projections of the per capita income and private consumptions of Indians till 2022

Source: The figure has been adopted in original form IMF World Economic Database published in October 2017

Additionally, there will be more participation of a lot of funds who are manded by where they can invest in countries only with a certain rating. This will mean more investments in indian debts and indian equity. Higher investments will help pay off the government the debts faster and thus improving their credibility. While, with higher investments in Indian equity will mean higher share prices for firms. With this bullish future there are quite a lot chances of these businesses expanding operations and opting for higher growht options.

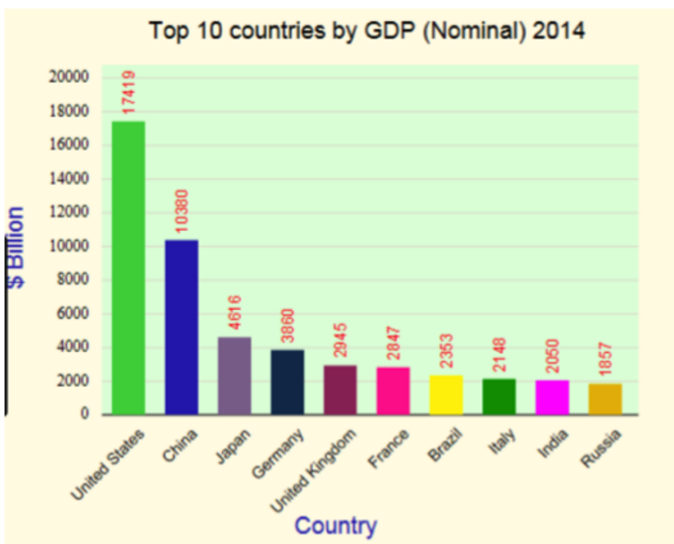
Also as the rating of a single local firm can’t be higher than the soverign rating thus it will mean higher availabitlty of funds for the companies who borrow from abroad. Higher availaiblity means more ease in doing business as the firms will have more availabilty of cash in hand and thus with higher growth chances, the companies will be able to contribute to the Indian GDP and thus lead to higher growth. With higher availabilty of funds, it will also mean that the costs of borrowings will be low which will enable the businesses to keep their cost of production minimal.

The upgarde is a fitting reply to the critics of the Modi Government that the steps taken by him will hamper the growth. “The possibilities for India in the next 20 years are dramatic. India has massive potential”. If one think of the next three to six months, that the economy is slowing a little because of demonetisation, they’ll miss the idea of the longer term which Modi and othe committee men vision.

Financial sectors will lend benefit in terms of lower cost of borrowings. The lower cost will pass on to the private banks which in turn will be passed on to the customers/borrowers in terms of lower interst rates and thus in such a system each one will benefit. The Tax to GDP ratio has increased from 16 to 18 since Modi has come, it can rise to 20.4 by 2020 with the kind of reforms that have taken place. This again gives a clear indication of the higher economic growth potential of the Indian economy which Moodys appreciated.

“After the agency upgraded the credit ratings on November 17, it received criticism from several quarters on the basis that while India is lacking on the economic growth front and its debt-to-GDP ratio is on the rise, the report gave thumbs up to the economic initiatives taken up by the government. Moody's explained that current the slowdown in the economic growth - India's GDP growth slowed to 5.7% in the first quarter from 6.1% in the previous quarter – was” the factor it lowered India's growth forecast to 6.7% in 2017-18 (Business Today Online 2017). However, again the US based investor laid more stress on the long term prospect where the GDP can reach upto 8.2% in a time span of 5 years.

Although this is a temprorary disruption with the introduction of all the reforms, but now a base has been formed in the Indian economy and the growth rebound will be in a big way.



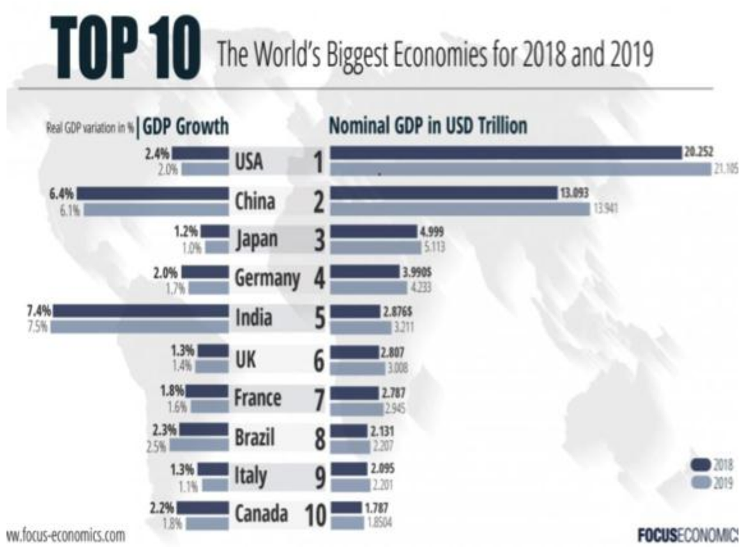


Figure 3 and 4:-Nominal GDP in 2014 & 2018,19' respectively
Source: The figures have been adopted from StatisticsTimes and FocusEconomics respectively

From the above 2 figures as well it is clearly evident that in the year 2014, India was at the 9^{th} position in terms of the Nominal GDP rank, having a Nominal GDP of 2060$ billion. However, in Fig 4 it is clear that India has moved up 4 places in the ranks and now is projected to have grown to 2876$ billion. The rise in Nominal GDP by $816 billion gives rise to the fact that how with the introduction of a few reforms have helped India prosper in the long run.

Improved business climate in India:-
World Bank lifted India's position of doing business from 142 to 100. The jump of 42 places in the world rankings is definitely a key aspect in the long-term prospects, with more and more foreign firms looking at India, fast growing economy. And thus are envisioning India as a great opportunity. One such recent example is that of IKEA, the world's largest furniture retail country that has already began planning on building factories and also customized their product portfolio according to Indian market. Another example is that of Walmart and Flipkart. Walmart the retail giant was trying to get in India since more than a decade and has finally got a break with the leading e-commerce brand saying that it has great expectations from both, the consumers as well as the working environment.

"Longer term, India's growth potential is significantly higher than most other Baa-rated sovereigns," said Moody's. This statement gives a clear indication of the bright business future the Moodys see in India.

The introduction of the Insolvency and Banktrucp code or the IBC in 2016 is also one of the spearheads for the upgrade as it is a combination of all other default related laws in a time bound manner (IIFL 2017). It is widely believed that this legislation, when implemented in letter and spirit, will change the negative perception of NPAs, recovery and litigation associated with India. "The new bankruptcy law will be a useful tool for international creditors and investors from the perspective of PE funds continuing to grow their investments in India. According to the World Bank's Ease of Doing Business report, it takes more than four years on an average to resolve insolvency in India, however which now can be cut down to the time of less than a year with the new law. This will not only improve the ease of doing business in India, but also facilitate a better and faster debt recovery mechanism in the country. It is widely believed that this legislation will change the negative perception of recovery and litigation associated with India."

An example of one industry which is forecatsed to benefit is the Indian consturcution industry. The value of this industry as a whole is seen rising till the FY 2021 till 250$ billion from approximately 150$ billion in FY 2016. The year over year percentage is also rising most of the time till FY21 where it dips by .31%.

Figure 5:-Forecasted growth in the Indian construction industry

Source: The image has been adopted from The Economic Times published on November 2017 at the date of 17th

Stable financing for government debt:-

There was a big havoc on the fiscal state after these several reforms, which were the causes for the upgrade. In short run, there are chances of overshooting on the fiscal deficit as these changes were more of a shock to the economy and thus people were not ready. However, Moody's upgrade is recognition of the fact that the government has taken some bold steps towards progress for the long run. The upgrade clearly doesn't mean that the fiscal deficit will be over in a year's time, however, it does mean that it is a clear indication that the Indian fiscal situation is good and will remain so. Thus, this point is something that is already been taken care of and the upgrade is a positive support of the fact that in the years to come the Indian government's fiscal state is in good hands.

India as an investment opportunity country:-

The very obvious outcome after the upgrade, which has come out is that now for India as a country the FDI's and FII's will most likely improve which earlier were a matter of concern. This is mainly due to the fact that now the country has been termed more reliable for investment opportunities and credit worthiness.

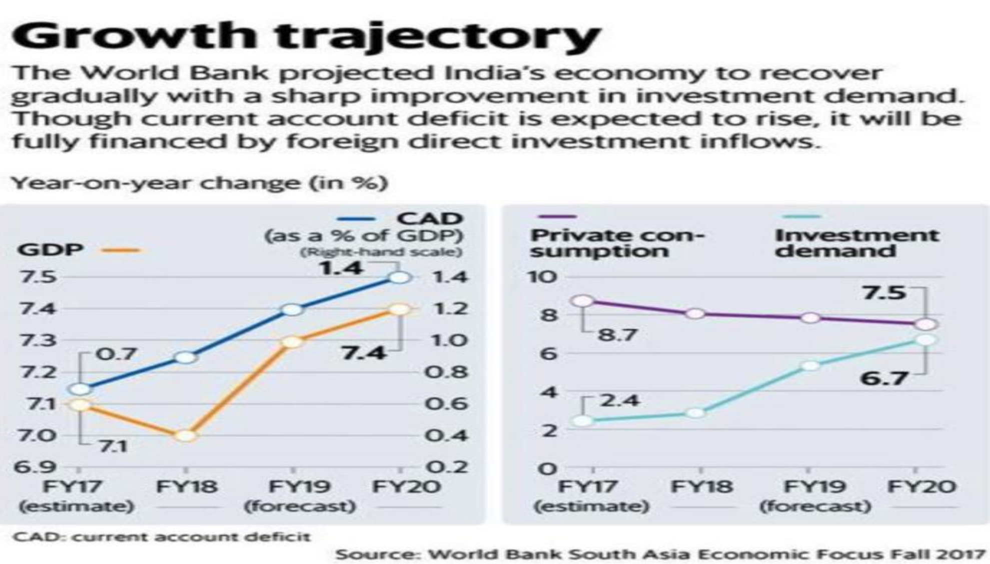


Figure 6:-Growth trajectory of India till FY20

Source: The image has been adopted from the World Bank South Asia Economic

The figure above also indicates that the blue line of the investment demand is to increase by almost 4% within the time span of three years. This indicates that India will be slowly and steadily be moving towards recovery. This is supported more by the increase in GDP after a dip in FY18. Thus, although the short run growth and recovery is slow, however, in the long run India's front as an investment opportunity country is positive.

Sunil Mittal, India's leading industrialists and chairman Bharti Enterprises, said, "The ratings upgrade underlines the efficacy of the bold structural reforms undertaken by the government in recent years. It clearly shows that the economy is turning the corner and is poised for a big leap potential that India offers as a global investment destination." This claim shows the optimistic future for the nation and how this upgarde will be seen as a great boost and an oppurtunity to grow further.

There will now be more participation of a lot of funds who are manded by where they can invest in countries only with a certain rating forward, highlighting the immense investments in terms of FDI's and FII's the country can receive for growth and development purposes.

Public View:-
Arun Jaitley – Finance Minister Arun Jaitley in a media briefing on Friday welcomed Moody's upgrade of India's sovereign rating from Baa3 to Baa2 and changing of outlook from positive to stable (FP Staff 2013). "Moody's rating upgrade comes after a long gap of 13 long years that means the world has acknowledged India's structural reforms," Jaitley said. A sovereign rating by the global agency evaluates a country's friendliness to foreign investors and an upgrade means a more conducive environment for doing business.

The finance minister while continuing his media briefing listed out major structural reforms undertaken by Narendra Modi government. He said setting up of Monetary Policy Committee, demonetisation and roll-out of the Goods and Services Tax were sweeping policy changes that changed world's view for India." "He also pointed out World Bank's recent 'ease of doing business' ranking for India. The country jumped 42 ranks in the index from earlier 142 to 100th position which, according to Jaitley, was due to the reforms of the present NDA government. "For the three consecutive years, India has been among the fastest growing major economies," Jaitley added."

"I'm sure that many who had doubts in their minds about India's reform process would now seriously introspect on their own positions," finance minister Arun Jaitley said.

Conclusion:-

India's future is seen optimistic by a lot of experts as well as the projections shown above. The fact that was appreciated by all was that India has massive potential to grow considering the fact that like India is the fastest growing economy in the world currently. The several reforms, i.e. the causes for the Moody's upgrade in India are seen to slow down the economy in the short run and not been received well by the Indians. There is a recognition of the fact that however there will be disruption in the short run due to the government's bold and correct moves, but the upgrade will lead to faster economic growth in times to come. Thus, though a beneficiary move, the reforms and actions taken by the government and their effects will take some time to recover as shown in this paper.

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