Extreme move for credit rating agencies to downgrade India to junk status: Gita Gopinath

Radhika P Nair, ET Bureau Sep 14, 2012, 06.44AM IST

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It would be an extreme move for credit rating agencies to downgrade India to junk status, says economist Gita Gopinath, the first tenured woman professor of Indian origin at Harvard university's economics department. In Kochi for a Kerala government initiative to promote investment, Gopinath, 40, told **ET** that the appointment of her former colleague, Raghuram Rajan, as the chief economic adviser in the finance ministry makes her more optimistic about the future. Excerpts:

(The fiscal situation is...)

Ratings agencies are threatening to downgrade India's credit rating to junk. How justified is this?

I don't see a rating cut in the immediate horizon. The fiscal situation is a source of concern but with sovereign debt entirely rupee denominated, the fears of default are remote; so downgrading to junk status would be extreme. That said, rating agencies have not been very astute in their rating decisions in the past.

If they do downgrade the debt to junk status, it could lead to offloading of this debt by several investors since all investment banks have clear rules on how much non-investment grade bonds they can hold on their portfolios. This would trigger adverse reactions in the rest of the market.

But there are serious concerns about the Indian economy...

There is a sense, in India and outside, that policy making and reforms have come to a standstill. That is the biggest concern. The added problem is, that going forward, even past the elections in 2014, policymaking will continue to be hostage to coalition politics. This uncertainty and lack of direction is generating a negative sentiment about the Indian economy.

Opinion is converging that growth will plateau at 5.5-6%. What is your view?

With current growth rates at 5.5-6%, and with little major change expected to happen, everyone naturally expects growth rates to stay at this level. I have to say though that the appointment of Raghuram Rajan as the chief economic adviser in the finance ministry makes me more optimistic about the future.

We were colleagues at the University of Chicago and I know him very well. He is an incredibly good economist and has the ability to clearly see what needs to be done. He also has the people skills to make things happen. **But is there political will to initiate big-ticket reforms?**

That is the concern. That is why there is so much of pessimism.

Will India be the first fallen angel among Bric nations considering its growth has slowed the most? Or are we overstating the risks?

Maybe overstating will give relevant people a sense of urgency. In India, we have the 'chalta hai' attitude. If we do that then I am worried nothing serious will get done. So, I am glad that dire scenarios are being painted.

Is the domestic demand enough to prop up growth?

I think 0.5-1% of the decline in India's GDP growth rate can be attributed to the global slowdown. However, growth in India is mainly domestic demand driven and with high interest rates to combat inflation and an uncertain investment environment, domestic demand has taken a hit.

What in your view are the reforms urgently required?

On the macro level, the fiscal deficit and inflation continue to be a problem. Though there is a Fiscal Responsibility Act, it has only existed on paper so far. The perennial issues of fuel and fertiliser subsidies need to be tackled head on.

On the micro side, steps need to be taken to address concerns that doing business in India is slipping back to the 'licence raj' and red tape days. Also, announcing retroactive changes in tax codes will scare away investors. There has been too much of the one step forward two steps backward approach to policy by the current government that needs to change.

How big is the inflation worry?

It is a big concern and that is one of the reasons why the RBI has been so cautious about cutting rates. I think the RBI is right. The last thing we want is for everybody in India to think they are living in a country with 10% inflation.

If this sets in, bringing inflation down to 4-5% will be very hard. It would help if fiscal policy is worked along with monetary policy to moderate demand, so that all of the work does not have to be done by high interest rates.

Also, infrastructure-based supply side strategies will help. Allowing for FDI investment in multi-brand retail will bring the technology know-how to raise efficiency in the retail sector. This will help with controlling inflation.

You have questioned the timing of the Food Security Bill...

What countries find very hard to do is save when going is good, so when things go bad they have a rainy day fund. New subsidies and transfers being created give me cause for concern.