

Widening trade gap credit negative for India: Moody's

Global rating agency Moody's today warned that India's widening trade deficit is "credit negative" for the country and also raises its vulnerability to global shocks.

At present, Moody's has a 'Baa3' (lowest investment grade) rating for India with a stable outlook and any downward revision from here could pull the country's credit rating into junk grade.

Commenting on the latest government data showing an increase in India's trade deficit to USD 20 billion as on January 31, Moody's said: "India's widening trade deficit is credit negative... These rising deficits are being financed by increased foreign-currency borrowing, raising India's vulnerability to international financial volatility."

The country's trade deficit in January stood at its second highest level, while the biggest ever gap of USD 21 billion was recorded in October, 2012.

"Wider trade deficits can also weaken the currency, raising domestic prices of imported commodities, further fuelling India's already high inflation rate," Atsi Sheth, Vice President - Senior Analyst, Sovereign Risk Group, Moody's Investors Service said.

India's trade deficits averaged about USD 13.5 billion a month in 2011 and USD 16 billion a month in 2012, up from an average of USD 9.5 billion a month between 2008 and 2010.

Moody's said the three main factors responsible for widening trade deficit over the past two years include slowing global growth that has lowered demand for Indian exports, rising prices of oil and gold that account for a bulk of the country's merchandise imports, and a loose fiscal policy which stimulates domestic demand, and thus demand for imports.

Loose fiscal policy also fuels domestic inflation, which erodes the competitiveness of both export and import-competing sectors, further widening the trade gap.

"Trends in the first two factors are unlikely to turn significantly benign in 2013. Therefore, an improvement in India's trade balance will require a shift to policies to enhance domestic competitiveness," Moody's Sovereign Risk Group Associate Analyst Andrew Schneider said.

Since foreign-currency debt plays a larger role than foreign investment in financing India's trade deficit, the external debt burden has risen to USD 365 billion as of third-quarter 2012 from USD 137 billion in third-quarter of 2006.

"Should the current trend of more rapid growth in debt and import payments than export earnings and non-debt inflows persist, these ratios, and thus India's vulnerability to external shocks, will deteriorate significantly," the rating agency said.

(Economic Times)