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Junk threat recedes as Narendra Modi seen spurring economy

The strongest electoral mandate in three decades is fuelling optimism that Modi-led govt will avert a junk debt rating

Bond risk of Indian companies slumped to the lowest in a year after Narendra Modi's BJP swept polls ended this month with the biggest majority since 1984. Photo: Bloomberg

Mumbai: The strongest electoral mandate in three decades is fuelling optimism India's new government will revive economic growth and avert a junk debt rating.

Bond risk of Indian companies slumped to the lowest in a year after **Narendra Modi**'s Bhartiya Janata Party (BJP) swept polls ended this month with the biggest majority since 1984. The average cost of protecting the debt of seven firms against non- payment for five years using credit-default swaps fell to 232 basis points, according to data provider CMA.

Modi takes oath as prime minister in New Delhi on Monday. Goldman Sachs Group Inc. said while it expects his government to revive stalled projects, boost investment and cut some subsidies, improving the budget deficit will take at least a year. Standard and Poor's warned in November that India may lose the BBB- investment grade, first awarded in 2007, should the new administration fail to revive growth from near a decade-low.

"The downgrade pressure has been pushed aside for now," D.R. Dogra, managing director of CARE Ratings Ltd in Mumbai said in a 23 May telephone interview. "I don't think there will be any such speculation for a reasonably long time."

Credit-default swaps for **State Bank of India** (SBI), the nation's largest and regarded by some investors as a proxy for the sovereign, reached 193 basis points as of 22 May, the lowest since June 2013, CMA data show. Contracts protecting **Reliance Industries Ltd**, the nation's second-largest company by market value, were at a one-year low of 165. The cost of insuring Bank of China's debt rose to near a one-month high of 146.

'Positive implications'

The BJP won 282 of the 543 seats in the lower house of parliament and, along with its allies, controls 336, according to results published by the Election Commission. The mandate will give the government a freer hand in implementing policies that could help improve India's sovereign credit metrics, Kim Eng Tan, S&P's senior Director for Asia-Pacific Sovereign Ratings said in a 19 May webcast.

"There's a clear opportunity to manage policies in a way that there are positive implications on the sovereign outlook," Dharmakirti Joshi, chief economist at Crisil Ltd, S&P's local unit, said in a 22 May telephone interview. "Confidence in the economy is restored."

India may even become eligible for an upgrade if the government cuts the budget deficit, simplifies investment rules and builds infrastructure, Atsi Sheth, a sovereign analyst at Moody's Investors Service in New York, said on 19 May. It ranks India Baa3, the lowest investment grade.

Growth outlook

Investments by private companies fell to 9.2% of gross domestic product (GDP) in the year ended March 2013, the lowest in data going back to 2005, according official estimates.

GDP growth will accelerate to 5.5% in the fiscal year ending March 2015 and reach 6.5% in the following 12 months, Goldman analysts including Tushar Poddar wrote in a 22 May report. The government estimates Asia's third-largest economy grew 4.9% in the period ended 31 March, near the decade-low of 4.5% in the preceding year.

“We believe we will see the steps that are needed to achieve growth rates of as much as 8%,” Lalit Jalan, chief executive officer at Reliance Infrastructure Ltd, controlled by billionaire **Anil Ambani**, said in a 19 May interview in Mumbai.

As the chief minister of Gujarat, Modi, 63, attracted investments from companies such as **Tata Motors Ltd** and billionaire Gautam Adani’s **Adani Enterprises Ltd**, while the state outpaced the national economic growth rate in 11 of the past 12 fiscal years for which data are available.

Yield premium

Overseas borrowing costs declined to the lowest in more than six-and-a-half years after the polls. The extra yield investors demand to hold dollar-denominated Indian debt over US. Treasuries fell to 260 basis points as of 21 May, the lowest since November 2007, a JPMorgan Chase and Co. index shows.

While three interest-rate increases since September by central bank governor **Raghuram Rajan** have helped reduce inflation, April’s 8.59% gain in the consumer-price index was the highest in Asia after Pakistan. Goldman analysts expect price increases to average 8% this fiscal year and 7% in the next, and predict the Reserve Bank of India (RBI) will increase its benchmark repurchase rate to 8.5% in the second half of 2014 from 8%.

Inflation woes

“Inflation isn’t at acceptable levels and its curbing would take precedence over other objectives such as boosting growth,” Rupa Rege Nitsure chief economist at state-run Bank of Baroda, said in a 22 May telephone interview. “There may be prolonged cautiousness before the optimism sets in.”

The yield on the rupee-denominate benchmark 10-year sovereign bonds will climb to 8.8% by year-end, from 8.63% on 23 May, because of elevated inflation and a large fiscal deficit, according to the Goldman report.

Currency and stock markets reflect growth optimism. The rupee surged 3.1% to 58.5075 per dollar this month, the most among 11 Asian currencies tracked by *Bloomberg*. One-month implied volatility, a gauge of expected exchange-rate moves used to price options, fell to 7.48% on 23 May, the lowest since 5 March. The S&P BSE Sensex of shares surged 10.2% this month to close at a record 24,693.35.

“The most stable government in three decades would improve credit profiles of companies,” Vibha Batra, New Delhi-based Group-Head of financial-industry ratings at ICRA Ltd, the local unit of Moody’s, said in a 21 May telephone interview. “Equity markets are rallying on expectations of these improvements.” **Bloomberg**