SOUTH INDIAN Bank

STUDENTS' ECONOMIC FORUM

To kindle interest in economic affairs...
To empower the student community...

Open Access

www.sib.co.in
ho2099@sib.co.in

September 2011

Theme 238

THE S&P DOWNGRADE

A monthly publication from South Indian Bank

19th Year of Publication

SIB proudly presents an innovative Savings Bank and Recurring deposit account exclusively for women with free insurance coverage - Mahila Savings Bank & Recurring Deposit Accounts.

We offer an array of revolutionary advantages and services to help every woman achieve their goals.

FREE FACILITIES ATTACHED EXCLUSIVELY TO THE MAHILA SAVINGS BANK ACCOUNT.

◆ **FREE Personal accident death insurance** cover exclusively to the first named female of the Mahila SB account for **₹ 1 lac** for the first 1 year worldwide ◆ **FREE House to house Travel Insurance for ₹ 0.50 lac** covering Loss due to snatching, burglary and ₹ 10,000 for misfortune of jewellery and valuables like watches, camera and cash and also loss of baggage up to ₹ 2,000/- while in hotel stay exclusively to the first named female of the Mahila SB account for the first 1 year occured within India. ◆ **FREE Remittance** by way of cash up to ₹ **50,000/- per month** to Resident Mahila ABB Account through other branches. ◆ **FREE Remittance** by way of transfer or clearing up to **₹ 50,000/- per month** to Mahila ABB Account through other branches. ◆ **FREE cash withdrawal up to ₹10,000/- daily** through other branches apart from ATM withdrawals. ◆ **FREE** payment of cheque through speed clearing Pan India without limit. ◆ **FREE** purchase of **2 Draft/PO up to ₹10,000/- Monthly** ◆ **FREE** 25 Cheque leaves per year. ◆ **FREE ATM cum Debit card with no AMC** ◆ **FREE** Internet banking facilities. ◆ **FREE** Bill payments, mobile top-up & e-commerce through SIB website "southindianbank.com"

CONDITIONS

◆ The insurance cover is valid only for one year from the date of account opening. Existing customers who wish to renew the insurance for the second year will have to open a fresh Mahila RD Account. ◆ All the free facilities will be available exclusively in the Mahila Savings Bank account only; ◆ 15 days waiting period applicable in case of house to house travel insurance. ◆ In case minimum balance of ₹1000 is not maintained in the SB account, normal service charges will be collected. ◆ General T & C attached to SIB's SB account will apply for this SB also.

Also available: Mahila Plus Account with more free facilities.

Disclaimer : Insurance cover is offered by United India Insurance Co. and the decision of the insurance company will be final

SOUTH INDIAN Bank

Experience Next Generation Banking

The South Indian Bank Ltd., Regd. Office: SIB House, Mission Quarters, Thrissur, Kerala, Pin - 680 001. e-mail : sibcorporate@sib.co.in Tel : 91-487-2420020, **Toll free: 1800-843-1800 (India), 1800- 425-1809 (BSNL)**

SOUTH INDIAN Bank
Experience Next Generation Banking
The South Indian Bank Ltd., H.O. : 'S.I.B. House', Thrissur, Kerala

SIB STUDENTS' ECONOMIC FORUM

SEPTEMBER 2011

THEME 238 : THE S&P DOWNGRADE

A well informed customer will make the policy makers as well as organisations which produce goods and services more responsive to the customer needs. This will also result in healthy competition among organisations and improve the quality of goods and services produced.

The "SIB Students' Economic Forum" is designed to kindle interest in economic affairs in the minds of our younger generation. We highlight one theme in every monthly meeting of the "Forum". On August 5, 2011, the International Credit Rating Agency, Standard & Poor's (S&P) Rating Services lowered its long term sovereign credit rating on the United States of America to AA+ from AAA. This month we discuss on this topic "The S&P Downgrade".

Give an overview of the recent S&P downgrade on USA ?

- S&P has lowered its long term credit rating on USA from AAA to AA+.
- S&P has affirmed its short term rating on USA at A1+.
- S&P has removed both short & long term ratings from Credit Watch negative.

What was the political background in US leading to the controversy over raising the statutory debt ceiling?

The recent developments indicate that USA is facing a political turmoil leading to a financial crisis. During the last three years, the US administration had to spend heavily to withstand the recessionary pressures set ablaze by the sub prime crisis. The US Congress was of the opinion that public spending is on the rise due to heavy allocation for social security, war, bailouts and so on. The huge public spending compelled the Government to borrow several trillion dollars. The debt almost reached the ceiling limit, posing a threat of default in payment. The only recourse was to increase the debt limit but the Republican Party opposed to further increase. Despite the stiff resistance, the House of Representatives approved the bill increasing the sovereign debt ceiling limit by $ 2.8 trillion from $ 14.3 trillion with a condition to reduce public spending by $ 2.4 trillion (S&P had prescribed $ 4 trillion).

What was the stand taken by S&P over the US policy decision?

The S&P report says the US policy making bodies and politicians have failed to catch up with the ongoing fiscal and economic challenges, on which they had already assigned a negative outlook to the rating on April 18, 2011. The ratings on both short term and long term were already placed on credit watch negative. S&P reveals that they are not optimistic about the capacity of the US administration and political parties there to leverage at a broader fiscal consolidation plan to stabilise the debt dynamics. They have also hinted that the outlook on long term rating is negative and a further down grading is on the cards within the next two years. S&P points out that US administration has to combat the new fiscal pressures by lowering the higher interest rates and higher spending to come out of the tangle. The fiscal consolidation plan of the US has not yielded the necessary results to stabilise the US Government's medium term dynamics.

What was the action taken by S&P to remove the US Government from its list of risk free borrowers?

S&P, one of the three major international debt securities rating companies, announced that it was cutting its rating on long term federal debt to AA+, one notch below the top grade, reducing its confidence in the US government's ability to manage its finances. However the rating agency affirmed that the short term rating as well as the ability of the US based public and private sector issuers to secure foreign exchange remains at A1+ and AAA respectively. But the outlook on long term rating is negative. This is the first time S&P is downgrading the US. The market participants view that the US and European economies may find it difficult to maintain the current GDP growth.

What is the rationale behind downgrading the long term sovereign debt rating on USA by S&P?

There was a controversy prevailing in USA over raising the statutory debt ceiling. There were heated debates among the political institutions over the threat of payment default posed by delays in raising the debt ceiling. The prolonged controversy over raising the ceiling clearly indicates that neither the administration nor the political parties have the will to contain growth in public spending, especially on social security, war , bail outs and welfare schemes. There was no consensus among the political factions on programmes for raising revenues. The rating agency is of the view that the fiscal consolidation plan envisaged by the US congress was far below the stipulations necessary to stabilise the administration's debt burden in the near future. The agency opines that there was uncertainty in policy making and there were no effective changes in the US administration's economic, external and monetary credit attributes. In its view, the failure to arrive at a consensus on fiscal policy matters imposes a strain on management of public finance thereby adversely affecting balanced and diversified economic growth. The US Administration passed the Budget Control Act 2011on August 2, 2011 to remove the immediate threat of payment default caused by delay in raising the government's debt ceiling. The rating agency views it as a clear indicator that all future fiscal policy decisions of the government may be influenced by political bargains rather than by financial acumen. S&P highlights the decision to raise the debt ceiling as a pointer to the less stable, less effective and less predictable policy decisions of the US administration.

What is the present outlook on US economy?

USA, the custodian of almost 25% of the world GDP, was the major investment hub for the world's leading mutual funds, pension funds and insurance funds. Most of the countries preferred US to Europe for their long term bond investments. China, OPEC countries and South East Asia are the major exporters to US. China has already hit out at the United States for its “addiction to debts”. The US downgrade has elicited strong reactions from almost all major countries demanding forceful implementation of a newer strategy to calm the nerves. The downgrade with a negative outlook on long term debts poses a threat to the US economy of further lowering the rating by S&P. The US Administration continued the tax cuts allowed in 2001, 2003, 2005 by President Bush. During the last ten years the income of the 1% high income group rose by 18%, but that of the blue collar fell by 12%. The present US administration has to devise plans to achieve a more balanced and dynamic economic growth. Each day the government debt burden is on the rise and the government has to devise effective measures to raise tax rates and thereby enhance the revenues.

What are the immediate impacts envisaged in USA?

- The downgrade may worsen the fiscal deficit problem
- Reduction in public spending may depress the economy further.
- The cost of borrowings by the Government may go up.
- Sovereign credit quality may remain under pressure.

What are the different views about the post downgrade scenario?

A few countries fear of a general recession but the majority see it only as a threat and believe that the world economy shall be more resilient. The general fear is that US may go for a $ devaluation and the Euro may collapse. The Indian administration was prudent enough to bring down the investments in US funds, following the sub prime crisis. We have brought down our investment of reserves in US treasury to 13% and increased our investments in Gold to 8% of reserves during the last three years. India is confident of posting the same growth rate in current fiscal despite the negative global sentiment. As far as India is concerned, the outlook on exports is a worrying factor. but the fall in crude oil prices is good news because it will keep fiscal deficit in check.

How does RBI take stock of the situation?

RBI is closely watching the global development and taking effective steps to maintain the domestic markets in order. The central bank keeps a close watch on the international crude oil prices and the commodity prices. During the last 16 months we have seen a rise in policy rates almost 11 times . As such there is every chance of the monetary policy stance to be reassessed with fall in commodity prices. The increased inflow in FDI /FII may strengthen the Indian rupee in the long run. Recession in US may affect Indian equity as well as commodity markets in the short run.

How does the S&P downgrade affect India?

The Government of India does not foresee any material impact on our economy. The downgrade may affect Indian exporters in case a further slowdown results in demand getting culled. The software, gem and jewellery exporters may feel the heat of a falling dollar and strengthening rupee. The stock markets may experience some shave offs and the yellow metal may get rated as one of the safest investments and may be more expensive. But, in reality, the crude oil prices may slash, resulting in drop in the commodity prices and inflation. India may be a safe haven for the long term investments by the Western countries. But the tourism industry and software exports may face a setback hampering growth in the economy.

The United States is a significant partner for most of the countries. As such the recent tremors may create only a psychological impact. The downgrade seems nothing to the common man, but still leaves some space to be optimistic about a faster economic growth.

Do investors use credit ratings in making investment decisions?

Sovereign ratings indicate the country's future fiscal and monetary flexibility based on the past economic and political performance. Credit ratings need not be indicative for making investment decisions. It means the ratings are not recommendations for buying, selling or holding but serve as signals on the suitability of an investment. The rating agencies reveal only one aspect of customer preferences namely credit quality and the same need not be the sole criterion in investment decision.

Does the downgrade send any positive signals to investors?

The downgrade seems to benefit the investors. The fixed income group have been experiencing the low interest regime since 2008. The medium and long term investments may yield higher returns but investors have to be watchful on the fall in bond price with rising interest rates. It seems that short term investments may yield higher returns and excellent investment opportunities are on the offing.

What do you know about credit rating by International agencies?

Credit rating is the opinion of the rating agency about the ability and willingness of an issuer , such as the Government, to meet its financial obligation in full on time. A country's sovereign credit rating indicates its ability to make periodical interest payments on the long term debts and repayment in full on the due date. The rating agencies assess how likely a borrower is able to repay its debt .Each agency applies its own methodology in measuring creditworthiness and uses a specific rating scale to publish its opinions. S&P relies on a model with five variables ranking from strongest to weakest on a six point scale taking into consideration both qualitative and quantitative aspects.

The ratings undergo adjustments due to overall shifts in economy or business climate. Also the credit risk may vary due to factors such as competition, technology and so on. Mostly certain factors like inflation, which affects interest rates and cost of capital, do have an impact on the present ratings. Ratings do not provide any guarantee of credit quality or an absolute measure for default probability. Generally the agencies consider default as the single most important factor in their assessment of creditworthiness.

CREDIT RATINGS by International Credit Rating Agencies:

- **AAA** - Highest rating-extremely strong capacity to meet financial commitments.
- **AA** - very strong capacity to meet financial commitments.
- **A** - Strong capacity to meet financial commitments, but susceptible to adversities.
- **BBB** - adequate capacity to meet financial commitments but more subject to adversities.
- **BBB-** - considered lowest investment grade.
- **BB+** - considered highest speculative grade
- **B** - more vulnerable to adversities.
- **CCC** - currently vulnerable and dependant on favourable business
- **CC** - currently highly vulnerable.
- **C** - currently highly vulnerable obligations.
- **D** - payment default on financial commitments.

RATING MODELS by International Credit Rating Agencies

Fitch	Moody's	S&P	Rating
AAA	Aaa	AAA	Prime
AA+	Aa1	AA+	High grade
AA	Aa2	AA	-do-
AA-	Aa3	AA-	-do-
A+	A1	A+	-do-
A	A2	A	Upper medium grade
A-	A3	A-	-do-
BBB+	Baa1	BBB+	-do-
BBB	Baa2	BBB	Lower medium grade
BBB-_	Baa3	BBB-	-do-

Current Ratings by international Credit Rating Agencies: Long Term Sovereign Debt:

Country/ International Rating agency	USA	UK	Germany	Spain
Fitch	AAA with stable outlook.	AAA with stable outlook.	AAA with stable outlook.	AA+ with negative outlook
Moody's	Aaa-under review	Aaa with stable outlook	Aaa with stable outlook	A2- under review
S&P	AA+ with negative outlook	AAA with stable outlook	AAA with stable outlook.	AA with negative outlook.

Source: www.guardian.co.uk/news/datablog/2010.

Your comments and feedback on this publication may be sent to Staff Training College, The South Indian Bank Ltd., Thrissur 680 001 or by E.mail: ho2099@sib.co.in


www.southindianbank.com
JUST FOLLOW...
SIB JUNIOR
An exclusive SB account for students
SOUTH INDIAN Bank
Experience Next Generation Banking
The South Indian Bank Ltd., Regd. Office, SIB House, P.B. No.28, Thrissur, Kerala, Pin-680 001. Ph: 0487 2420020, Fax: 0487 2442021, Toll free (India) 1800-843-1800, 1800-425-1809 (BSNL) Email: sibcorporate@sib.co.in