An outline on India's Financial Sector during the Global Economic Recession

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Abstract: The present study is proposed to evaluate the different dimensions of Indian financial sector during economic recession conditions. The analysis is based on the official reports of the government of India; RBI reports, United Nations reports etc. Growth rates/ percentages are thoroughly used towards effective analysis. The Indian banks have stood their own feet and attacked the recession than the USA and other European banks. This paper suggested that public sector property can stabilize the economy rather than provide stimulus packages while the private sector pushes the economy in to adverse conditions and reduce unnecessary administrative expenditure of the governments to stabilize this sector. Inflationary conditions have also taken place in the recent. Hence, sufficient credit policy for balance the money and commodity markets have to be maintained.

Key words: public sector property, Global Economic Recession, liquidity shock

1. Introduction

The present study is proposed to evaluate the different dimensions of Indian financial sector during economic recession conditions. The analysis is based on the official reports of the government of India; RBI reports, United Nations reports etc. Growth rates/ percentages are thoroughly used towards effective analysis.

2. Global Economic Recession and the India

America is the most effected country due to global recession, which comes as a awful news for India. India has most outsourcing deals from the US. With the collapse of huge Wall Street banks and the resulting freeze of bank credit flows in the West, there was an immediate worldwide liquidity crunch and a massive amplification of the recessionary forces in the US, Europe and Japan. The liquidity shock was immediately felt in India, with foreign institutional investors (FIIs) withdrawing their money, credit for foreign trade vanishing and loans from foreign banks drying up. With the sudden shrinkage in world trade after September 2008, India's exports in January-March, 2009 were about 20 percent lower than in the previous year. This meant that hundreds of thousands *of jobs were lost* in sectors like garments, textiles, footwear and leather products and gems and jewellery.

In the winter 2006/7 US housing prices started to fall for the first time in fifteen years. As a result many of the subprime housing loans became bad loans. This meant that hundreds of billions of dollars of financial derivatives which were based on these underlying mortgage loans also lost most of their value. Thus, by the summer of 2007 "the house of financial cards" began to collapse and a growing number of American and European banks announced huge losses on their

mortgage related securities and investments. This process of financial collapse gradually gathered steam and came to a boil in September 2008 when major American investment banks (like Lehman Brothers) collapsed and others (such as Merrill Lynch) were saved through forced mergers with healthier banks. The financial melt-down of September 2008 led to a freeze of credit markets in the US and Europe and transmitted the sudden liquidity squeeze throughout the financial world.

3. **Recessional Contagion effects on Indian financial sector**

The effect of recession on the Indian Economy was not significant in the beginning. In India, the impact of the crisis has been deeper than what was estimated by our policy makers although it is less severe than in other emerging market economies. The extent of recessional impact has been limited due to the Indian Financial sector particularly our *banks have no direct exposure to tainted assets* and its limited off-balance sheet activities. The credit derivatives market is in an *embryonic stage* and there are restrictions on investments by residents in such products issued abroad. India's growth process has been *largely domestic demand* driven and its reliance on foreign savings has remained around 1.5 per cent in recent period. India's comfortable foreign exchange reserves at some extent provide confidence in our ability to manage our balance of payments notwithstanding lower export demand and dampened capital flows. Rural demand continues to be robust due to mandated agricultural lending and social safety-net programmes.

a. Indian Stock Market-out flows of portfolio investment

The global economic recession has had a deep impact on the Indian stock market as it was evident from the fact that Bombay stock market benchmark index touched a high of about 21200 in January 2007 to a low of around 7000 points in the year 2008 (source: Sensex reports of concern years and Misra and Puri 2010). The combined effect of the reversal of portfolio equity inflows (given details in FDI flows), the reduced availability of international capital both debt and equity and the perceived increase in the price of equity with lower equity valuations has led to the bearish influence on stock market. But now the SENSEX crossed to 20 thousand and above points due announced the stimulus packages by the government and more FIIs.

b. Forex reserves

Forex outflows trend is registered during the recession period. The Forex reserves were increased to 7.14 percent in 2005-06 compared with the previous year and recorded highest level at 51.76 percent in 2007-08. It was fallen to minus level at -18.71 percent in 2008-09 and became positive growth in 2009-2010 (December 2009) respectively. Other words, At end-March 2009 the foreign exchange reserves stood at US $ 252 billion which was declined from US $ 309.7 billion in 2007-08 (table-1). Obviously, the recession had slight impact on Forex reserves in the country. The out flow of foreign exchange by FIIs, as fallout of crisis is tightening of liquidity situation in the economy. Thus, money and credit markets were also affected (Misra and Puri 2010).

d. FDI and portfolio flows

FDI is considered to be the most attractive capital inflow for emerging economies as it is expected to bring latest technology and enhance production capabilities of the economy. FDI and portfolio investment inflows have been maintained systematically but the growth is fluctuated. FDI inflows was $ 34,360 million in 2007-08 but a slightly increased to $ 35,168 million in the next year which is very less than the previous periods. On an average, the percentage of FDI inflows to the GDP was 0.5 percent in 2004-05 it was 1.4 percent in 2008-09. Meanwhile, the real impact has focused on the inflows of portfolio investment inflows due the fear of speculation. The portfolio inflows were as high as $27,433 million in 2007-08 turn negative and stood at -$ 14,030 million during 2008-09. This is due to sale of equity stakes by FIIs to replenish overseas cash balances,(this knock-on effect on the stock market and the exchange rates through creating a supply- demand imbalance in the Forex market (ESI, 2009-2010)

e. Taxation

The economic slowdown has severely dented the Centre's tax collections with indirect taxes bearing the brunt. The tax- GDP ratio registered a steady decreased from 12.56 per cent to 10.95 per cent between 2000-01 and 2008-09. The government expects tax revenue to increase from 100 billion to 120 billion rupees in 2010 by expanding economic activities.

Table -1. Selected indicators of the external sector (% to the GDP)

Items	2004-05	2005-06	2006-07	2007-08	2008-09
Trade Balance	-4.7	-6.2	-6.5	-7.4	-9.7
Invisible Balance	4.3	5.0	5.5	6.1	7.4
(BOP)	-2.6	-3.4	-3.4	-4.3	-5.6
ECBs	0.7	0.3	1.7	1.8	0.7
FDI (net)	0.5	0.4	0.8	1.3	1.4
Portfolio Investment	1.3	1.5	0.7	2.2	-1.2
External Debt	18.1	16.7	17.5	18.1	20.5

Note : ECBs- External Commercial Borrowings; Source: Economic survey of India of concerned year.

5. Attacking efforts against the Crisis by government & RBI

Faced by the sharp credit crunch and the sudden slowing down of the economic activity after September 2008, the Government and Reserve Bank responded quite swiftly. The Government launched three fiscal stimulus packages between December 2008 and February 2009. They include *Fiscal Response, Monetary Response and Risk Management Credit Management.* These stimulus packages came on top of an already announced expanded safety-net programme for the rural poor, the farm loan waiver package. The challenge for fiscal policy is to balance immediate support for the economy with the need to get back on track on the medium term fiscal consolidation process.

In order to deal with the liquidity crunch and the virtual freezing of international credit, RBI took steps for monetary

expansion which gave a cue to the banks to reduce their deposit and lending rates. RBI taken steps such as reduction in the cash reserve ratio (CRR) by 400 basis points from 9.0 per cent in August 2008 to 5 per cent in January 2009. • Reduction in the repo rate (rate at which RBI lends to the banks) by 425 basis points from 9.0 per cent as on October 19 to 4.75 per cent by July 2009 (the lowest in past 9 years) in order to improve the flow of credit to productive sectors at viable costs so as to sustain the growth momentum. • In order to make parking of funds with RBI unattractive for banks, the reverse repo rate (RBI's borrowing rate) was reduced by 275 points which currently stands at 3.25 per cent. These steps have resulted positively to the economy.

6. Conclusions

To sum up, the global financial recession was started off as a sub-prime crisis of USA has brought all nations including India into its fold. The GDP growth has slowed since the last quarter of 2008 owing to deceleration in employment, export-import, and tax-GDP ratio, reduction in capital inflows and significant increase in outflows of Forex reserves due to economic slowdown. Outlining the areas hit by the recession, in India, exchange rates have come down at some extent and Indian exports have plummeted showing a negative growth of 10- 15 per cent. Money is flowing out of India and domestic liquidity has been squeezed.

The demand for bank credit is also slackening despite comfortable liquidity in the system. The recession has little direct effect on Indian Economy because of the conservative policies followed by Indian banks especially the Reserve Bank and lesser inter-bank borrowings as compared to the Europe and USA.

Nevertheless, a sound and resilient banking sector, well-functioning financial markets, robust liquidity management by banks and payment and settlement infrastructure, buoyancy of foreign exchange reserves have helped Indian economy to remain largely immune from the contagious effect of global meltdown. Indian financial markets have capable of withstanding the global shock at some extent (except stock market); strong internal drivers for growth may escape the worst consequences of the global financial crisis.

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