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A brief review on global crisis and the Indian banking system

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Abstract

Policy makers in India are consistently pursuing the path of liberalisation, globalisation and privatisation in all spheres of the economy, including in finance and banking. Perhaps this crisis will precipitate in NBFC and mutual funds and possibly the entire financial sector may have to pass through rough weather once again. Presently world is moving in coordinated economic system and recession of one country impact economic growth of other countries. If, US or European Union (EU) goes into recession; Asian economies will feel the heat and will be the biggest victim. Normally recession is a temporary collapse of a business activity and can be controlled methodically at its early stage

Key words: Economic growth, financial rules, macroeconomic policies

Introduction

In an increasingly interdependent financial world, the global financial crisis has had a cascading effect on economies and finances across the nations. The crisis had an impact on Indian economy and finance in a subdued scale and magnitude, when compared to the US and other developed nations. The crisis is widely viewed as a glaring example of the limitless pursuit of greed and overindulgence at the expense of caution, prudence due diligence and regulation. Wall Street firms broke financial rules and regulations and the people of the world were called upon to bear the burden. In general, a huge crisis is generated by factors such as overheating of the markets, excessive leveraging of debt, credit booms, miscalculation of risks, rapid outflows of capital from a country, unsustainable macroeconomic policies, off-balance sheet operations by the banks, and so-called imaginative and innovative financial instruments, products, services and unbridled deregulation. The crisis of 2008 was no exception.

Genesis of the crisis

The crisis was an outcome of the interplay between both macroeconomic and microeconomic factors. From a macroeconomic perspective, the crisis has been attributed to the persistence of global imbalances, an excessively accommodative monitory policy and lack of recognition of asset prices in policy formulation. From a microeconomic perspective, the crisis has been attributed to rapid financial innovations without adequate regulations, credit boom and the lowering of credit standards, inadequate corporate governance, inappropriate incentive schemes in the financial sector and overall lax oversight in financial systems. The same can be listed as:

1. Subprime mortgage.
2. Securitisation and repackaging of loans.

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3. Excessive leverage.
4. Misleading credit rating.
5. Unbridled financial innovations in products and services.
6. Imperfect understanding of the implications of derivative products.
7. Unfair valuation of assets.
8. Failure in corporate governance.
9. Complex interplay of multiple factors.
10. Typical characteristics of financial systems.

India: Where does it stand: The Indian banking system has had no direct exposure of sub-prime mortgage assets or failed institutions? It has very limited off balance sheet exposure. India's growth is driven predominantly by domestic consumptions and investments. However, with the advent of globalisation, India's two-way trade — trade globalization and financial integration with the world, which includes Indian corporate sector's access to external funding — India has been hit by the crisis. Despite India not being part of the financial sector, the problem has been created due to external shocks and domestic vulnerabilities. The Indian financial system largely escaped unhurt with the intervention of the regulator, that is, the Reserve Bank of India (RBI), but it is difficult to ascertain precisely the process. It is likely that a sizeable portion of today's huge Non-Performing Assets (NPA) can be traced back to the projects undertaken before 2013 when a false sense of security was being given with the impression that Indian economy and finance is immune to global shocks.

The present data on NPAs is revealing:

- Between 2000 to 2010, the growth in NPA was minus 6.20%, while between 2010 to 2015, it was plus 365%. Between 2015 to 2018, it was plus 221%.
- Between 2009-10 to 2017-18, the addition in NPA is Rs 18,84,507 cr.
- In 2009, 18 banks have provided Rs 8,80,277 crore towards NPA out of profits.
- Between 2010 to 2018, banks have written off bad debts amounting to Rs 4,23,428 crore. The current figure of NPA, Rs 8,42,291 crore, is excluding the figure of the write off.
- Top 12 NPA accounts amount involved is Rs 2,53,729 crore, which is more than 25% of the total NPA.

This revelation of NPA largely came on surface only after Asset Quality Inspection by the RBI at the instance of the then governor of RBI, Raghuram Rajan. It is not an overnight addition in the NPA, which, till this time, were suppressed by resorting to policy prescriptions provided by the same regulator, that is, the RBI, such as Corporate Debt Restructuring, which commenced in 2001, and Strategic Debt Restructuring, which commenced in 2015. Development financial institutions like the ICICI and IDBI were converted into commercial banks. Corporates were left with no other choice than to approach commercial banks for long-term funding for infrastructure and core sector projects, consequent upon a credit crunch in the global market due to the global financial crisis. Thus, it can be fairly concluded that the present crisis in Indian banking has its roots in the global financial crisis.

This impact is not only circumscribed to NPA. Overall, Indian banking is passing through one of the worst crisis in history. Since the last three years, banking in the public sector is almost stagnant. Of the 21 public sector banks, only two are showing profits. With continued losses, capital of those banks has been eroded. Thanks to the central government with whose support those banks are surviving. It can be perceived that the overall situation in Indian banking, more or less, is similar to the US in 2008. As stated in the financial stability report by the RBI, of the total credit, corporates share 55% of which 86% are the NPA. This indicates that the present crisis in banking is linked with the corporates who have borrowed from the banks disproportionately by resorting to lapses in the system and by so-called imaginative and innovative financial instruments, products and services. While big bang financial sector reforms could not be pursued mainly because of opposition from Left parties and trade unions, incremental liberalisation and integration with the global financial markets has continued in India. The reason why India did not witness a financial crisis as witnessed in the US or elsewhere is mainly because the Indian financial system is far more regulated and the public sector dominates the market.

However, policy makers in India are consistently pursuing the path of liberalisation, globalisation and privatisation in all spheres of the economy, including in finance and banking. Perhaps this crisis will precipitate in NBFC and mutual funds and possibly the entire financial sector may have to pass through rough weather once again. Presently world is moving in coordinated economic system and recession of one country impact economic growth of other countries. If it is not controlled efficiently within short period then with passing time it will become depression which is considered as a dead end, total state of irrevocable economic failure and result in complete shutdown. It is found that during the period the ratio of export and import of our country was 70:30 respectively and due to globalization it has increased too many folds especially to US, which declined by 22 percent due to recession in US. According to commerce ministry report (Oct, 2006), that around 86% of export & 89% import deals invoiced in USD. It is estimated that around 30 percent to 50 percent of the exports will be affected and exports houses will suffer badly due to economic slowdown and recession.

Recommendation:

In order to organize banking with growth, banks have to adopt rationale profit maximization policy in which it can protect the banking activities with minimum risk. Mixed banking system (PSUs and Private Banks) can only balance the banking activities effectively and efficiently. PSUs are state oriented and are prone toward providing safety and security to the society. Regulatory body should be made more empowered and tighter regulations should be adopted to protect the economic and financial activities. Interest rate policy should be futuristic and clear as its fluctuation largely depend upon overall internal and external economic conditions which are influenced by high growth and recessions thus they should be judiciously implemented with social structure for the betterment of the society as a whole. In order to grow, banks have to develop trust in society and have to develop mass motivation, later have to convert this motivation into investment. To meet the global competition they have to adopt continuous up gradation and modernization policies and have to implement effective balance score card in order to evaluate their performance time to time

Conclusion: The Indian economy is more connected with the global financial system today than it was a decade before. The exposure to FII has increased drastically which tends to be volatile, making the economy more vulnerable to any external shocks. There is trust among the people in the country about the strength of the banking system mainly because public sector banking dominates the scene. Thus, despite majority of them having faced losses, the public continues to have faith in them. It is the public sector character which matters and not their capital or compliances with BASEL or otherwise. Now, the current political dispensation in Delhi is taking a contrary position and is initiating a discourse in favour of privatisation, instead of recovering NPA so as to strengthen Indian banking. This brazen shift may prove to be disastrous.

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