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DYNAMISM OF INDIA'S FINANCIAL SECTOR DURING THE GLOBAL ECONOMIC RECESSION

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ABSTRACT
The present paper tries to evaluate the different dimensions of Indian financial sector and future perspectives. It is found that the current global economic recession (GER) is the results of very much global market integration and less level of government intervention. More or less, the GER has been affected the Indian financial sector in various dimensions such as financial flows- FDI and Portfolio investments, stock market, Forex reserves, BOP, government revenue, etc. The Forex reserves were fallen from 51.76 percent to -18.71 percent, due the outflow of portfolio investments, fluctuations in BOP, and over speculation of FIIs/. However, 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.

KEYWORDS
Depression, Forex reserves, Globalization, Global recession, portfolio flows sub-prime.

INTRODUCTION
Eight decades ago, entire the world economies had suffered with great depression due to laissez-faire of free market conditions with out government intervention. In the recent, 2007 onwards, the similar trend has appeared over the globe. Even though India recognized 3rd strongest country after America and China, India has been facing some recessional waves from the rest of the world. Financial sector institutions and their regulators have been at the centre of the global crisis. In the age of globalization, no country can remain isolated from the fluctuations of the world economy. It is evident that there is sharp decline in the growth rate of GDP to 5.8 percent in the second half of from 7.8 percent in the first half of 2008-09(Economic Survey 2009-10) and more or less, financial sector especially financial flows, stock market, Forex reserves, balance of payments etc affected in this regard. In this context, the present study is tried to evaluate with the following purpose.

PURPOSE AND METHODOLOGY ADOPTED
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.

GLOBAL ECONOMIC RECESSION AND THE INDIA
In the winter 2006/7 US housing prices started to fall for the first time in fifteen years. As a result many of the sub prime 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 (www.bsodmyself.com).
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.

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 (foreign exchange) 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).

c. BALANCE OF PAYMENTS IN INDIA (BOP)

The current economic crisis was largely insulated by the reversal of Foreign Institutional Investors (FIIs), external commercial borrowings (ECB) and trade credit. India's BoP exhibited considerable resilience during fiscal 2008-09 despite one of the severest external shocks. The current account balance [(-) 2.4 per cent of GDP in 2008-09 vis-à-vis (–) 1.3 per cent in 2007-08] remained well within the sustainable limits and there was limited use of *foreign exchange reserves*, despite massive decline in net capital inflows to US$ 7.2 billion in 2008-09 as against US$ 106.6 billion in 2007-08. As per the latest BoP data for fiscal 2009-10, exports and imports showed substantial decline during April-September of 2009-10 compared to the corresponding of 2008-09 (table 2). Moreover, there is reduction in the capital account receipts in 2008-09 with total net capital flows (Economic survey of India (ESI), 2009-10). The external debt has continuously increased from18.1 percent in 2004-05 to 20.5 percent in 2008-09.

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)

TABLE - 1 SUMMARY OF CHANGES IN FOREIGN EXCHANGE RESERVES (US$ BILLION)

Items	Foreign exchange Reserves at the end of the financial year		Total Increase / decrease reserves	Increase / decrease in reserves of BOP basis
	Reserves	% Growth		
2004-05	141.5	-	+ 28.6	+26.2
2005-06	151.6	7.14	+ 10.1	+15.0
2006-07	199.1	30.92	+ 47.5	+36.5
2007-08	309.7	51.76	+ 110.6	+92.2
2008-09	252.0	-18.71	- 57.7	-20.1
2009-2010	283.5	12.70	+31.5	+11.2

Source: Economic survey of India of concerned year.

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. (www.india-briefing.com)

TABLE – 2: 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

f. BANKING - SECTORAL DEPLOYMENT OF CREDIT

As mentioned previously, the Indian banks have strongly stood their own feet and attacked the recession the growth recovery is significant in the later because of strong and healthy performance of financial sector as opined by the experts. Indian banking activities in the recession period is much better than the USA and other European banks due their large domestic operations. No bank (slightly effected the ICICI bank) has highly effected; however, gross banking credit to various sectors is slightly declined. The impact of recession on banking in India is assessed by their credit operations.

The table 3 shows that credit to the priority sector fallen by 15.4 per cent (year-on-year) in 2009 as compared to 22.5 per cent in 2008. Among the priority sub-sectors, credit to micro and small enterprises (MSEs) recorded a growth of 19.3 per cent (year-on-year) in November 2009 as compared to 22.7 per cent in March 2007-08. The credit operations have a slight declining trend in almost all lending sectors like Public Food Procurement Credit, Non-Food Gross Bank Credit, Priority Sectors, Industry, Housing, Real Estate Loans and Tourism and Hotels and Restaurants. Worst position is occurred by Public Food Procurement Credit. This declining trend may be fear of global recession even though different financial packages by government were introduced to wind up the recession conditions in the economy.

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.

TABLE 3: SECTOR WISE DEPLOYMENT OF GROSS BANK CREDIT

Items	2007-08	2008-09
Gross Bank Credit	17.9	9.9
1. Public Food Procurement Credit	4.1	-15.3
2. Non-Food Gross Bank Credit	18.1	10.4
a) Priority Sectors	22.5	15.4
i. Agriculture	23.0	21.4
ii. Micro and Small Enterprises (MSEs)	22.7	19.3
iii. Other Priority Sectors	21.9	4.7
b) Industry (Medium & Large)	18.6	12.8
3. Housing	7.4	7.3
4. Real Estate Loans	44.6	15.3
5. Tourism and Hotels and Restaurants	11.6	22.7

Source: Economic survey 2009-2010

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.

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.

SOME POLICY IMPLICATIONS/ FUTURE OUTLOOK

Talking about what needs to be done at global front to fight against the recession, there should be a need of coordinated fiscal stimulus by major economies like US, China, Japan; rapid capitalization of weak financial institutions; better international surveillance of financial market; no rise in protectionist measures related to goods and services; improved and better coordinated regulations and supervision of financial institutions and increased resources for IMF and World Bank can, to some extent, lessen the affect of recession in hard hit countries.

A lot of recessions have been worsened or lengthened particularly by the U.S siding with players in different military and political conflicts around the world. Thus, it should adhere to the wisdom of good terms and trade with all nations including USA.

Economists have reporting that the recession has not controlled in the country. Hence, easy access of credit at low interest rate can expands investment. RBI should also consider reduction in repo and reverse repo rates but rose in the recent die to inflationary conditions.

Besides the recessionary conditions, interestingly, on the other side, in the recent, inflationary conditions have also taken place in the economy. It will further add fuel to flame elevating the inflation numbers as people tend to borrow and spend on least important needs than priority needs since they have easy access to funds. Inflationary conditions have also taken place in the recent. Hence, sufficient and suitable credit policy for balance the money and commodity markets have to be maintained.

To ensure liquidity of mutual funds, all close ended schemes should be listed on the stock exchange. The need of the hour is to prohibit premature redemption of close ended schemes.

It is view that during market fall, the market lot of derivatives segment should have been kept as it is or it should have been reduced instead of increasing the same or the Securities Exchange Board of India (SEBI) should introduce index wise uniform market lot size for example sensex stocks 200, mid cap stock 1000.

Government should give tax sops on the savings of Indian citizens abroad, who are bringing back money to homeland to invest it here.

Short selling should be banned in India as there are chances that the speculators may use this instrument to make money out of the global financial meltdown.

People at the top government level should be the role models in cutting down unnecessary expenditure by switching to simple lifestyles and shelving down not-so-important projects. A government can't spoon feed all of its population. Reduce subsidies and less priority expenditures of the government.

An ideal government should be not only a facilitator of business providing infrastructure to a community but also conductor of business. It may reduce outflows of Forex reserves, funds so saved to infrastructure development and activities that will generate employment at the time of adverse trade cycle conditions. Maintain public/government assets (PSUs) including financial institutions to stabilize the economy rather than provide stimulus packages while the private sector push the economy in to adverse conditions as evidence that, in the midst of the current world economic crisis, many claims that there is a necessity to return to the Marxian and Keynesian traditions that of state intervention in order to better understand the dynamics of market economies like India. If various regulatory bodies and government do adopt the above said suggestions, it may prove to be an effective weapon to fight out adverse trade cycle conditions.

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