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IMPACT OF GLOBAL RECESSION ON INDIAN FINANCIAL MARKET

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ABSTRACT

Almost everybody today seems to be discussing about the US Recessionary trend and its impact on emerging countries, more particularly India Economists, Industrialists and the common man on the streets seem to have been horrified by the very thought of recession in India and that too due to US. Decreasing industrial production, inflation, decreasing job opportunities, cost cutting, reducing purchasing power parity, et al are the aspects discussed among them through every possible mode like articles, talks & walks and places like washrooms, canteens, etc. In this paper we will be looking on these important points: The main reason of crisis in India is Globalization. The Indian banking system has had no direct exposure to the sub-prime mortgage assets or to the failed institutions. Our banks continue to remain safe and healthy. India's recent growth has been driven predominantly by domestic consumption and domestic investment. The contagion of the crisis has spread to India through all the channels –the financial channel, the real channel, and importantly, as happens in all financial crises, the confidence channel. The failure of Lehman Brothers in mid-September was followed in quick succession by several other large financial institutions coming under severe stress. This made financial markets around the world uncertain and unsettled. This contagion, spread to emerging economies, and to India too. There is evidence of economic activity slowing down. Real GDP growth has moderated in the first half of 2008/09 and the projected GDP for 2010 is 7.7%. For the first time in seven years, exports have declined in absolute terms for three months in a row during October-December 2008. The index of industrial production has shown negative growth for two recent months and investment demand is decelerating. All these factors suggest that growth moderation may be steeper and more extended than earlier projected. In addressing the fall out of the crisis, India has several advantages like Headline Inflation. The decline in global crude prices and naphtha prices will reduce the size of subsidies to oil and fertilizer companies, opening up fiscal space for infrastructure spending.

KEYWORDS
Global recession, impact on Indian markets, lessons learnt, recovery trends, monetary and fiscal implication, response to crisis.

INTRODUCTION

Alan Greenspan called it a "once in a century credit tsunami", born of a collapse deep inside the US housing sector. Instability has surged from sector to sector, first from housing into banking and other financial markets, and then on into other parts of the real economy. The expansion of 2002-2007 began with a bang-the bursting of the US tech-stock bubble in 2000-2001, which had a substantial wealth effect on American households. To minimize the duration and depth of the resulting recession, the Federal Reserve aggressively eased monetary policy by reducing the Fed Fund rate by 27 times between January 2001 and 2003, with the funds rate falling from 6.5% to 1.0% over the period. This expansionary monetary policy averted a deeper recession by stimulating boom in the housing market, which soon turned into a housing bubble.

Contrary to the 'decoupling theory', emerging economies too have been hit by the crisis. The decoupling theory, which was rationally fashionable even as late as a year ago, held that even if advanced economies went into a downturn, emerging economies will remain untouched because of their substantial foreign exchange reserves, improved policy framework, strong corporate balance sheets and relatively healthy banking sector. In a rapidly globalizing world, the 'decoupling theory' was never very influential. Given the evidence of the last couple of years – capital flow reversals, sharp widening of spreads on sovereign and corporate debt and sudden currency depreciations - the 'decoupling theory' stands totally invalidated. Reinforcing the notion that in a globalized world no country can be an island, growth prospects of emerging economies have been diluted by the cascading financial crisis with, of course, considerable variation across countries.

The Indian economy looked relatively insulated from the global financial crisis that started in August 2007 when the 'sub-prime mortgage' crisis first surfaced in the US. In fact, the RBI was raising interest rates until July 2008 with the view to cooling the growth rate and hold inflationary pressures. However, as the financial meltdown, morphed in to a global economic downturn with the collapse of Lehman Brothers on 23 September 2008, the impact on the Indian economy was almost immediate. Credit flows suddenly dried-up and, overnight, money market interest rate spiked to above 20 percent and remained high for the next month. Many economists alleged that the 'Great Recession' of 2008-2009 was the worst global recession since the 1930s.

RESEARCH OBJECTIVE

This paper is an attempt to look into the impact of Global Recession on Indian Financial market and the Lessons learnt from it.

RESEARCH METHODOLOGY

Secondary Data

IMPACT ON INDIAN FINANCIAL MARKET

The fiscal year 2009-10 began as a difficult one. There was a significant slowdown in the growth rate in the second half of 2008-09, following the financial crisis that began in the industrialized nations in 2007 and spread to the real economy across the world. The growth rate of the gross domestic product (GDP) in 2008-09 was 6.7 per cent, with growth in the last two quarters hovering around 6 per cent. There was apprehension that this trend would persist for some time, as the full impact of the economic slowdown in the developed world worked through the system. It was also a year of calculation for the policymakers, who had taken a calculated risk in providing substantial fiscal expansion to counter the negative fallout of the global slowdown. Inevitably, India's fiscal deficit increased from the end of 2007-08, reaching 6.8 per cent (budget estimate, BE) of GDP in 2009-10. A delayed and subnormal monsoon added to the overall uncertainty. The continued recession in the developed world, for the better part of 2009-10, meant a sluggish export recovery and a slowdown in financial flows into the economy.

However, over the span of the year, the Indian economy posted a remarkable recovery, in terms of overall growth figures and in terms of certain fundamentals, which justify optimism for the economy in the medium to long term. The extent of impact has been restricted due to several reasons such as-

- Indian financial sector particularly our banks had no direct exposure to tainted assets and it's off- balance sheet activities have been limited. The credit derivative market is in nascent stage and there are restrictions on investments by residents in such products issued abroad.
- India's comfortable foreign exchange reserves provide confidence in our ability to manage our balance of payments notwithstanding lower export demand and dampened capital flows.
- India's recent growth has been driven predominantly by domestic consumption and domestic investment. External demand, as measured by merchandize exports, accounts for less than 15 per cent of our GDP.

- Accordingly, in India, while encouraging foreign investment flows, especially direct investment inflows, a more cautious, nuanced approach has been adopted concerning debt flows. Debt flows in the form of external commercial borrowings are subject to ceilings and some end-use restrictions, portfolio investment in government securities and corporate bonds are also subject to macro ceilings, which are modulated from time to time taking into account developing macroeconomic and monetary conditions. Thus, prudential policies have attempted to prevent excessive recourse to foreign borrowings and dollarisation of the economy.

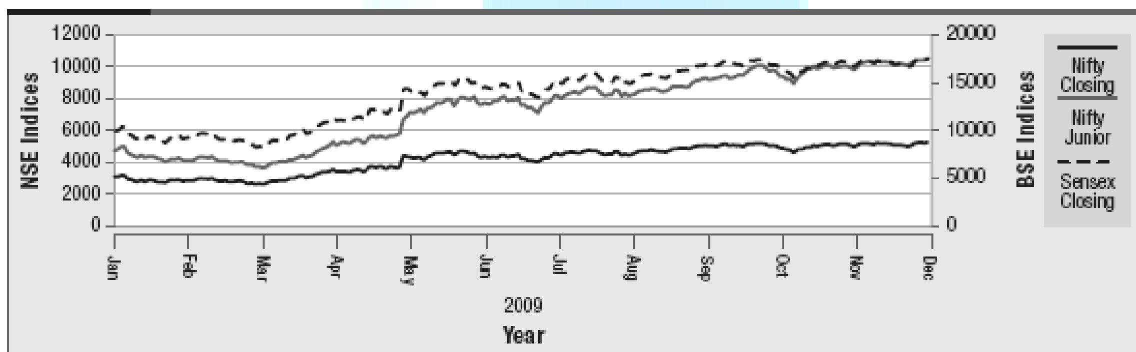
Despite these mitigating factors, India too had to weather the negative impact of the crisis mainly because of the increasing integration of the Indian economy and its financial markets with rest of the world. If we take a measure of globalization, as the ratio of total external transactions (gross current account flows plus gross capital flows) to GDP, this ratio has more than doubled from 46.8 per cent in 1997-98 to 117.4 per cent in 2007-08. The contagion of the crisis had spread to India through the financial channel, the real channel, and importantly, confidence channel. Because of the global liquidity squeeze, Indian banks and corporates found their overseas financing drying up, forcing corporates to shift their credit demand to the domestic banking sector. In addition, the forex market came under pressure because of reversal of capital flows as part of the global deleveraging process. As regards the real channel, the transmission of the global cues to the domestic economy had been quite straight forward – through the slump in demand for exports. The United States, European Union and the Middle East, which account for three quarters of India's goods and services trade, are in a corresponding down turn. Beyond the financial and real channels of transmission as above, the crisis also spread through the confidence channel. In sharp, contrast to global financial markets, which went into a crisis of confidence, Indian financial markets continued to function in an orderly manner. Nevertheless, the tightened global liquidity situation in the period immediately following the Lehman Brothers failure in mid-September 2008, coming as it did on top of a turn in the credit cycle, increased the risk aversion of the financial system and made Indian banks cautious about lending.

I. SECONDARY MARKET

The stock market of India has witnessed a radical transformation in last decade or so owing to the judicious policy measures implemented through the financial sector reforms of nineties. The adoption of international quality trading and settlement mechanisms and reduction of transactions costs have made the investors, domestic and foreign, more optimistic which in turn evidenced a considerable growth in market volume and liquidity. The market features a developed regulatory framework, a modern market infrastructure, removal of barriers to the international equity investment, better allocation and mobilization of resources and increased transparency. Despite this transformation, Indian stock market has recently shown greater volatility due to global financial crisis. It was the combined effect of the reversal of portfolio equity flows and the reduced availability of international capital both debt any equity that led to the bearish influence on stock market.

However, the Indian equity markets, which had declined sharply during 2008, reflecting the volatility in international financial markets and foreign institutional investment outflows, began the year 2009 on a subdued note. The market remained range bound during April-March 2009 but exhibited signs of recovery from April 2009. With the revival of foreign institutional investors' (FIIs) interest in emerging market economies including India, the equity markets gained strength during May-July 2009. There was a fresh spell of bullish sentiment in September 2009, with the Bombay Stock Exchange (BSE) Sensex recording a high of 17,126.84 during the month and then crossing 18000 for the first time in 25 months on 7 April 2010. Now, the stock market of India has returned to its previous growth track in spite of a greater degree of volatility.

FIGURE 1: MOVEMENT OF INDICES OF NSE AND BSE



SOURCE: Economic Survey, 2009-2010, Government of India

II. PRIMARY MARKET

The primary market is mainly used by issuers for raising fresh capital from the investors by making initial public offers or rights issues or offers for sale of equity or debt.

Though, resource mobilization from the primary market through equity investments was sluggish in 2009 both in terms of number of issues and amount raised through public rights issues and follow-on public offerings, there was an increase in debt market activity and private placements. The total number of initial public offerings (IPO's) declined to 20 in 2009 from 37 in 2008. The total amount mobilized through equity issues in 2009 was lower at Rs 23,098 crore as compared to Rs 49,485 crore raised in 2008. The amount raised through IPO has however, increased slightly in 2009 to Rs 19,296 crore from Rs 18,393 crore in 2008.

TABLE 1: RESOURCE MOBILIZATION THROUGH THE PRIMARY MARKET (RS. CRORE)

Mode	Calendar Year			
	2006	2007	2008	2009(P)
1. Debt	389	594	0	3,500
2. Equity	32,672	58,722	49,485	23,098
of which, IPOs	24,779	33,912	18,393	19,296
Number of IPOs	75	100	37	20
Mean IPO size	330	339	497	965
3. Private Placement	1,17,407	1,84,855	1,55,743	2,38,226
4. Euro Issues (ADR/GDR)	11,301	33,136	6,271	15,266
Total (1 to 4)	1,61,769	2,77,307	2,11,499	2,80,090

SOURCE: SEBI and RBI (For Euro issues) and Economic Survey 2009-10. P-Provisional

III. FOREX MARKET

Foreign exchange reserves are an important component of the Balance of payment and an essential element in the analysis of an economy's external position. India's foreign exchange reserves comprise of foreign currency assets (FCA), gold, special drawing rights (SDRs) and reserve position in the International Monetary Fund (IMF). The level of foreign exchange reserves is largely the outcome of the RBI's intervention in the foreign exchange market to smoothen exchange rate volatility and valuation changes due to movement of the US dollar against other major currencies of the world. Foreign exchange reserves are accumulated when there is absorption of the excess foreign exchange flows by the RBI through intervention in the foreign exchange market, aid receipts, interest receipts, and funding from the International Bank for Reconstruction and Development (IBRD), Asian Development Bank (ADB), International Development Association (IDA), etc. Beginning from a low level of US$ 5.8 billion at end-March 1991, foreign exchange reserves increased progressively to US$ 25.2 billion by end-March 1995, US$ 38.0 billion by end-March 2000, US$ 113.0 billion by end-March 2004 and US$ 199.2 billion by end-March 2007. They reached their peak at US$ 314.6 billion in end-May 2008. The reserves declined thereafter to US$ 252.0 billion at the end of March 2009. The decline in reserves in 2008-09 was because of the fallout of the global crisis and strengthening of the US dollar vis-à-vis other international currencies and the fact that our reserves are measured in dollar terms. During 2009-10, the level of foreign exchange reserves increased from US$ 252.0 billion at the end of March 2009 to US$ 283.5 billion at the end of December 2009, mainly because of valuation gain as the US dollar depreciated against most of the other major international currencies in 2009. In fiscal 2008-09, the widening of the Current Account Deficit coupled with net capital outflows resulted in the drawdown of foreign exchange reserves of US$ 20.1 billion (excluding valuation) as against an accretion of US$ 92.2 billion in 2007-08. In fiscal 2008-09, the rupee depreciated against major international currencies, except the pound sterling, due to deceleration in capital flows and widened trade deficit. The annual average exchange rate of the rupee in 2008-09 was Rs 45.99 per US dollar, Rs 64.98 per euro and Rs 46.22 per 100 yen, indicating depreciation by 12.5 per cent, 12.2 per cent and 23.5 per cent respectively over the annual average exchange rate during 2007-08. However, annual average exchange rate of the rupee per pound sterling of 78.29 in 2008-09 indicated appreciation by 3.2 per cent over 2007-08. In fiscal 2009-10, the rupee has strengthened against the US dollar on the back of significant turnaround in FII inflows, continued inflows under FDI and NRI deposits, better macroeconomic performance of the Indian economy and weakening of the US dollar in international markets.

TABLE 2: SUMMARY OF CHANGES IN FOREIGN EXCHANGE RESERVE (US$ Billion)

Sl. No.	Year	Foreign exchange reserves at the end of financial year (end March)	Total Increase / decrease in reserves
1	2004-05	141.5	+ 28.6
2	2005-06	151.6	+ 10.1
3	2006-07	199.1	+ 47.5
4	2007-08	309.7	+ 110.6
5	2008-09	252.0	- 57.7
6	2009-2010 (upto Dec. 2009)	283.5	+31.5

SOURCE: RBI and Economic survey 2009-10

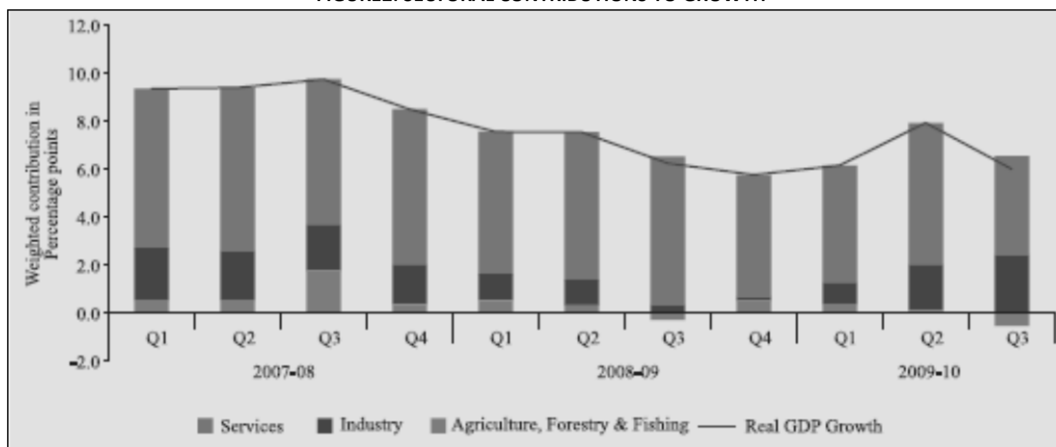
IV. BANKING SECTOR

The Indian banking sector was not completely insulated from the effects of the slowdown in the economy in 2008-09. The consolidated balance sheets of Scheduled Commercial Banks (SCBs) expanded by 21.2% in end-March 2009 as compared to 25% in the previous year. While the balance sheets of Public Sector Banks maintained their growth momentum, private-sector and foreign banks registered a deceleration in growth. Overall, the incremental credit–deposit (C-D) ratio declined sharply reflecting the slowdown in credit growth. Apart from cyclical factors, which led to slowdown after a period of high credit growth, the deceleration was accentuated this year because of the overall slowdown in the economy in the aftermath of the global financial turmoil. As the Indian banking sector was not completely insulated from the effects of the slowdown, the growth rates of income as well as expenditure of the SCBs slowed down, leading to deceleration in growth of net profits. Indian banks recovered a higher amount from Non Performing Assets (NPAs) during 2008-09 as compared to the previous year, pointing towards efforts for improvement in the asset quality of banks. Though some slippage was to be expected in the current global context, it has been moderate as compared to the problems faced by banks all over the world.

V. SLOWING GDP

In the past 5 years, the economy has grown at an average rate of 8-9 per cent. Services, which contribute more than half of GDP, have grown fastest along with manufacturing which has also done well. However, this impressive run of GDP ended in the first quarter of 2008. According to the revised estimates released by the CSO (May 29, 2009) for the overall growth of GDP at factor cost at constant prices in 2008-09 was 6.7 per cent as against the 7 per cent projection in the midyear review of the Economy presented in the Parliament on December 23, 2008. The slowdown in growth of GDP was more clearly visible from the growth rates over successive quarters of 2008- 09. In the first two quarters of 2008-09, the growth in GDP was 7.6 and 7.5 respectively, which fell to 5.8 per cent in the fourth quarters of 2008-09. The last quarter was an added deterioration in manufacturing due to the deepening impact of the global crisis and a slowdown in domestic demand. However, as anticipated in the Economic Survey 2008-09, the economy exhibited a sharp 'V'-shaped recovery within a span of a few months of the stimulus measures, both fiscal and monetary, working through the system. The turnaround in the growth momentum was established with the (Q2) 2009-10 estimates, when the economy recorded a GDP growth of 7.9 per cent as against 7.5 per cent in the corresponding quarter of 2008-09.

FIGURE2: SECTORAL CONTRIBUTIONS TO GROWTH

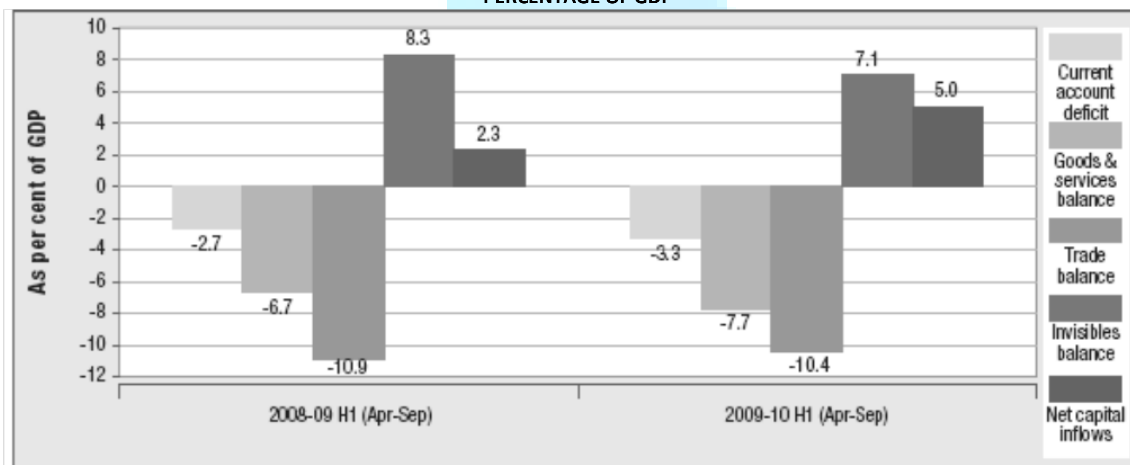


SOURCE: RBI

VI. STRAIN ON BALANCE OF PAYMENTS

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 flows 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 (H1) of 2009-10 vis-à-vis the corresponding period in 2008-09. There has been improvement in the BOP scenario during H1 of 2009-10 over H1 of 2008-09, reflected in higher net capital inflows and lower trade deficit. However, the invisible surplus declined and current account deficit widened vis-à-vis the corresponding period last year.

FIGURE 3: CURRENT ACCOUNT DEFICIT, GOODS AND SERVICES BALANCE, TRADE BALANCE, INVISIBLES BALANCE AND NET CAPITAL INFLOWS AS A PERCENTAGE OF GDP



SOURCE: Economic Survey 2009-10

VII. UNEMPLOYMENT

Employment opportunities in the current financial year were affected by the global financial crisis and economic slowdown in India. A sample survey conducted by the Labour Bureau, Ministry of Labour and Employment to measure the Effect of Economic Slowdown on Employment in India (July-September 2009). Survey included eight sectors, namely textiles, leather, metals, automobiles, gems & jewellery, transport, IT/BPO and handloom/power loom. It was observed that employment declined by 4.91 lakh during the October-December 2008 quarter, increased by 2.76 lakh during January-March 2009, again declined by 1.31 lakh during April-June 2009; and then increased by 4.97 lakh during the July-September 2009 quarter. Thus, even based on this small sample, estimated employment in the selected sectors has experienced a net addition of 1.51 lakh during the last one-year period from October 2008 to September 2009.

RESPONSE TO THE CRISIS

Fiscal 2009-10 has witnessed a global recovery after a crisis of severe worldwide proportions. The risks of double-dip recession however remain, with need for caution in dealing with high public debt and unwinding of fiscal and monetary stimuli. The Indian economy also saw a turnaround, registering 7 per cent growth during H1 (April –September 2009) of 2009-10, after touching a low of 5.8 per cent in the third and fourth quarters of 2008-09. The balance-payments (BOP) situation improved on the back of a surge in capital flows and rise in foreign exchange reserves, which was accompanied by rupee appreciation.

I. FISCAL RESPONSE

The fiscal expansion undertaken by the Central Government as a part of the policy response to counter the impact of the global economic slowdown in 2008-09 continued in fiscal 2009-10.

- The expansion took the form of tax relief, to boost demand and increased expenditure on public projects to create employment and public assets. The net result was an increase in fiscal deficit from 2.6 per cent in 2007-08 to 5.9 per cent of the revised GDP (new series) in 2008-09 and 6.5 per cent in the budget estimates for 2009-10.
- As part of the fiscal stimulus, the Government enhanced the borrowing limits of the State Governments by relaxing the targets by 100 basis points. As a proportion of the GDP, the Plan expenditure at 5.3 per cent of the GDP in 2009-10(BE) was the highest in recent years. Non-Plan expenditure grew by 19.4 per cent and 14.8 per cent respectively in 2008-09 and 2009-10 (BE).
- The approach of the Government was to increase the disposable income in the hands of the people by expanding public expenditure on programmes like the National Rural Employment Guarantee Act (NREGA) and on rural infrastructure.
- Fiscal 2009-10 saw the strengthening of several public initiatives and programmes with a view to cushioning the impact of the global slowdown on the more vulnerable segments of the population in the country.

- The continuation of the path of fiscal prudence complemented the recovery process in the near term and laid the foundation for reviving the growth momentum in the long term.
- The initiatives have been taken to control fiscal deficit through institutional reform measures like the intention to move towards a nutrient- based subsidy regime in fertilizers; encouraging people's participation in public sector undertakings (PSUs) through disinvestment; and bringing about structural changes in direct taxes through the draft Direct Taxes Code and moving towards a harmonized goods and services tax (GST).
- As part of fiscal stimulus package to revive demand, it was excise that bore the brunt of tax cuts and the effect of economic slowdown was evident in the consumption than on income. Exemption from service tax provided to inter-State or intra-State transportation of passengers in a vehicle bearing "contract carriage permit", with specified conditions.
- Exemption from service tax leviable under "banking and other financial services" or under "foreign exchange broking services" provided to inter-bank purchase and sale Services provided in relation to transport of goods by rail exempted from service tax.

II. MONETARY RESPONSE

The monetary response in India since October 2009 has been calibrate to India's specific macro economic policy in the wake of the global economic crisis, the reserve bank pursued an accommodative monetary policy beginning in March 2008. This policy instilled confidence in market participants, mitigated the adverse impact of the global financial crisis on the economy and ensured that the economy started recovering ahead most other economies.

The stance of monetary policy against this of background was intended to anchor inflation expectations, while being prepared to respond appropriately, swiftly and effectively to further inflationary pressures. Actively manage liquidity to ensure that the growth in demand for credit by both the private and the public sectors in a non-disruptive way. Maintain an interest regime consistent with price, output and financial stability.

The monetary policy specifies the following measures:

- The repo rate(the rate at which RBI lends to banks) has been raised by 25 basis points from 5.0% to 5.25%
- The reverse repo has been increased by 25 basis points from 3.5% to 3.75%
- The cash reserve ratio (CRR) of scheduled banks has been by 25 basis points from 5.75% to 6.0%.

OUTLOOK FOR INDIA: CONCLUDING OBSERVATIONS

- India has by-and-large been spared of global financial contagion due to the sub-prime turmoil since 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 along with a very comfortable level of forex reserves.
- The credit derivatives market is in an embryonic stage; there are restrictions on investments by residents in such products issued abroad; and regulatory guidelines on securitization do not permit immediate profit recognition.
- Financial stability in India has been achieved through perseverance of prudential policies, which prevent institutions from excessive risk taking, and financial markets from becoming extremely volatile and turbulent.
- In spite of being one of the least affected by the global crisis, risks such as double-digit recession with high unemployment rate, growing fiscal deficit and high public debt - GDP ratios in advanced economies remain, which can have direct implications for the Indian economy, with increasing integration with the rest of the world.
- The recent global financial turmoil raised many issues about governance of financial intermediaries and awareness of investors. Investor awareness is a prerequisite for investor protection. In fact, investor protection and education are two sides of the same coin. A simultaneous and coordinated effort on both fronts would help investors take well-informed financial decisions besides protecting their interests and ensuring orderly conditions in markets. Greater effort therefore is needed for investor education and promoting investors' protection.
- There are some deep changes that have taken place in India, which suggest that the economy's fundamentals are strong. First, the rates of savings and investment have reached levels that even ten years ago would have been dismissed as a self-delusion for India. On this important dimension, India is now completely a part of the world's fast growing economies. In 2008-09, gross domestic savings as a percentage of GDP were 32.5 per cent and gross domestic capital formation 34.9 per cent.
- There has been a revival in investment and private consumption demand, though the recovery is yet to attain the pre-2008 momentum. Indian exports also have recorded impressive growth in November and December 2009 and early indications of the January 2010 data on exports are encouraging. Further, infrastructure services, including railway transport, power, telecommunications and, more recently but to a lesser extent, civil aviation, have shown a remarkable turnaround since the second quarter of 2009-10.
- In an analysis of 63 companies of the list of BSE 500 that announced their results for the last quarter of 2009-2010 by April 24, 2010, the year on year aggregate profit growth was a healthy 26%, with the corresponding revenue growth of 50%. The total profits of the 63 companies rose from Rs. 15156 crore in the quarter ended March 2009 to Rs. 19,099 crore in the latest quarter.
- Therefore, a reasonable forecast for the year 2010-11 is that the economy will improve its GDP growth by around 1 percentage point from that witnessed in 2009-10. Thus, allowing for factors beyond the reach of domestic policymakers, such as the performance of the monsoon and rate of recovery of the global economy, the Indian GDP is expected to grow around 8.5 +/- 0.25 per cent, with a full recovery, breaching the 9 per cent mark in 2011-12. If, in addition to this, there are improvements in infrastructure, both urban and rural, and reform in governance and administration, which cuts down bureaucratic transactions costs that slow down enterprise in India and breed corruption, it is entirely possible for India to move into the profound domain of double-digit growth and even attempt to get into the mantle of the fastest-growing economy in the world within the next four years.

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