
2009 KfW Financial Sector Development Symposium–

Crisis Resilience of Financial Markets

By

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SMALL INDUSTRIES DEVELOPMENT BANK OF INDIA

We empower MSMEs

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India Growth Story – Pre-crisis Period

- Average GDP growth rate of 8.8% during 2003-08
 - High Savings as % of GDP – 37.7% in 2007-08
 - High Investment rate as % of GDP – 39.1% in 2007-08
 - Robust Credit Growth - 28% during 2005-08
 - Buoyant Capital Market
 - BSE Sensex grew by more than 36% annually during 2005-08
 - Fiscal deficit reduced to 2.7% in FY 2008
 - Stable Forex Market
 - Forex Reserve reached high of USD 312 bn in June 08
 - High Net Capital Inflow USD 108 bn in FY 2008
 - Comfortable current account deficit -1.5% in FY 2008
 - Increasing Exports – 25% annually during 2005-08
 - Greater thrust on infrastructure development to support the growth
 - Growth also driven by strong domestic demand
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Transmission of Crisis

- De-coupling never happened in reality
- However, “pass-through effect” not complete
- Crisis transmitted to
 - Credit Market
 - Capital Market
 - Forex Market and
 - Real sector
 - through trade, finance and confidence Channel

Crisis Impact on Financial Markets

Liquidity Shortage – Increased Credit Demand

- Liquidity declined in International markets
 - Break-down in payments chain
- Increased demand for bank credit
 - Indian companies shifted from foreign sources to domestic banks
- Liquidity problem for NBFCs
- Heavy redemption in Mutual Funds
- As crisis spread to real sector, banks became cautious – a pause in lending to assess impact

Crisis Impact on Capital Markets

- Equity sell off by FFIs, Indian companies and Public
 - BSE Sensex fall from peak of 21000 to 8000
- Net capital Inflows declined heavily
 - USD 9.1 Bn in 2008-09 from USD 108 bn in 2007-08
- FII net investment in Equity turns negative
- Reduced investment in equity market by MFs > 134%
- Money lost the role of 'store of value' or 'asset value'

Crisis Impact on Forex Markets/ Balance of Payment

- Increased volatility
- Reversal in Capital Flows due to
 - FFIs sell-off
 - Falling remittances,
 - declining exports,
 - reduced volume of ECBs
- Exchange rate depreciated by around 9%
- Forex Reserve declined by USD 40 bln in 6 months
 - from USD 292 bn in Sep 08 to USD 252 bn in March 09
- Current account deficit increased to 13% in Oct-Dec, '08

Crisis Impact on Micro Finance Institutions (MFIs)

- Crisis affected more to medium and small MFIs
 - 5 largest MFIs recorded more than 71% increase in O/s portfolio during FY 2008-09
 - Medium Size MFIs portfolio growth reduced from 72% to 29%
 - Small Size MFIs recorded negative growth
- Rural Based MFIs recorded higher growth
- MFIs having diversified portfolio suffered less
 - Less impact with services sector clients
- Not much impact of credit risk
 - PAR (30 days) showed improvement to 0.5% and much less 0.2% for top 10 MFIs
- No increase in Interest rates

Crisis Impact on Overall Economy

- Indian Economy experienced growth moderation
 - Average growth rate slowed down from 8.8% during preceding 5 years to 7.7% during first half of FY 2009 and Further to 5.8% during the second half of FY 2009
- Industrial sector growth turns negative in Q4 of FY 2009
- Export growth turns negative
- Services sector remained immune from shock and grown by 9% during second half of FY 2009

Resilience of Indian Financial Markets

- Financial market showed resilience
 - Quick return to normalcy
 - Banking sector not affected – Banks dominate financial system
 - No unregulated segment in financial system
 - No direct exposure to US sub-prime market
 - Capital adequacy of Banks over 13%
 - Mandatory investment in G-secs - solvency & liquidity
 - Sectoral limits – high risk mitigant
 - Prudential exposure norms for CRE, infrastructure, etc.
 - Prudential norms for asset classification, income recognition, etc.
 - Net NPA - 1.1%
 - Improvement in overall efficiency
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Resilience of Indian Financial Markets

- Resilience also due to prompt and prudent Monetary Policy
- Active counter–cyclical policy facilitated by favorable factors
 - Falling inflation and
 - Declining international commodity prices
- Important Monetary measures
 - Liquidity injection (by almost USD 100 billion)
 - through reduction in key policy rates (CRR, SLR)
 - Sector specific liquidity packages for housing, MSMEs, Mutual Funds, NBFCs, etc.
 - Advised banks to consider restructuring of MSME loans
 - Reduced provisioning requirements
 - Extend the period of Rupee export credit
- Delivered three objectives of economic growth, price stability and financial stability
- Managing ‘Impossible Trilemma’

Resilience of Indian Financial Markets

Fiscal Stimulus

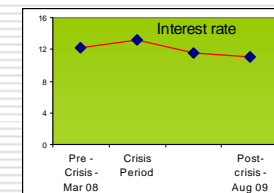
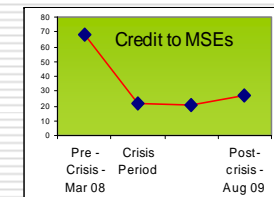
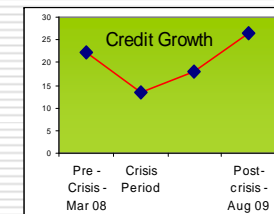
- Boosting 'Effective Demand' of the economy
- Stimulus packages by Government of India
 - Pump priming of almost USD 640 million
 - Reduction in taxes and duties
 - Enhancement of ECGC Guarantee
 - Changes in Credit Guarantee Scheme
 - Stronger thrust on infrastructure investment
 - 'Crowding in' private investment
 - Increased expenditure on social sector - NREGA

Fiscal Policy and Monetary policy working in great coordination

Resilience of Indian Financial Markets

Impact of policy measures on Financial Sector

- Credit growth improved
 - March 08 – 22.3% , August 08 -13.3%
 - March 09 - 18.1% , August 09 -26.5%
- Credit growth to MSE sector increased
 - March 08 – 67.7% , August 08 -21.1%
 - March 09 – 20.4% , August 09 -27.4%
- Interest rates declined
 - March 08 – 12.25-12.75% , August 08 -13.25-14%
 - March 09 – 11.5-12.5% , August 09 - 11-12%
- NPA level contained
- Capital Market Recovered
- Stability in Forex Market



Resilience of Indian Financial Markets

Impact of policy measures on Real Sector

- Faster economic recovery – ‘V’ shape
- Projected GDP growth rate – 6-7% for FY 10 and 7.7% for FY 11
- Industrial Sector and Infrastructure sector started recording growth
 - Index of Industrial production (IIP) for August 2009 accelerated
- Robust growth in FDI volume
 - Higher expected capital inflow in FY 2010
- Indian economy ‘Re-emerging’
 - One of the leading country for the global economic recovery

Way Ahead

- Sustained financial sector reforms in the Indian financial system
 - Following reforms to global standards adjusted to local conditions
 - Strengthening risk management system and monitoring
 - Enhancing core capital of banks
 - Deepening of financial services and promoting inclusive growth
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THANK YOU

