

**T**HE worldwide banking industry has been one of the worst affected by the ongoing financial crisis. Aggressive marketing of products and unchecked lending operations have led many of the global financial majors down the alley, forcing governments – especially those in the US and Europe – to come to the rescue with expensive bail-out packages.

The unprecedented shake-out of the banking sector has seen some of the most reputed and venerated financial institutions being humbled in recent months. Not only have these institutions turned bankrupt, but many banks have also had to write-off their huge exposures in the troubled entities.


Fortunately for the Indian banking industry, none of the players have been dragged into the vortex and the government has also not had to launch rescue operations. Both Prime Minister Manmohan Singh and Finance Minister P. Chidambaram have been interacting frequently with the Reserve Bank of India (RBI) Governor, D. Subbarao, and with the managements of both public and private sector banks. The RBI has been monitoring the developments in the global financial sector closely, intervening frequently with timely regulations to calm an uncertain industry. The fiscal policies of the RBI and the close monitoring of the economy by the government have ensured that the banking sector has not had to take any major hits on account of the global crisis.

The RBI, which had been raising rates and tightening credit in the early part of this year to curb inflationary trends in the economy, went in for a reversal to ensure that the economy was not starved of funds when foreign institutional investors (FIIs) began dumping shares and withdrawing billions of dollars from India's capital markets, leading to a liquidity squeeze.

When the Sensex – the benchmark index on the Bombay Stock Exchange – plummeted from a high of 20,000-plus in January 2008, to sub-8,000 levels in October 2008, many FIIs panicked and made hasty withdrawals. During the first 10 months of 2008, there was a net outflow of US\$12 billion of FII investments from the stock markets (as against a net inflow of US\$17.5 billion during the same

# SOUND AND STABLE





The global financial crisis, which has humbled many international banks and institutions, has had minimal impact on India, thanks to a well capitalised and well regulated banking industry, says **Nayantaraa Lama**

period in 2007).

The Indian rupee also plunged, breaching the Rs 50 (to the US dollar) mark in October 2008. Foreign exchange reserves declined sharply, falling from a high of US\$315 billion in May to around US\$270 billion in October.

Once again, the RBI intervened promptly by lowering both the cash reserve ratio (CRR) and the repo (the key short-term lending rate) to 5.5 per cent and 7.5 per cent respectively. Both the CRR and the repo rate had peaked at 9 per cent in July 2008. By the time the full impact of the financial crisis reverberated around the globe, the RBI began reducing both the CRR and the repo, injecting over \$20 billion into the economy. The central bank has also modified the norms governing external commercial borrowings (ECB). Corporates can now borrow up to US\$500 million a year for rupee expenditure and/or foreign currency expenditure for permissible end-uses under the automatic route.

The sensible policies of the RBI and the close monitoring of the economy and the financial services sector by the government have ensured that the Indian banking sector has not had to take any major hits on account of the global crisis. The World Bank says India is in a position to withstand the crisis, even though it might slow down the country's economic growth. "India, like China, has been growing very well," notes Robert Zoellick, president, World Bank. "I think you will see some slowdown, but for a number of reasons I hope India will be in a position to weather the storm. There are issues that the government is focusing on and the Prime Minister is keenly aware of them."

Chanda Kochhar, joint managing director, ICICI Bank, says, "While growth projections for our economy have been revised from 8 per cent to 7.5 per cent to 8 per cent, we still remain one of the fastest growing economies in the world. This should also be seen in context of the overall slowdown in global economic growth – China's growth rate in the third quarter this year has declined to less than 10 per cent for the first time in more than five years."

Indian banks have been reassuring customers about the safety of their deposits, not only in the immediate future but also in the days ahead. Subbarao reiter-

ates that the country's financial sector is stable and healthy and that Indian banks do not have any direct financial exposure to the US sub-prime assets. "Foreign subsidiaries and foreign branches of Indian banks have suffered some mark-to-market losses on financial instruments due to the general widening of credit spreads," he points out. "These losses are modest relative to the size of their business. Adequate provisioning has been made for these."

According to him, "The overall capital adequacy ratio of commercial banks in India is 12.7 per cent, well above the regulatory minimum of 9 per cent and the Basel Accord requirement of 8 per cent. Furthermore, the regulatory mandate of 25 per cent as statutory liquidity ratio (SLR) and 6.5 per cent as CRR provides an inherent strength to Indian banks."

One of the most prominent symptoms of the problem in the financial sectors of advanced countries has been the freezing up of inter-bank markets. "On the

contrary, the inter-bank market in India has been functioning in an orderly manner," he adds. Public sector banks have also expressed optimism on withstanding this global crisis. The majority sentiment in the industry is that the Indian banking industry is better poised to cope with the current global financial crisis as stricter regulations are in place.

"The Indian banking sector is better placed to cope with the adverse consequences of the ongoing financial turmoil in the West," remarks M.D. Mallya, global chairman and managing director of public sector Bank of Baroda. "In order to strengthen capital requirements, the credit conversions factors, risk weights and provisioning requirements for specific off-balance sheet items, including derivatives, have been reviewed in the last few years. Moreover, in India, complex structures like synthetic securitisation have not been permitted so far."

The RBI, in a temporary measure to

help mutual funds, has allowed banks to avail of additional liquidity support of up to 0.5 per cent of their net demand and time deposits. This is in addition to the ad hoc reduction in the statutory liquidity ratio to 24 per cent. Banks have also been allowed to raise interest rates on NRI deposits so that more money would flow to India.

Overall, the macro effects of the global financial turmoil on India would remain muted due to the strength of its domestic demand and the reasonably healthy balance sheet of its corporate sector.

"Although the global financial crisis would have an adverse impact on the Indian financial sector, it would not extend to a huge amount," explains Jagdish Capoor, chairman, HDFC Bank. "The economy is likely to be protected. We have seen some impact, but that is because people are withdrawing assets from the market."

The RBI has advised banks to unwind their interest rate swap (IRS) transactions with Lehman Brothers, even as the

## STRONG RESERVES AND GROWTH POTENTIAL CUSHION ECONOMY FROM SHOCKS

INDIA'S strong foreign exchange reserves position has helped the country withstand the massive fluctuations on the currency front. The rupee came under intense pressure following the huge repatriation of funds by foreign institutional investors (FIIs).

But thanks to the reserves, the Indian rupee managed to withstand the onslaught and staged a smart comeback. Continued inflow of foreign direct investment (FDI) and buoyant international trade have also helped the economy.

While global trade flows have been hurt severely following the sustained financial crisis and the recessionary conditions in many advanced economies, India's export growth has slowed down.

"Emerging and developing economies have not decoupled from this downturn," says Union Minister for Commerce and Industry, Kamal Nath. "GDP growth of advanced economies (the US, Canada, Germany, France, the

UK and Japan) would slow down to 1.5 per cent in 2008 and 0.5 per cent in 2009, from a level of 2.6 per cent in 2007."

Global growth (real GDP) is projected to slow down to 3.9 per cent in 2008 and 3 per cent in 2009, as against 5 per cent in 2007. The International Monetary Fund (IMF) has scaled down its forecast for World Trade Volumes (both goods and services) from 6.1 per cent projected in July to 4.9 per cent for 2008. This is against a robust 9.3 per cent in 2006 and 7.2 per cent in 2007.

Worse, imports by advanced economies are expected to slow down to 1.9 per cent in 2008 and 1.1 per cent in 2009, as against 4.5 per cent in 2007.

India's exports during the first half of the current fiscal (April-September) grew by 30.9 per cent, amounting to US\$94.97 billion, as against US\$72.55

billion in the same period of the previous fiscal. Exports in September were up by 10.4 per cent (over the September 2007 figure), adding up to US\$13.74 billion. Imports in September, however, were up by 43.3 per cent at US\$24.38 billion; in the first half of the fiscal, imports grew by 38.6 per cent to US\$154.74 billion.

Oil imports accounted for US\$55.06 billion in the April-September period this fiscal, up 59.2 per cent over the same period last year. Non-oil imports grew by 29.3 per cent to US\$99.68 billion in the first half of the financial year. The trade

deficit for April-September 2008 is estimated at US\$59.77 billion, as against US\$39.09 billion in the same period last year.

But given the strong reserves position and the potential for continued growth, the Indian economy can cushion itself from such shocks.



158-year-old investment banking giant's market loss over the past year exceeded the combined market loss of all Indian banks put together for the same period.

According to O.P. Bhatt, chairman, State Bank of India – the country's largest commercial bank – "The indirect adverse impact of the sub-prime crisis is being felt in the form of tightening system liquidity and firmness in pricing, which has kept rates from softening. The full impact is still getting revealed and affecting more institutions and countries."

The impact of the sub-prime crisis in India, however, is likely to be limited because of the small size of the external sector and prudent policies put in place by the regulators and policy makers, adds Bhatt. In the wake of the crisis, Prime Minister Singh assured the Lok Sabha – the Lower House of the Indian Parliament – that "Our first concern is to ensure the stability of our banking system. The Indian banking system is not directly exposed

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to the sub-prime mortgage assets. Their exposure to other problem assets is also minimal. Our banks, both in the public sector and in the private sector, are financially sound, well capitalised and well regulated. There should be no fear of a failure of any bank. In particular, I wish to assure depositors in our banks that their deposits are entirely safe. Many observers have described this as the worst crisis since the Great Depression of 1930s. India, like other developing countries, is experiencing the ripple effects of the financial crisis. However, we have taken a number of steps to minimise the impact."

By ensuring adequate liquidity in the banking system, the government has ensured that the biggest challenge to the financial services sector has been handled wisely, without resorting to panicked measures. Indeed, many countries are enviously looking at India's banking industry, hoping to emulate the regulations. 