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GLOBAL FINANCIAL CRISIS: PERFORMANCE & RESPONSES OF BANKING SECTOR IN INDIA

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1. INTRODUCTION

The Global Financial Crisis which was emerged since mid-2008 tested the boundaries of the functioning of the Global Financial System and magnified the interlink ages between financial and real economy. When some of the Prime Wall Street Financial Institutions collapsed the US Sub Prime Market problems in August 2007 reached their peak leading to the worldwide confidence failure during September 2008. Financial Institutions were almost unwilling to lend to each other and Credit Market virtually froze. In early stages, the loss of confidence was responsible for declining assets and commodity prices, deleveraging, unemployment, falling incomes, shrinking demand and trade and trade and capital flows in the advanced economies. EME's (Emerging Market Economies) were also affected substantially by the crisis. As the bankruptcy of Lehman Brothers Inc. in mid-September 2008, the turmoil in Financial Sector of Advanced Economies travelled to the same of EME's. Thus, as a Sub Prime Crisis in the US housing market in August 2007 relatively turned into a Global Banking Crisis, a Global Financial Crisis and finally as a Global Economic Crisis.

2. INTERNATIONAL RESPONSES TO THE CRISIS:-

In the deteriorating environment the crisis evoked unprecedented policy responses. Both conventional and unconventional actions were taken by the national governments and central banks of several countries. The responses included varying combinations of monetary and fiscal measures, deposit guarantees, debt guarantees, capital injections and assets purchases which were coordinated globally. Restoring normalcy and strengthening financial regulation or supervision was the policy attention of advanced countries. EME's were also to be active partners to find out meaningful resolution mechanism to this global problem.

The forceful and coordinated policy actions got successful in diminishing the initial damages. Moreover, the unconventional measures have posed several challenges and risks while helping in the stabilizing financial system.

3. INDIAN FINANCIAL SECTOR AND IT'S RESPONSES TO THE MELTDOWN

The Global Financial Crisis originated in mortgage sector in US spread to the entire financial system and the real economy across countries.[1] With the increasing integration of the Indian Economy and its financial markets with rest of the world, there is recognition that the country does face some downside risks from these international developments.[2] During the initial phase of the crisis, the impact of the Indian financial markets was rather muted; however, since mid-September 2008, the impact on Indian financial market became amplified. India's financial markets – equity markets, forex market, and credit markets had all came under pressure.[3]

On the financial side, the RBI took a series of measures in matching risk management with supervisory and regulatory actions. The RBI shifted its policy stance from monitory tightening in response to the elevated inflationary pressures in the first half of 2008-2009 to monitory easing in response to easing inflationary pressures and moderation of growth engendered by the crisis. Through the Reserve Bank's actions, the cumulative amount of primary liquidity potentially available to the financial system is about 7 per cent of GDP.[4]

The government launched three fiscal stimulus packages between December 2008 and February 2009. These stimulus packages came on top of an already announced expanded safety – net programme for the rural poor, the farm loan waiver packages and payout following the Sixth Pay Commission Report, all of which added to stimulating demand. The combined impact of these fiscal measures is about 3 per cent of GDP.[5]

4. PERFORMANCE OF BANKING SECTOR IN INDIA

Being well capitalized and having greater exposure to domestic conventional assets, the strength and resilience was derived in the balance sheets of Indian banks. The direct effects of the Global Financial Crisis on the Indian Banking and Financial System were almost negligible due to limited exposure to riskier assets and derivatives and the relatively low pressure of Foreign Banks (Thorat 2009). Prima facie, Indian banks faced the stess because foreign investors pulled out of the economy and created a liquidity crunch. There was suddenly less money to borrow or lend. The tightened global liquidity situation in the period immediately following the failure of Lehman Brothers Inc. 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 banks cautious about lending (Subbarao,2009). At the same time, corporate and retail investors exerted redemption pressures on mutual funds, some of which got transmitted to NBFCs due to their dependence for funds on mutual funds. Thus, despite of not being getting a hit on the balance sheets, Banks and other Financial Institutions were impacted by the indirect spillovers of the crisis during 2008-09.[6]

Indicators	Large banks		Big banks		Medium banks		Small banks	
	2008	2009	2008	2009	2008	2009	2008	2009
1	2	3	4	5	6	7	8	9
(i) No. of banks	9	9	17	17	20	19	16	16
(ii) Proportion of time deposits to total deposits	62.79	66.29	66.05	68.69	68.51	68.81	67.19	72.51
(iii) Proportion of liquid assets to total assets	31.30	31.39	32.39	31.94	33.48	32.51	38.13	37.26
(iv) Proportion of term loans to total loans	55.75	55.61	61.50	61.52	54.96	54.00	42.07	37.36
(v) Return on advances	8.86	9.40	8.92	9.91	9.52	11.25	8.62	10.50
(vi) Return on investments	6.66	6.55	6.80	6.56	6.58	6.28	6.50	6.26
(vii) Cost of deposits	5.33	5.65	5.42	5.74	5.63	5.93	4.15	5.47
(viii) Proportion of contingent liability to total assets	129.65	86.72	262.03	148.91	331.19	302.81	3325.33	1698.61
(ix) Interest spread	3.53	3.75	3.50	4.17	3.89	5.32	4.47	5.04
(x) Proportion of interest income to total income	85.14	85.60	85.19	85.35	83.57	83.98	75.25	73.16
(xi) Proportion of other income to total income	14.86	14.40	14.81	14.65	16.43	16.02	24.75	26.84
(xii) Proportion of provision to total loans	1.67	1.73	1.71	2.36	1.66	2.51	4.42	7.92
(xiii) CRAR	13.12	13.15	11.80	12.18	13.06	13.67	14.93	16.28
(xiv) NNPA ratio	1.04	1.06	0.78	0.90	0.80	0.92	0.87	1.48

Source: Report on Trend and Progress of Banking in India, 2008-09.

The banks were comparatively better positioned in terms of capitalization, the capital to risk weighted assets stood higher than that of the banks in EME's and advanced economies. Indian banks had lower NPAs comparing to the advanced and EMEs. The rate of return was lower but it was higher than the banks of advanced countries. The improved proportion of time deposits to total deposits in 2008-09 indicates the improved confidence of public in banks. All commercial banks met the minimum capital adequacy norm of 9 percent as at end of March-2009. However, the share of liquid assets declined marginally during 2008-09, it remained near about to the level just for the level of previous year in case of the large banks. (See Table 1)

The deposits growth of commercial banking declined marginally during 2008-09, as well growth in bank credit declined at faster pace than deposits during 2008-09. As the liquidity pressures in the financial markets, the growth in borrowing by commercial banks declined sharply during 2008-09. In the sense of economic slowdown, the steep fall in the CD Ratio, emerged from lower credit relieved commercial banks from the pressure of resource mobilization through borrowing. Commercial banks held their available resources in terms of NDTL and SLR at higher range. The growth in investments also declined during 2008-09. The income growth rate in 2008-09 was lower than previous year. (See Table: 2)

Table 2: Growth of Balance Sheet of Scheduled Commercial Banks-Bank Group-wise

Item	Public Sector Banks			Old Private Sector Banks			New Private Sector Banks			Foreign Banks			All SCBs		
1	2007	2008	2009	2007	2008	2009	2007	2008	2009	2007	2008	2009	2007	2008	2009
1. Capital	0.7	5.2	3.6	4.4	1.8	8.2	5.6	14.6	- 3.1	45.4	71.4	16.3	17.3	35.2	10.2
2. Reserve & Surplus	20.0	31.3	20.4	11.6	47.1	14.6	17.4	97.9	9.1	30.6	34.7	25.8	20.0	45.3	17.7
3. Deposits	22.9	23.1	26.9	6.0	19.8	20.3	38.8	23.1	5.4	31.5	26.8	12.0	24.6	23.1	22.4
4. Borrowings	5.7	28.4	1.2	22.3	8.0	22.6	42.8	26.3	7.1	33.0	14.1	20.3	19.6	24.5	6.8
5. Other Liabilities & Provisions	16.3	25.6	21.3	16.1	21.6	8.1	51.1	17.3	12.8	72.4	65.5	57.8	28.1	29.0	15.4
Total Liabilities / Assets	21.1	23.8	24.6	7.1	21.2	19.3	38.7	27.5	6.7	37.6	32.7	22.8	24.2	25.0	21.2
1. Cash & Balances with RBI	26.1	61.5	-2.4	25.9	74.4	-14.6	93.7	74.2	-20.7	49.8	81.2	-28.9	35.2	65.4	-8.0
2. Balances with Banks & Money at Call & Short Notice	26.8	-32.6	106.5	5.8	-24.2	47.1	91.9	-33.7	27.8	41.9	- 25.1	66.8	35.9	- 33.1	82.0
3. Investments	4.9	20.3	26.6	-3.6	23.9	33.7	26.4	31.3	4.3	36.4	38.4	31.8	9.7	23.8	23.1
4. Loans & Advances	30.2	24.8	25.7	12.0	20. 2	15.1	39.9	26.4	9.9	29.5	27.5	2.7	30.6	25.0	21.2
5. Fixed Assets	37.7	42.6	17.2	-5.6	26.1	8.0	4.2	15.9	1.2	24.4	32.3	19.4	25.0	35.2	14.1
6. Other Assets	7.1	31.0	2.0	0.7	-1.7	28.2	33.9	28.3	19.8	72.9	67.0	68.1	22.5	38.2	25.0

Source: RBI, Report on Currency & Finance, P. 220

Banks with negative deposit growth and a pressure on resources during 2008-09 witnessed a significant fill in their credit growth; these banks had higher NPAs also. These banks have lower proportion of time deposits.

Thus, the financial crisis, seems to have had an adverse impact on banks having fewer core deposits. During this period the stable deposit situation was helpful in withstanding the liquidity squeeze. Those banks having significant decline in credit growth in 2008-09 experienced a steep fall in their off balance sheet exposure. In contrary, banks having high credit growth expanded their off balance sheet exposure. (See Table: 3)

Table 3: Credit Growth and Financial Performance: 2008-09

Credit growth	Less than 0 per cent	0-10 per cent	10-20 per cent	More than 20 per cent
1	2	3	4	5
(i) No. of banks	11	5	17	28
(ii) Proportion of time deposits to total deposits	63.6	72.6	70.4	70.5
(iii) Proportion of liquid assets to total assets	39.6	33.8	33.0	31.2
(iv) Proportion of term loans to total loans	44.2	53.5	51.2	55.2
(v) Return on advances	11.8	11.9	10.4	9.6
(vi) Return on investments	6.6	6.3	6.3	6.4
(vii) Cost of deposits	5.0	6.5	5.9	5.8
(viii) Proportion of contingent liability to total assets	2377.6	291.1	226.9	170.6
(ix) Interest spread	6.8	5.4	4.5	3.9
(x) Proportion of interest income to total income	65.2	81.5	85.9	85.8
(xi) Proportion of other income to total income	34.8	18.5	14.1	14.2
(xii) Proportion of provision to total loans	11.8	3.2	2.2	1.7
(xiii) CRAR	15.9	15.9	13.3	13.1
(xiv) NNPA ratio	1.5	1.4	0.9	1.0
(xv) Deposits growth	-3.4	3.1	18.8	28.9
(xvi) Contingent liability growth	-29.4	-10.2	-11.2	20.0
(xvii) Investments growth	30.4	24.6	27.7	31.2
(xviii) Advances growth	-10.5	5.0	15.2	30.9
(xix) Equity growth	23.5	22.3	30.6	33.5
(xx) Liquidity growth	18.9	10.2	17.7	23.0

Source: Report on Trend and Progress of Banking in India, 2008-09.

5. CONCLUSIONS

1) The Indian Banking System is not directly exposed to the Subprime Mortgage Assets. It has very limited indirect exposure to the US mortgage market, or to the failed institutions or the stressed assets.

2) Indian banks, both in the private and public sector are financially sound, well capitalized and well regulated.

3) Banks in Indian context were impacted not directly but by the indirect spillovers, despite not being hit on the balance sheets.

4) Though the declined share of liquid assets, in the form of improved deposits indicated the improved confidence of public.

5) Only the banks having fewer core deposits experienced the adverse impact of the crisis but on the other hand these banks had higher NPAs also.

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