INDIAN ECONOMY TO GLOBAL FINANCIAL CRISIS - A CASE STUDY

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ABSTRACT

The global financial crisis is bound to have a major impact on developing countries, with the International Monetary Fund (IMF) having downgraded its growth forecasts for 2009 by nearly two percentage points over the last two months for both developed and developing countries. Net financial flows to developing countries may fall by as much as $300 billion over 2007-2009, equivalent to a 25% drop. The impact of the crisis on developing countries will affect four different types of international resource flows: private capital flows such as Foreign Direct Investment (FDI), portfolio flows and international lending; official flows such as development finance institutions; and capital and current transfers such as official development assistance and remittances. In this case the author has considered the effect of global financial crisis on Indian economy by putting different issues related to private capital flows and probable solutions suggested by CII.

Key words: Financial Crisis, Private Capital flows, Reserve Bank, Mortgage

INTRODUCTION

The turmoil in the international financial markets of advanced economies that started around mid-2007 has exacerbated substantially since August 2008. The financial market crisis has led to the collapse of major financial institutions and is now beginning to impact the real economy in the advanced economies.

Recent events in the global financial system have been nothing short of seismic. Hundreds of billions in capital value have been lost in stock markets. Inter-bank credit has almost frozen up. Actual costs of borrowing have gone up (even with falling central bank interest rates), unemployment has been rising in the major world economies, and home foreclosures and bankruptcies are on the rise. This crisis is sought to be addressed by a variety of policy initiatives, the most important aspects of which are the injection of vast amounts of public funds into financial institutions and the provision of sovereign guarantees on bank accounts. But the ability to do so is limited. The budget deficit for 2008 in the US has trebled as compared to its forecasted value and the ratio of public plus private debt to GDP is well over 300 percent. The huge injection of funds to stabilize the financial system will need to be financed. But the US treasury is already stretched and, with a recession looming, prospects for enhanced tax revenue in 2009 do not appear bright. The subprime mortgage crisis is an ongoing financial crisis characterized by contracted liquidity in global credit markets and banking systems triggered by the failure of mortgage companies, investment firms and government sponsored enterprises which had invested in subprime mortgages. The crisis, which has roots in the closing years of the 20th century but has become more apparent throughout 2007 and 2008, has passed through various stages exposing pervasive weaknesses in the global financial system and regulatory framework. The investment banks are the models of modern financial products, offering advisory services. Their main function is capital market funding for corporate houses, bringing innovative financial products, offering advisory services for restructuring, innovating, expanding businesses. Their ability & expertise to create new products & structures resulted in increased willingness to lend. The borrowed funds were invested to buy assets, wherein returns from trading these assets were higher than borrowing costs. This was possible for lower Fed rates. Investment banks bought mostly liquid assets 7 for illiquid assets; they managed to create liquidity through "Financial engineering"

As this crisis is unfolding, credit markets appear to be drying up in the developed world. With the substantive increase in financial globalization, how much will these developments affect India? India, like most other emerging market economies, has so far, not been seriously affected by the recent financial turmoil in developed economies. Reasons for the relative resilience shown by the Indian economy to the ongoing international financial markets' crisis will be followed by some discussion of the impact till date on the Indian economy and the likely implications in the near future.

Aim of the Study

This paper endeavors to fit a silver lining to the cloud .Broadly speaking, to find opportunities in trouble and finding new avenues by adopting steps to alleviate global financial crisis.

Who is to be blamed?

Legislators in the U.S who dreamt of financial inclusion in terms of home for every American regardless of the repayment capacity, created Freddie Mae & Freddie Mac (government sponsored entities that bought 80% of all US mortgages, bought toxic mortgaged papers via CDOs. The idea for cheap & easy credit via securitization was floated. The CDO Rating agencies like Moody's, S&P converted low rated mortgages into high rating securities.CDS was created - the insurance against defaults. Finally, CDS issues were bloating , banks and lenders cleaned their balance sheets by selling these securities. Investment shifted their focus from advisory services (underwriting, wealth management, IPO management) to use the borrowed money to the extent that leverage ratio had gone up by 30 times. Consequently, top five investment bank collapse, Lehman Brothers filed bankruptcy petition Bear sterns and Merrill lynch have been acquired by band, and Morgan Stanley and Goldman-Sachs have been converted into commercial banks. The dilution of BASEL II rules for banks is also responsible for the havoc. (Iceland's banks facility by holding loans more than the country's GDP). Last but not the least is the US consumers whose savings went into negative.

The crisis began with the bursting of the United States housing bubble and high default rates on "subprime" and adjustable rate mortgages (ARM), beginning in approximately 2005-2006. For a number of years prior to that, declining lending standards, an increase in loan incentives such as easy initial terms, and a long-term trend of rising housing prices had encouraged borrowers to assume difficult mortgages in the belief they would be able to quickly refinance at more favorable terms. However, once interest rates began to rise and housing prices started to drop moderately in 2006-2007 in many parts of the U.S., refinancing became more difficult. Defaults and foreclosure activity increased dramatically as easy initial terms expired, home prices failed to go up as anticipated, and ARM interest rates reset higher. Foreclosures accelerated in the United States in late 2006 and triggered a global financial crisis through 2007 and 2008. During 2007, nearly 1.3 million U.S. housing properties were subject to foreclosure activity, up 79% from 2006. Major banks and other financial institutions around the world have reported losses of approximately US$435 billion as of 17 July 2008. The liquidity concerns drove central banks around the world to take action to provide funds to member banks to encourage lending to worthy borrowers and to restore faith in the commercial paper markets. The U.S. government also bailed out key financial institutions, assuming significant additional financial commitments. The risks to the broader economy created by the financial market crisis and housing market downturn were primary factors in several decisions by the U.S. Federal Reserve to cut interest rates. During the week of September 14, 2008 the crisis accelerated, developing into a global financial crisis. Following a series of ad-hoc market interventions to bail out particular firms, a $700 billion proposal was presented to the U.S. Congress in September, 2008. These actions are designed to stimulate economic growth and inspire confidence in the financial markets. On 3 October 2008, President George W. Bush signed the amended version of the bill into law. The following week the Dow-Jones index of the largest companies traded on the U.S. stock market declined 22%, the worst week in the index's 118-year history. Since 1 January, 2008, owners of stocks in U.S. corporations have suffered about $8 trillion in losses, as their holdings declined in value from $20 trillion to $12 trillion. Losses in other countries have averaged about 40%.

Subprime lending is the practice of making loans to borrowers who do not qualify for market interest rates owing to various risk factors, such as income level, size of the down payment made, credit history, and employment status. The value of U.S. subprime mortgages was estimated at $1.3 trillion as of March 2007, with over 7.5

million first-lien subprime mortgages outstanding. Approximately 16% of subprime loans with adjustable rate mortgages (ARM) were 90-days delinquent or in foreclosure proceedings as of October 2007, roughly triple the rate of 2005. By January 2008, the delinquency rate had risen to 21% and by May 2008 it was 25%. The U.S. mortgage market is estimated at $12 trillion with approximately 9.2% of loans either delinquent or in foreclosure through August 2008.Subprime ARMs only represent 6.8% of the loans outstanding in the US, yet they represent 43.0% of the foreclosures started during the third quarter of 2007. During 2007, nearly 1.3 million properties were subject to foreclosure filings, up 79% versus 2006. An estimated 936,439 U.S homes were lost to foreclosure between August 2007 and November 2008 The ongoing US subprime mortgage crisis is likely to depress the Indian stock markets in addition to creating cash flow problems for the corporate. In the event of a dramatic tightening of credit, some of the sources of capital like Foreign Institutional Investors, Foreign Direct Investment and External Commercial Borrowing, could dry up. (The Economist).

Impact of the Crisis on India

How the Indian economy is expected to fare in the short-term and how has it responded to the crisis? So far the global financial crisis has had three major impacts on the Indian economy:

(i) The quantum of liquidity available during the first half of FY 2008-09 is about a third lower than during the first half of FY 2007-08;

(ii) With slackening external demand, export growth is expected to slow; and

(iii) Foreign Institutional Investors have withdrawn from Indian stock markets leading to sharp falls in key indices.

While the overall policy approach has been able to mitigate the potential impact of the turmoil on domestic financial markets and the economy, 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. The risks arise mainly from the potential reversal of capital flows on sustained medium-term basis from the projected slow down of the global economy, particularly in advanced economies, and from some elements of potential financial contagion. In India, the adverse effects have so far been mainly in the equity markets because of reversal of portfolio equity flows, and the concomitant effects on the domestic forex market and liquidity conditions. The macro effects have so far been muted due to the overall strength of domestic demand, the healthy balance sheets of the Indian corporate sector, and the predominant domestic financing of investment. As might be expected, the main impact of the global financial turmoil in India has emanated from the significant change experienced in the capital account

Table: Trend in Capital Flows			
Component	**Period**	**2007-08**	**2008-09**
FDI to India	April-Aug	8,536	16733
FIIs(Net)	April-Sept 26	15,508	-6421
External Commercial Borrowings(Net)	April-June	6,990	1559
Short Term Trade Credits(Net)	April-June	1,804	2173
ECB Approvals	April-Aug	13375	8127
Foreign Exchange Reserves(Variations)	April-Sept 26	48583	-17904
Foreign Exchange Reserves(End period)	September 26,2008	247762	291819
Note: Data on FIIs presented in this table represent inflows into the country and, thus, may differ from data relating to net investment in stock exchanges by FIIs.			

in 2008-09 so far, relative to the previous year (Table 1). Total net capital flows fell from US$17.3billion in April-June 2007 to US$13.2 billion in April-June 2008. Nonetheless, capital flows are expected to be more than sufficient to cover the current account deficit this year as well. While Foreign Direct Investment (FDI) inflows have continued to exhibit accelerated growth (US$ 16.7 billion during April-August 2008 as compared with US$8.5 billion in the corresponding period of 2007), portfolio investments by foreign institutional investors (FIIs) witnessed a net outflow of about US$ 6.4 billion in April-September 2008 as compared with a net inflow of US$ 15.5 billion in the corresponding period last year. Similarly, external commercial borrowings of the corporate sector declined from US$ 7.0 billion in April-June 2007 to US$ 1.6 billion in April-June 2008, partially in response to policy measures in the face of excess flows in 2007-08, but also due to the current turmoil in advanced economies.

With the existence of a merchandise trade deficit of 7.7 per cent of GDP in 2007-08, and a current account deficit of 1.5 per cent, and change in perceptions with respect to capital flows, there has been significant pressure on the Indian exchange rate in recent months. Whereas the real exchange rate appreciated from an index of 104.9 (base 1993-94=100) (US$1 = Rs. 46.12) in September 2006 to 115.0 (US$ 1 = Rs. 40.34) in September 2007, it has now depreciated to a level of 101.5 (US $ 1 = Rs. 48.74) as on October 8, 2008.

With the volatility in portfolio flows having been large during 2007 and 2008, the impact of global financial turmoil has been felt particularly in the equity market. The BSE Sensex (1978-79=100) increased significantly from a level of 13,072 as at end-March2007 to its peak of 20,873 on January 8, 2008 in the presence of heavy portfolio flows responding to the high growth performance of the Indian corporate sector. With portfolio flows reversing in 2008, partly because of the international market turmoil, the Sensex has now dropped to a level of 11,328 on October 8, 2008, in line with similar large declines in other major stock markets. As noted earlier, domestic investment is largely financed by domestic savings. However, the corporate sector has, in recent years, mobilized significant resources from global financial markets for funding, both debt and non-debt, their ambitious investment plans. The current risk aversion in the international financial markets to EMEs could, therefore, have some impact on the Indian corporate sector's ability to raise funds from international sources and thereby impede some investment growth. Such corporate would, therefore, have to rely relatively more on domestic sources of financing, including bank credit. This could, in turn, put some upward pressure on domestic interest rates. Moreover, domestic primary capital market issuances have suffered in the current fiscal year so far in view of the sluggish stock market conditions. Thus, one can expect more demand for bank credit, and non-food credit growth has indeed accelerated in the current year (26.2 per cent on a year-on-year basis as on September12, 2008 as compared with 23.3 per cent a year ago).The financial crisis in the advanced economies and the likely slowdown in these economies could have some impact on the IT sector. According to the latest assessment by the NASSCOM, the software trade association, the current developments with respect to the US financial markets are very eventful, and may have a direct impact on the IT industry and likely to create a downstream impact on other sectors of the US economy and worldwide markets. About 15 per cent to 18 per cent of the business coming to Indian outsourcers includes projects from banking, insurance, and the financial services sector which is now uncertain. In summary, the combined impact of the reversal of portfolio equity flows, the reduced availability of international capital both debt and equity, the perceived increase in the price of equity with lower equity valuations, and pressure on the exchange rate, growth in the Indian corporate sector is likely to feel some impact of the global financial turmoil. On the other hand, on a macro basis, with external savings utilization having been low traditionally, between one to two percent of GDP, and the sustained high domestic savings rate, this impact can be expected to be at the margin. Moreover, the continued buoyancy of foreign direct investment suggests that confidence in Indian growth prospects remains healthy.

Impact on the Indian Banking System

One of the key features of the current financial turmoil has been the lack of perceived contagion being felt by banking systems particularly in Asia. The Indian banking system also has not experienced any contagion, similar to its peers in the rest of Asia. The Indian banking system is robust & secure in comparison to the US banking industry, mainly because the PSBs continue to be a dominant part of the banking system. A good number of Indian populations have bank accounts, out of which 80% are in PSBs that are guaranteed by the government. The immediate problem of liquidity is being solved by the RBI by reducing the CRR to 6.5% & first repo rate cut of 1% since 2004.The RBI released Rs.25000cr under debt waiver scheme & Rs.20000cr for mutual funds. It infused liquidity into the market by these measures to the tune of Rs.45000.

A detailed study undertaken by the RBI in September 2007 on the impact of the subprime episode on the Indian banks had revealed that none of the Indian banks or the foreign banks, with whom the discussions had been held, had any direct exposure to the sub-prime markets in the USA or other markets. However, a few Indian banks had invested in the collateralized debt obligations (CDOs) / bonds which had a few underlying entities with sub-prime exposures. Thus, no direct impact on account of direct exposure to the sub-prime market was in evidence. However, a few of these banks did suffer some losses on account of the mark-to-market losses caused by the widening of the credit spreads arising from the sub-prime episode on term liquidity in the market, even though the overnight markets remained stable. Consequent upon filling of bankruptcy by Lehman Brothers, all banks were advised to report the details of their exposures to Lehman Brothers and related entities both in India and abroad. Out of 77 reporting banks, 14 reported exposures to Lehman Brothers and its related entities either in India or abroad. An analysis of the information reported by these banks revealed that majority of the exposures reported by the banks pertained to subsidiaries of Lehman Bros Holdings Inc, which are not covered by the bankruptcy proceedings. In the aftermath of the turmoil caused by bankruptcy, the Reserve Bank has announced a series of measures to facilitate orderly operation of financial markets and to ensure financial stability which predominantly includes extension of additional liquidity support to banks.

Steps to Alleviate Global Financial Crisis:

- Domestic demand to be boosted
- Ensure liquidity & affordability of credit
- Productivity to be improved
- Further rupee depreciation has to be checked
- Liberalization of ECB norms
- CRR,SLR & repo can be reduced further
- Interest rated to be reduced
- Creation of oil pool account
- Push projects & investments to create demand
- Trap of red-tapism to be brought to an end, where projects worth crores of investment are stuck.
- Encashing vote banks by popular means like subsidies, exemptions, waivers are to be discouraged.

RBI Response to the Crisis

The financial crisis in advanced economies on the back of sub-prime turmoil has been accompanied by near drying up of trust amongst major financial market and sector players, in view of mounting losses and elevated uncertainty about further possible losses and erosion of capital. The lack of trust amongst the major players has led to near freezing of the uncollateralized inter-bank money market, reflected in large spreads over policy rates. In response to these developments, central banks in major advanced economies have taken a number of coordinated steps to increase short-term liquidity. Central banks in some cases have substantially loosened the collateral requirements to provide the necessary short-term liquidity. In contrast to the extreme volatility leading to freezing of money markets in major advanced economies, money markets in India have been, by and large, functioning in an orderly fashion, albeit with some pressures. Large swings in capital flows - as has been experienced between 2007-08 and 2008-09 so far - in response to the global financial market turmoil have made the conduct of monetary policy and liquidity management more complicated in the recent months. However, the Reserve Bank has been effectively able to manage domestic liquidity and monetary conditions consistent with its monetary policy stance. This has been enabled by the appropriate use of a range of instruments available for liquidity management with the Reserve Bank such as the Cash Reserve Ratio (CRR) and Statutory Liquidity Ratio (SLR) stipulations and open market operations (OMO) including the Market Stabilization Scheme (MSS) and the Liquidity Adjustment Facility (LAF).

Furthermore, money market liquidity is also impacted by our operations in the foreign exchange market, which, in turn, reflect the evolving capital flows. While in 2007and the previous years, large capital flows and their absorption by the Reserve Bank led. At present, banks are required to hold 25 per cent of their net demand and time liabilities (NDTL) in Government (and some other approved) securities. As against this requirement of 25%, banks holdings of SLR securities were 26.7 per cent of their NDTL as on September12, 2008. Thus, banks held nearly 1.7 per cent excess SLR securities - equivalent to Rs. 700billion as on September 12, 2008 - which could be used by banks to avail of liquidity from the Reserve Bank under the daily LAF operations. In view of sustained large capital flows on the one hand and the finite stock of government Securities with the Reserve Bank, and the absence of the option of issuing central bank securities under the RBI Act on the other hand, a new scheme, Market Stabilization Scheme (MSS), were introduced in April 2004 to manage the large capital flows. Under this scheme, the Reserve Bank has been empowered to issue government Treasury Bills and medium duration dated securities exclusively for sterilization purposes, so as to manage liquidity appropriately. The proceeds collected under MSS auctions are kept in a separate identifiable cash account with the RBI, and can be used only for redemption and/or buy back of securities issued under the MSS. The payments for interest and discount on MSS securities are not made from the MSS Account, but shown in the Union budget and other related documents transparently as distinct components under separate subheads. The MSS securities are indistinguishable from normal government Treasury Bills and dated securities. The introduction of MSS has succeeded broadly in restoring LAF to its intended function of daily liquidity management (see Mohan (2006)).to excessive liquidity, which was absorbed through sterilization operations involving

LAF, MSS and CRR. During 2008, in view of some reversal in capital flows, market sale of foreign exchange by the Reserve Bank has led to withdrawal of liquidity from the banking system. The daily LAF repo operations have emerged as the primary tool for meeting the liquidity gap in the market. In view of the reversal of capital flows, fresh MSS issuances have been scaled down and there has also been some unwinding of the outstanding MSS balances. The MSS operates symmetrically and has the flexibility to smoothen liquidity in the banking system both during episodes of capital inflows and outflows. The existing set of monetary instruments has, thus, provided adequate flexibility to manage the evolving situation. In view of this flexibility, unlike central banks in major advanced economies, the Reserve Bank did not have to invent new instruments or to dilute the collateral requirements to inject liquidity. LAF repo operations are, however, limited by the excess SLR securities held by banks. While LAF and MSS have been able to bear a large part of the burden, some modulations in CRR and SLR have also been resorted, purely as temporary measures, to meet the liquidity mismatches. For instance, on September 16, 2008, in regard to SLR, the Reserve Bank permitted banks to use upto an additional 1 percent of their NDTL, for a temporary period, for drawing liquidity support under LAF from RBI. This has imparted a sense of confidence in the market in terms of availability of short-term liquidity. The CRR which had been gradually increased from 4.5 per cent in 2004 to 9per cent by August 2008 was cut by 50 basis points on October 65 (effective October 11, 2008) - the first cut after a gap of over five years - on a review of the liquidity situation in the context of global and domestic developments. Thus, as the very5 On a review of the evolving liquidity situation in the context of the abrupt changes in the international financial environment subsequent to the October 6th announcement, it was decided to reduce the CRR by 250 basis points to 6.50 per cent of NDTL with effect from the fortnight beginning October 11, 2008 (instead of the 50 basis points reduction announced on October 6, 2008). As a result, an amount of about Rs. 1000 billion would be released into the system (instead of the injection of Rs 200 billion announced earlier). A number of other measures were also announced on various occasions during September-October 2008 (see Annex II) recent experience shows, temporary changes in the prudential ratios such as CRR and SLR combined with flexible use of the MSS, could be considered as a vast pool of back up liquidity that is available for liquidity management as the situation may warrant for relieving market pressure at any given time. The recent innovation with respect to SLR for combating temporary systemic illiquidity is particularly noteworthy. The relative stability in domestic financial markets, despite extreme turmoil in the global financial markets, is reflective of prudent practices, strengthened reserves and the strong growth performance in recent years in an environment of flexibility in the conduct of policies. Active liquidity management is a key element of the current monetary policy stance. Liquidity modulation through a flexible use of a combination of instruments has, to a significant extent, cushioned the impact of the international financial turbulence on domestic financial markets by absorbing excessive market pressures and ensuring orderly conditions. In view of the evolving environment of heightened uncertainty, volatility in global markets and the dangers of potential spillovers to domestic equity and currency markets, liquidity management will continue to receive priority in the hierarchy of policy objectives over the period ahead. The Reserve Bank will continue with its policy of active demand management of liquidity through appropriate use of the CRR stipulations and open market operations (OMO) including the MSS and the LAF, using all the policy instruments at its disposal flexibly, as and when the situation warrants.

Measures Taken by the Reserve Bank during September-October 2008 in Response to the Global Financial Market Developments

- o CRR cut by 250 basis points to 6.5 per cent, effective fortnight beginning October 11, 2008
- o Repo rate cut by 100 basis points to 8.0 per cent
- o As a temporary measure, banks permitted to avail of additional liquidity support under the LAF to the extent of up to 1 per cent of their NDTL.
- o The mechanism of Special Market Operations (SMO) for public sector oil marketing Companies instituted in June-July 2008 taking into account the extraordinary situation then prevailing in the money and forex markets will be instituted when oil bonds become available.
- o Under the Agricultural Debt Waiver and Debt Relief Scheme Government had agreed to provide to commercial banks, RRBs and co-operative credit institutions a sum of Rs.25,000 crore as the first installment. At the request of the Government, RBI agreed to provide the sum to the lending institutions immediately.
- o Interest rates on FCNR (B) Deposits and NRE(R)A deposits were increased by 100 basis points each to Libor/ Swap rates plus 25 basis points and to Libor/Swap rates plus 100 basis points, respectively.
- o Banks allowed borrowing funds from their overseas branches and correspondent banks up to a limit of 50 per cent of their unimpaired Tier I capital as at the close of the previous quarter or USD 10 million, whichever is higher, as against the existing limit of 25 per cent.
- o Special 14 days repo to be conducted every day upto a cumulative amount of Rs.20,000 crore with a view to enabling banks to meet the liquidity requirements of Mutual Funds.
- o Purely as a temporary measure, banks allowed to avail of additional liquidity support exclusively for the purpose of meeting the liquidity requirements of mutual funds to the extent of up to 0.5 per cent of their NDTL.
- o Under the existing guidelines, banks and FIs are not permitted to grant loans against certificates of deposits (CDs). Furthermore, they are also not permitted to buy-back their own CDs before maturity. It was decided to relax these restrictions for a period of 15 days effective October 14, 2008, only in respect of the CDs held by mutual funds.

- For fine-tuning the management of bank reserves on the last day of the maintenance period, a second LAF (SLAF) on reporting Fridays, was introduced with effect from August 1, 2008. It was decided to conduct the SLAF on a daily basis till further notice.

India's economic growth has been rising and becoming more stable for the past 25 years, fuelled by higher savings and investment (now over 35 percent and 36 percent of GDP respectively), the demographic dividend of a younger, more educated labor force and accelerated total factor productivity growth. For the past three years, the economy has grown at 9 percent giving the Indian economy considerable momentum. Second, during the current FY trade growth has been impressive, with exports rising 35.1 percent in dollar terms and imports rising 37.7 percent during the period from April-August 2008. Investment has been buoyant and FDI during 2008-09 is expected to reach US$35 billion. Indian banks have strong balance sheets, are well-capitalized and well regulated. The capital adequacy ratio of every Indian bank is well above Basel norms and those stipulated by the RBI. Not one Indian bank has had to be rescued in the aftermath of the crisis. India has a long history of working with public sector banks and in engineering bank rescues. India's growth rate will slow in 2008-09. Growth during the quarter ending June 2008 was 7.9 percent. The current consensus for the 2008-09 FY is 7.5 percent to 8 percent. Principal reasons for this modest drop in economic growth include:

(i) A large and diversified consumption base for the Indian economy;

(ii) India's trade to GDP ratio is much smaller than that of, say, China; and

(iii) Indian financial markets are still relatively insulated from global financial markets. India has a healthy external balance, with high foreign exchange reserves, low ratio of short term external debt to GDP and less than complete capital account convertibility.

Nevertheless, that will be a significant slowdown compared to recent experience, but it will still be robust growth. The slower growth will be accompanied by reduced employment growth and slower poverty reduction. Indian policymakers have responded with measures to enhance liquidity - primarily by reducing the cash reserve ratio and the repo rate - and enhancing confidence. Bank guarantees, beyond those that already exist, have been deemed unnecessary. In 2009-10, if the world economy recovers, India can grow at 9 percent or more. If the world economy remains in recession, forecasts of Indian growth rates are harder to make.

Conclusion

India seems to have been spread the global crisis unlike other economies. India is yet a domestic economy 7 the growth process is largely domestic demand-driven. It has comfortable levels of foreign reserves. The financial market, especially; the credit derivatives market, is in a nascent stage & related regulations are very strong & prudent that prevents institutions from taking excessive risks.

- In 2007-08, net FII inflows into India amounted to $20.3 billion. As compared with this, they pulled out $11.1 billion during the first nine-and-a-half months of calendar year 2008, of which $8.3 billion occurred over the first six-and-a-half months of financial year 2008-09 (April 1 to October 16). This has had two effects: in the stock market and in the currency market.

- The sharp depreciation of the rupee has its own implications. While this depreciation may be good for India's exports that are adversely affected by the slowdown in global markets, it is not so good for those who have accumulated foreign exchange payment commitments. Nor does it assist the Government's effort to rein in inflation.
- A second route through which the global financial crisis could affect India is through the exposure of Indian banks or banks operating in India to the impaired assets resulting from the sub-prime crisis. Unfortunately, there are no clear estimates of the extent of that exposure, giving room for rumor in determining market trends. Thus, ICICI Bank was the victim of a run for a short period because of rumors that sub-prime exposure had badly damaged its balance sheet, although these rumors have been strongly denied by the bank.
- Finally, the recession generated by the financial crisis in the advanced economies as a group and the US in particular, will adversely affect India's exports, especially its exports of software and IT-enabled services, more than 60 per cent of which are directed to the US. International banks and financial institutions in the US and EU are important sources of demand for such services, and the difficulties they face will result in some curtailment of their demand. Further, the nationalization of many of these banks is likely to increase the pressure to reduce outsourcing in order to keep jobs in the developed countries. And the slowing of growth outside of the financial sector too will have implications for both merchandise and services exports. The net result would be a smaller export stimulus and a widening trade deficit.

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