Global Financial Crisis – The Indian Policy Response

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Structure of the Presentation

- Build up period (2003-08)
- Crisis response (2008–10)
- Exit from accommodative policy (2010-July 2012)
- July 2012 and after

Build-up to the Crisis (Pre Crisis 2003-08)

Indicators	2003-04	2004-05	2005-06	2006-07	2007-08
GDP	8.5	7.6	9.5	9.6	9.3
Indl Prdn	7.4	9.4	9.7	12.2	9.7
M 3	16.8	12.0	21.4	21.3	21.1
Fiscal Def.	4.48	3.9	4.0	3.3	2.5
Debt Service	15.9	5.9	10.1	4.7	4.8
Inv/GDP	26.2	32.8	34.6	35.7	38.1
Repo	6	6	6.5	7.75	7.75
RevRepo	4.5	4.75	5.5	6.0	6.0
CRR	4.5	5.0	5.0	6.0	7.5

Note: SLR was at 25.00 from October 25, 1997 – November 8, 2008

Sources of risk to financial stability:

- Excessive Capital inflows fuelled by global liquidity and exuberant expectations of growth in India

RBI concerns:

- Inflation, overheating, erosion in competitiveness, currency mismatches, higher growth of credit to riskier sectors

RBI Circular of 2005 – much prior to Crisis

“Necessary to build up provisioning to cushion banks' balance sheets in the event of a downturn in the economy or credit weaknesses surfacing later.

The various options available for reducing the element of pro-cyclicality include, adoption of objective methodologies for dynamic provisioning requirements, establishment of a linkage between the prudential capital requirements and through- the-cycle ratings instead of point-in-time ratings and establishment of a flexible loan- to-value (LTV) ratio requirements where the LTV ratio would be directly related to the movement of asset values.”

Policy Response - Build Up Period

- Allowing some appreciation of exchange rate, reserve build up, CRR / OMO/ MSS to sterilise impact
- Monetary measures for overheating. Repos rate raised from 4.5% to 6% to 7.75% and CRR from 4.5 to 7.5%
- Liberalised capital account outflows - residents, companies
- Limited debt inflows through ceiling on Non resident deposits, restrictions on end use, limited access to banks and financial sector, caps on FII investment in government securities and corporate debt

Policy Response - Build Up Period

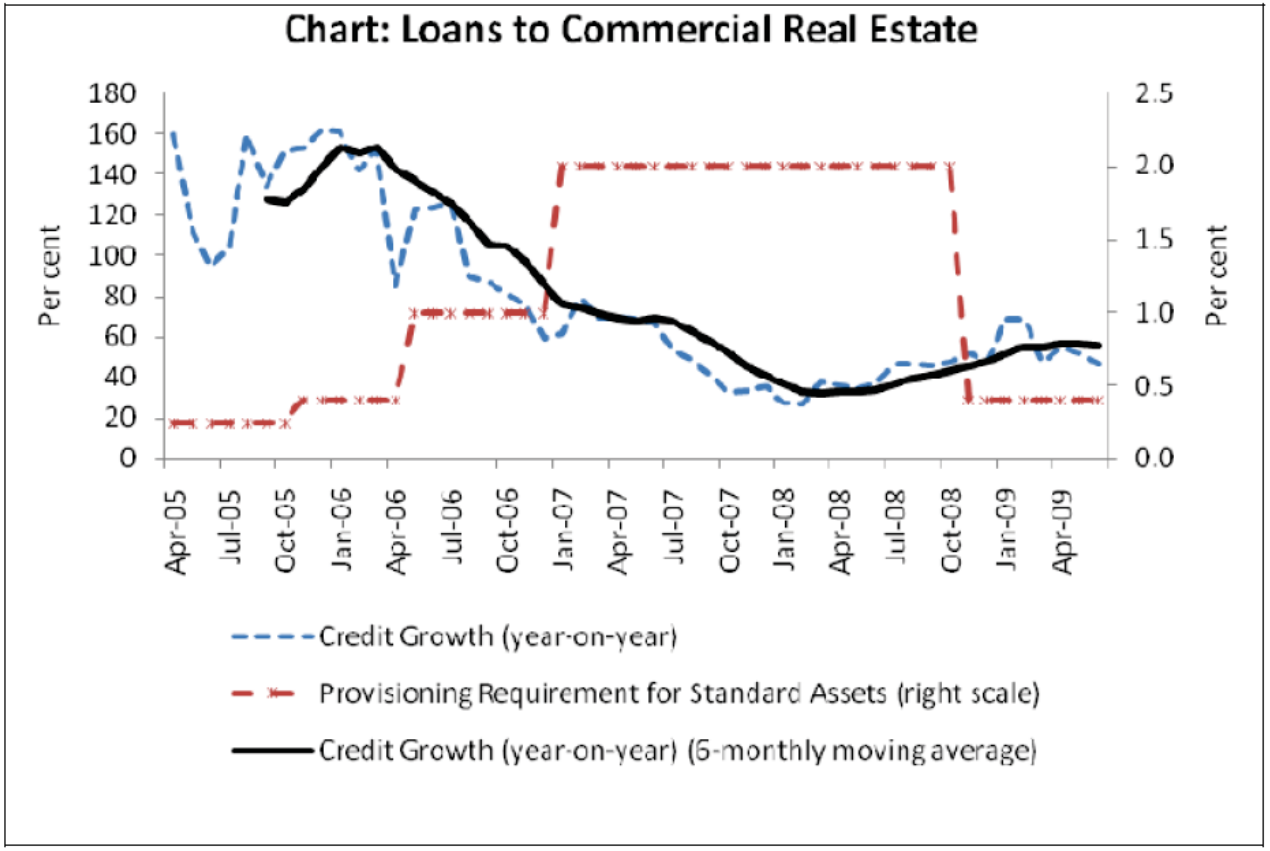
- Provisioning for standard assets, higher risk weights and higher provisions for sectors where credit growth was higher than 30 per cent yoy
- Accounting and prudential norms for securitisation
- Measures to restrict dependence on wholesale or borrowed funds
- Dealing with shadow banking- Systemically important NBFCs
- Well diversified financial sector –public and private and foreign banks –one form of presence

Macro-Prudential Measures - 2003-08

Year	Capital Market		Housing Market		Other Retail		Commercial real Estate		Systemically important NFCs	
	R W	Prov.	R W	Prov	R W	Prov	R W	Prov	R W	Prov
2004	100	0.25	75	0.25	125	0.25	100	0.25	100	0.25
2005	125	0.40	75	0.40	125	0.40	125	0.40	100	0.40
2006	125	1.0	75	1.0	125	1.0	150	1.0	100	0.40
2007	125	2.0	75	1.0	125	2.0	150	2.0	125	2.0
2008	125	2.0	50-100	1.0	125	2.00	150	2.0	125	2.0

Note: Graded risk weight for housing loans according to amount and LTV

Impact of Policy – Slowing of Credit Growth



Source: Mohan, Rakesh and Muneesh Kapur, 2009, "Managing the Impossible Trinity: Volatile Capital Flows and Indian Monetary Policy", Working Paper, Stanford Centre for International Development

Impact of crisis - Forex outflows, currency volatility, trade credit and interbank lines, slowing down of demand and growth, confidence

- Monetary measures – liquidity infusion
- Forex measures – intervention and capital flow measures
- Debt management
- Macro-prudential measures
- Sector specific measures

Policy Response to GFC - I

Liquidity

- reduction in reserve ratios and reduction in policy rates
- Special liquidity window for MFs and NBFCs
- Overall provision of liquidity 9% of GDP

Forex market

- spot and forward intervention, swap window for banks/EXIM, eased restrictions on overseas borrowing including those by banks and NBFCs, raised interest rate ceiling on Non resident Indian deposits, buy back of FCCBs at discount allowed

As Regulator

- Additional risk weights and provisions earlier introduced withdrawn
- Relaxations in restructuring norms for a short time from September 2008 up to March 2009
- NBFCs allowed to issue IPDs to qualify for capital and elongated time for reaching 15 % CRAR
- Special incentives for export, SME and housing sector – Special refinance/liquidity window

Policy Response to GFC - III

As Debt Manager

GFD rose 2.5% of GDP in 2007-08 to 6 % in 2008-09.

Increase in government net borrowing program from 2.1 % to 5.9 % of GDP

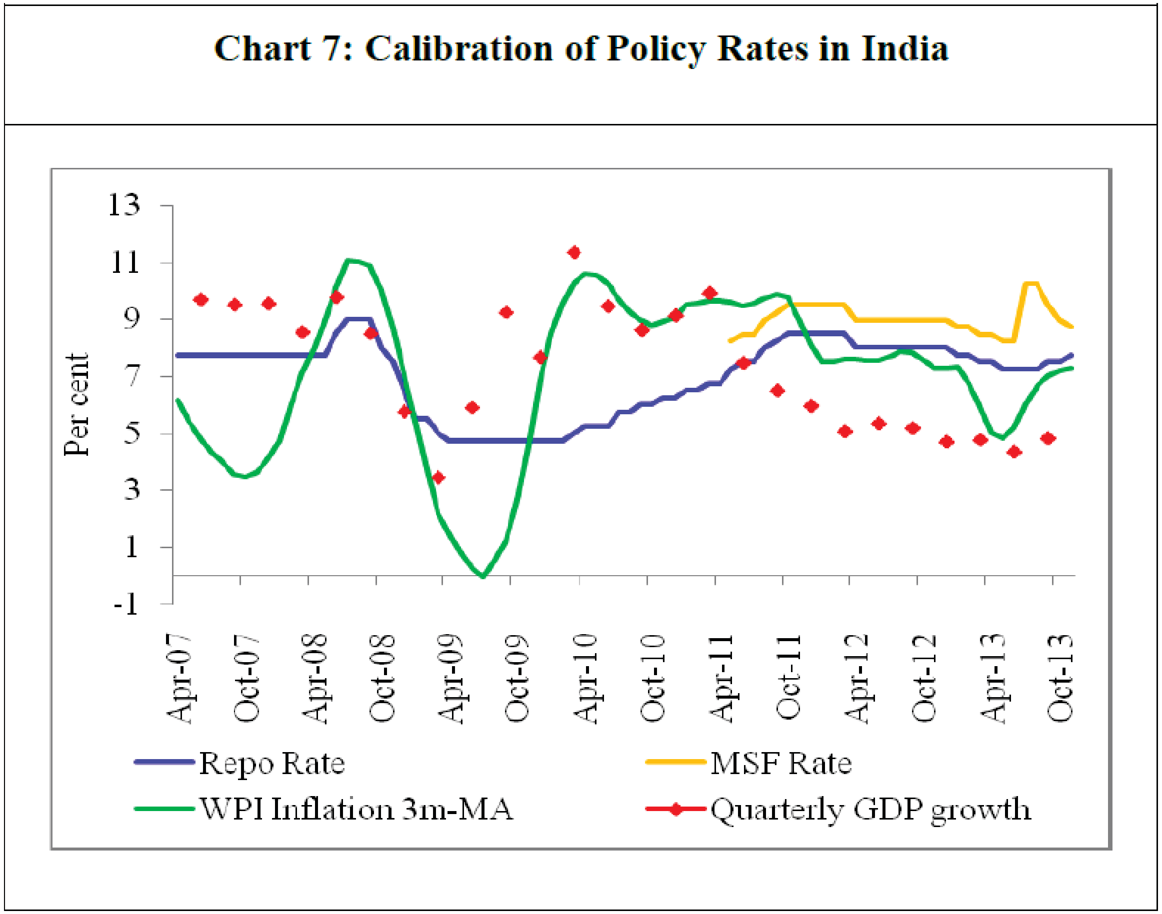
Response

- Orderly unwinding of MSS including early buy back
- Indicative calendar for open market purchase of Government securities to provide assurance to markets
- Shorter maturities, more benchmark, uniform auction

Macroeconomic Parameters and Monetary Measures 2008-13

Indicators	2008-09	2009-10	2010-11	2011-12	2012-13
GDP	6.7	8.6	9.3	6.2	5.0
Industry	4.4	9.2	9.2	3.5	3.1
M 3	20.5	20.0	16.5	13.6	16.0
GFD	6.0	6.5	4.9	5.75	5.9
Debt Service Ratio	4.4	5.8	4.3	6.0	4.5
Investment/GDP ratio	34.3	36.5	36.8	35.0	35.4
WPI(Av)	8.0	4.1	8.6	8.8	7.8
CPI(Av)	9.1	13.0	9.5	9	8.0
CAD	2.3	2.8	2.8	4.2	4.8
Repo	9 to 5	5 to 4.75	4.75 to 6.75	6.75 to 8.5	8.5 to 7.5
Rev repos	6 to 3.5	3.5 to 3.25	3.5 to 5.75	5.75 to 7.5	7.5 to 6.75
CRR	9 to 5	5.75 to 5	5.75 to 6.0	6.0 to 4.75	4.75 to 4.0
Gross NPA	2.3	2.4	2.5	3.1	3.6

Calibration of Policy Rates in India



Post Crisis 2010-12

Challenges

- Inflation – started inching up from 5 % in October 2009 and went to 9-10 % and remained elevated till Oct 2011
- Threats to Growth on account of Euro, US and Japan
- Rising Current Account deficit
- Capital inflows – exchange rate appreciation

Response

- Exit from accommodative policy – repos rate raised from 4.75 per cent to 8.5 per cent. CRR raised from 5% to 6 %
- Marginal Standing Facility (MSF) introduced at 100 bps above repos rate - up to 1% of liabilities – banks were allowed to go down to 23 % SLR

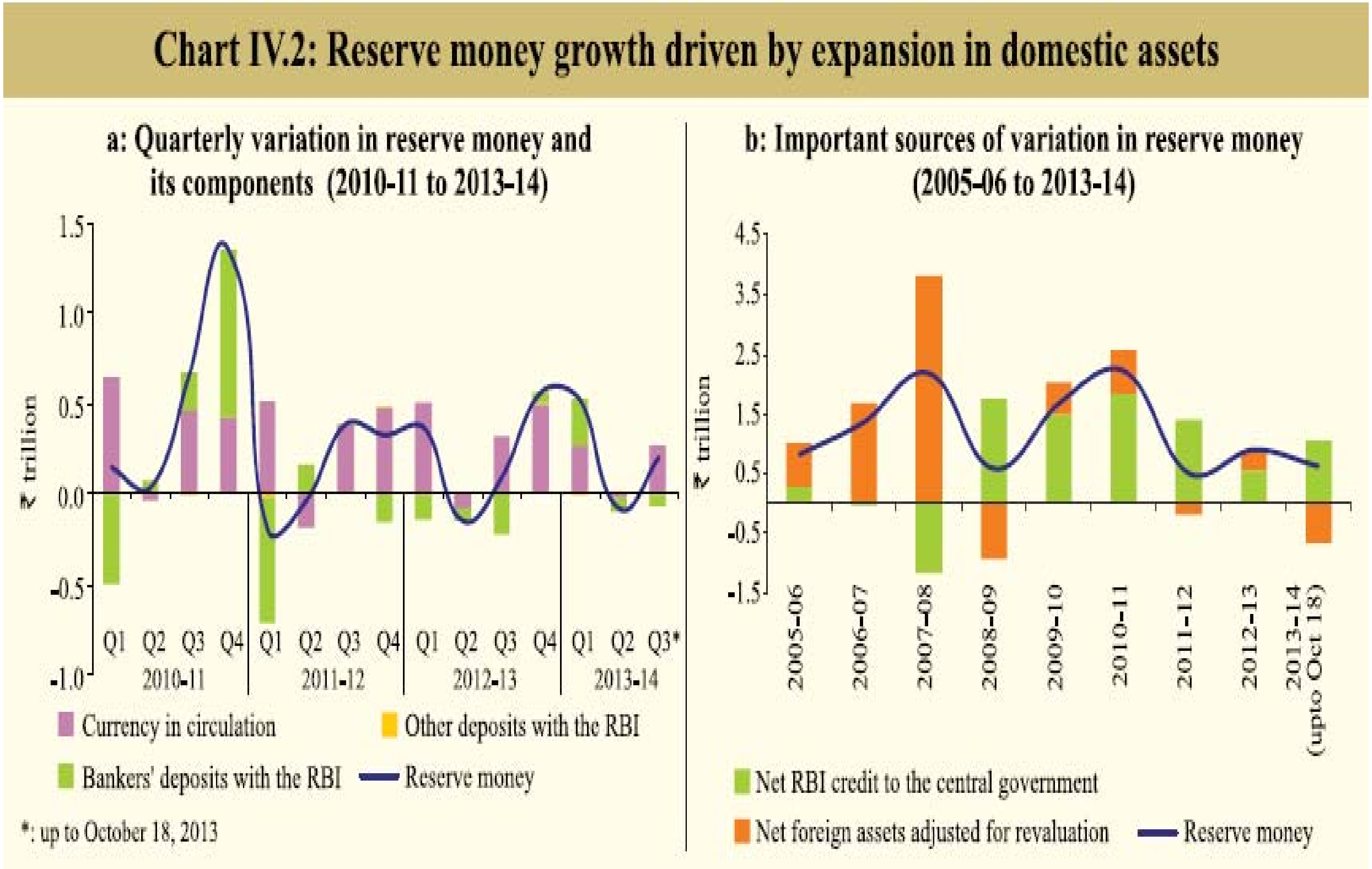
Post Crisis Recovery – Macro-Prudential Measures

- 70 % provisioning coverage for NPAs
- Provisioning for teaser loans to 2 %
- CRE risk weights increased
- Risk weight for larger housing loans increased
- Enforced Base Rate

Capital Flow Measures (2010-13)

- Interest rate caps NRI deposits raised
- Ceiling on export credit in Forex raised
- Premature buy back of FCCB liberalised
- ECB limit per borrower raised
- Infrastructure sector opened up through ECB route
- FDI investments raised in Government debt markets to US $30 bio.
- Allowed hedging of currency risk exposure on equity/debt holdings to FII
- Systemically important NBFCs allowed to raised FX loans

Impact on Money Supply



RBI action – July to September 2013

- Rupee depreciates from 55 to 60 between May and July and further to 68 on Sep 4 (23%). Recovered to 61-62 currently
- RBI uses monetary measures. Caps lending under repos and increases MSF rate by 300 bps. OMO sales and auction of cash management bills. CRR to be maintained 99 % on daily basis.
- Overseas investment limit curbed for companies(except where funded by external debt) and limit on outward remittances by individuals reduced
- Purchase of long dated securities to stabilise long term yields – (‘twist”)
- Prudential adjustments for valuation of government securities held as part of SLR
- Forex swap window for public sector oil companies
- Measures on gold-restriction on loans, duty rise

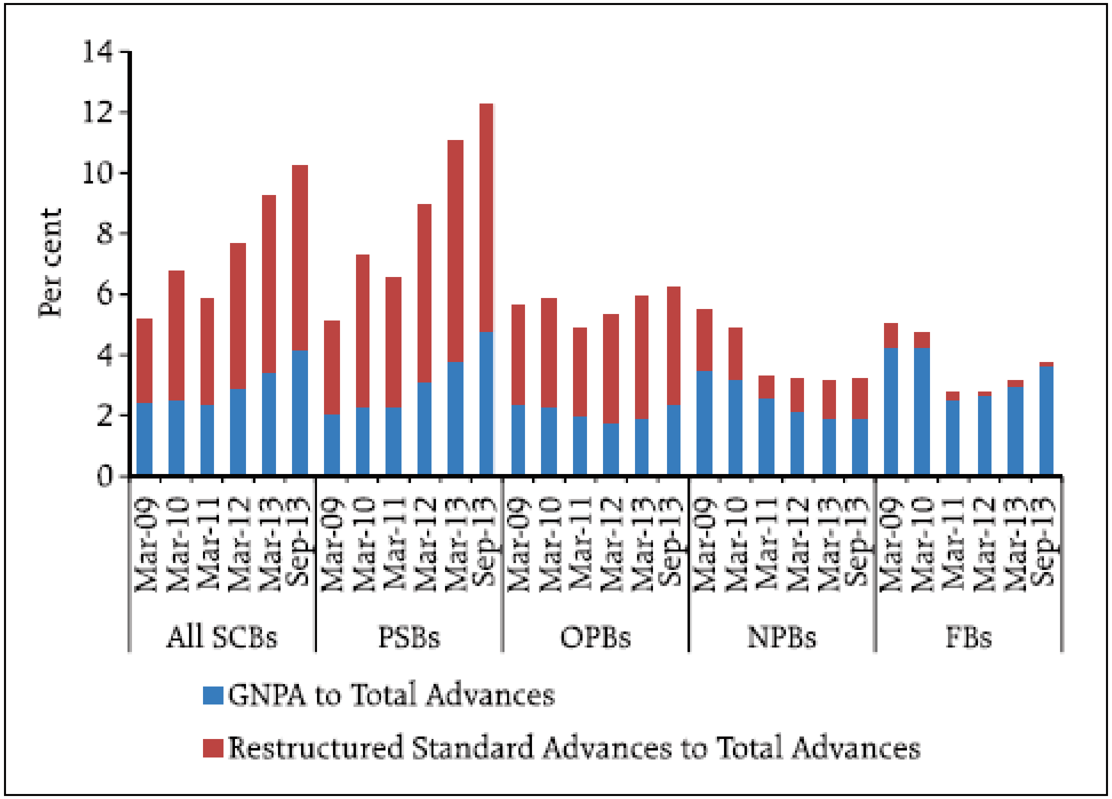
RBI action – post September 2013

- Forex swap window at concessional rate for NRI foreign currency deposits
- Limit on bank's overseas borrowing increased
- Forex swap window for banks at concessional rate
- Bilateral currency swap with Japan up to $50 bio
- CRR daily maintenance – 99% to 95 %
- MSF rate reduced by 150 bp in Sep/Oct and repos rate up by 50 bp in Sep/Oct
- Term repos (7 and 14 day) up to 0.5 of DTL
- RBI Refinance for SME sector through SIDBI
- Scheme for stressed assets

Rupee between Aug 2013 and Jan 2014

Gross NPAs and Restructured Advances Post GFC

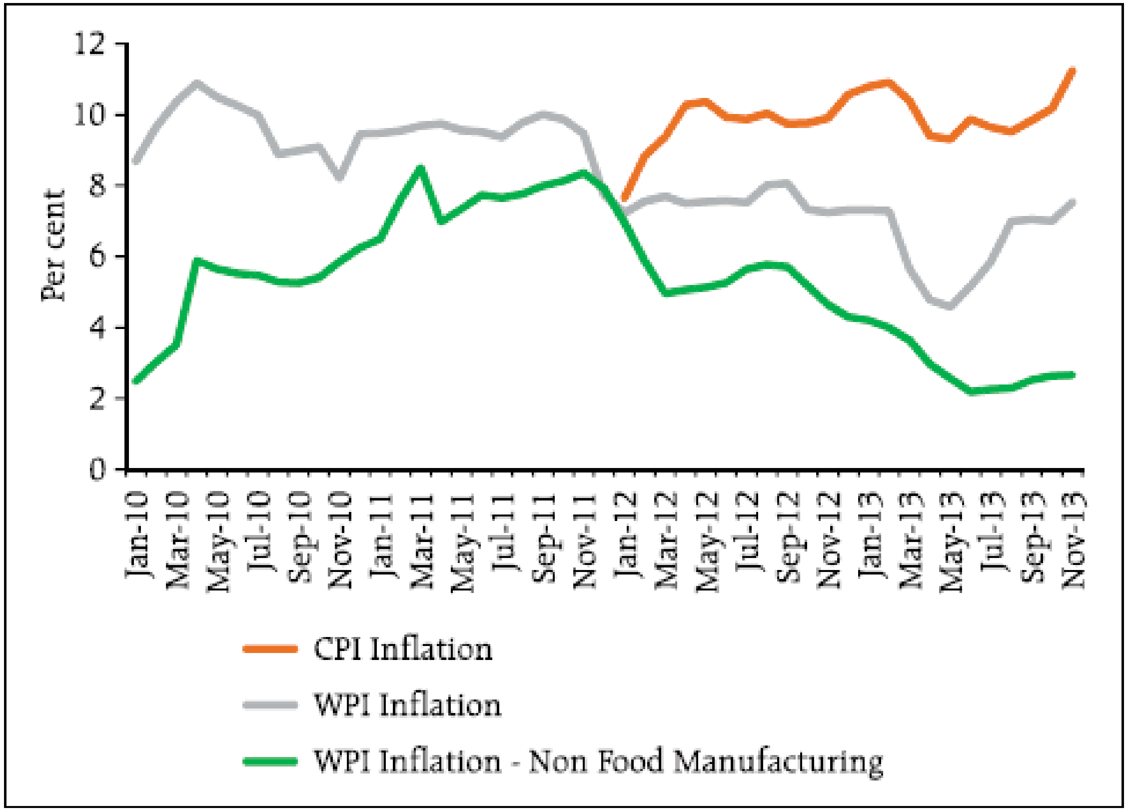
Chart 2.13: Asset Quality of SCBs



Source: RBI Supervisory Returns

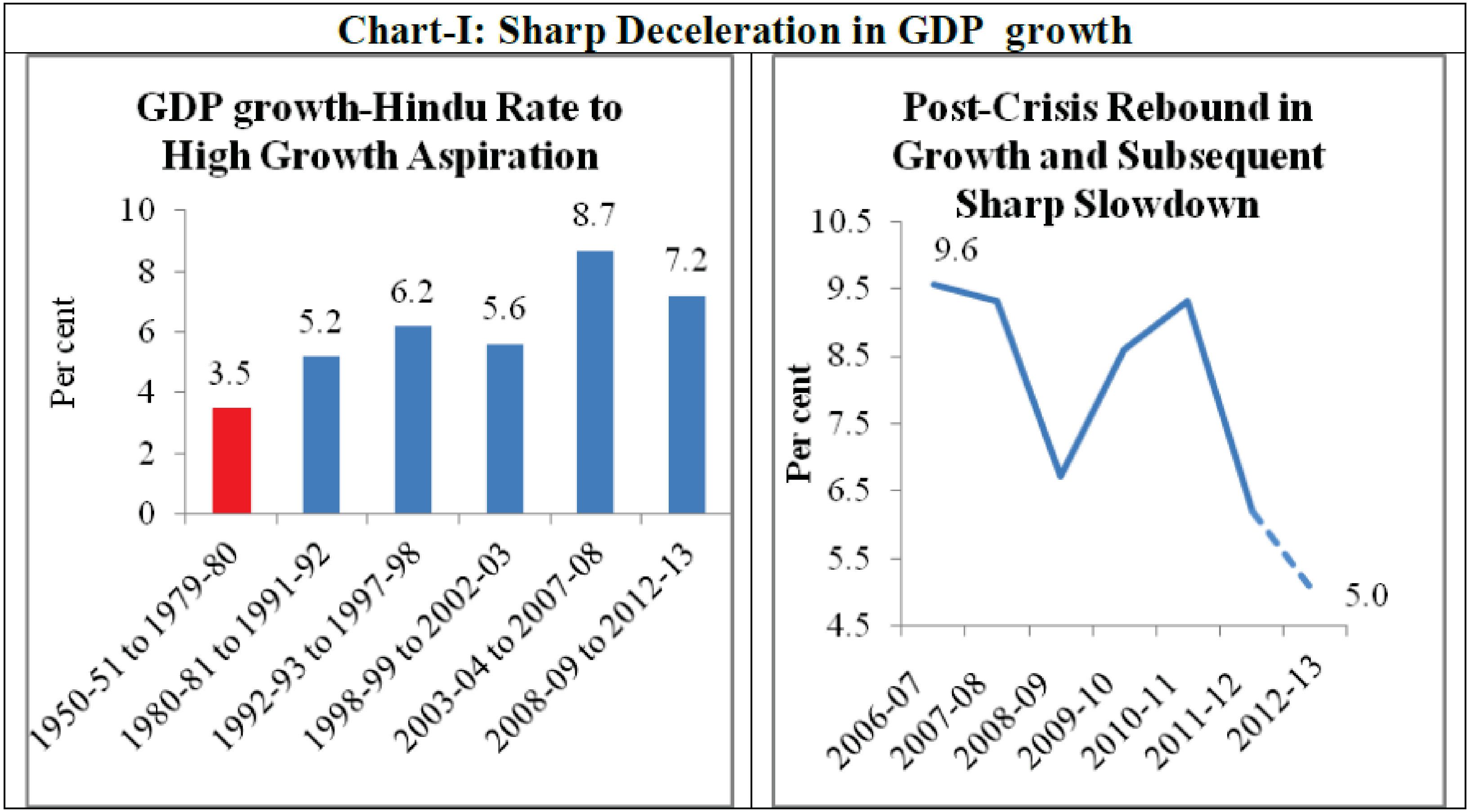
Inflation in India Post GFC Measures

Chart 1.7: Inflation in India



Source: Calculated using GoI Data

Sharp Deceleration in Growth



Current Challenges

- Inflation
- Growth Revival
- Preparation for Tapering
- Stressed Assets
- Currency Mismatches
- Fiscal Slippage

Thank you