

Impact of Financial Turmoil on India

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Good News

- Probably we have seen the bottom, and the worst is over

Background

- April 28, 2004 net capital value decision
- Risk to be estimated by own banks, not regulator
- Role of credit rating agencies
- Lehman decision

Issues in the crisis

- Guarantee asset (housing) prices so that panic sales stop
- Free up money markets– trust has gone
- Recapitalise

The U.S. bailout of \$700 billion

- Addressed only the liquidity problem
- Did not address the asset prices problem
- Did not address the equity problem

Mistakes made

- Not addressing the problem of value of underlying assets
- The Lehman bankruptcy and its consequences
- Freezing up short term money markets
- CDS valuations - the instruments do not go away, the risk premium increases

consequences

- People and funds are withdrawing
- Hedge fund investors are withdrawing, so hedge funds selling equities
- Banks keeping cash to meet CDS obligations

consequences

- Small country, big financial system countries are at risk
- The fact that there are no sub-prime or derivatives is not a relief.
- Iceland is an example
- Can happen even in Singapore— savings deposit guarantee rates are low
- Saving grace is that investments are from non-stressed countries.

Good Signs

- Markets close to bottom
- New support signals reassuring
- CDS auctions not as bad as expected
- Governments have acted in unexpected unison

India

- Positive side
- No sub prime
- No derivatives
- No international exposure to deposits or instruments
- Banking and financial system safe
- Why ICICI- because FII holding very high

But

- But lack of trust means no access to international funds
- Dropping equity market means that cash flows are low
- Current account deficit very high, exacerbated with FII outflow
- Pressure for dollar will weaken rupee further
- Short term debt is \$80 billion - will be drawn out soon

Sectors: IT

- IT hiring at lower end on freeze, the sector is likely to see job losses of around 50,000 this year
- Smaller companies likely to feel the brunt most, may close down.
- Financial sector in IT is already seeing job losses

IT continued

- Export earnings have improved on weakening rupee, but there is pressure on inflow of new orders and outlook for 2009
- Companies diversifying up the value chain and into new markets
- Internal demand for IT products
- Consolidation and cost savings

Exports

- Merchandise trade deficit –US \$31.6 billion, merchandise imports growing more than exports
- Net ECB by Indian companies plunged 78% YOY to US \$1.6 billion
- Overall surplus in BOP down to US \$2.2 billion from US \$11.2 billion over the same period last year.

Trade

- Export credit frozen up and trade credits unavailable
- So commodity shipping on spot like coal, scrap, iron ore getting affected
- Shipping rates falling
- May affect overall trade

Agriculture

- Kharif output lower than last year on all crops, except rice and jute
- Expect impact on prices as support prices have been hiked for crops
- Inflation will remain a little high, and lower interest rates may increase prices

Textiles and Engineering

- Export demand to U.S. and EU falling, being made up by improved realisation
- Industrial Production growth slowing down
- New capital projects looking for alternate financing
- Costs of borrowing have gone up, ad projects may slow down

Real Estate

- IT hubs under construction face shortage of demand
- Commercial sector buildings slowing down in Major metros
- Tier one cities slowdown in upper end residences
- Tier two mid range still buoyant
- Lowering steel, cement prices will help

Services

- Some slowdown in inbound tourism expected
- New starts in hotels are getting delayed
- Telecommunications and media sector continue to grow, as also advertising and related services

Positives

- No slow down in construction yet, especially in tier 2 and tier 3 cities
- FDI sharply on increase— has exceeded US \$10.1 billion in Apr-June 2008, more than twice last year
- No signs of reduction in consumption expenditures
- Savings rates continue to be high, so net banking credit satisfactory

Positives

- Infrastructure activity continuing, projects under implementation exceed a trillion rupees
- No reduction in internal travel, restaurants, hotels, consumer purchases
- Recent festival season sales satisfactory
- Considerable funds with Mutual Funds and institutions like LIC, waiting to invest in market

Positives

- Sectors like pharma, chemicals, paints and hardware, FMCG consumer spending, still growing at last year's rates.
- Expansion projects in chemicals, paper, fertiliser, petrochemicals, plastics, pharmaceuticals, light engineering, capital goods, earth moving machinery under implementation
- Elections will induce activity and liquidity

Positives

- Reduction in crude oil prices will reduce import pressure
- Commodity prices softening
- China, post Olympics, has not got its act together– exports slowing down, inflation high, SMEs closing, internal demand not increasing
- So cement, steel, other imports will be softer

Conclusion

- Indian economy well protected from the impact, will continue to grow – perhaps concerns are lesser than in China due to robust domestic consumption
- There are worries on the policy front – that this should not become an excuse for tighter controls and regulations as policy makers move towards left of centre policies
- Fiscal deficit and budgetary responses need to be carefully calibrated – avoid political decisions like oil bonds

Conclusions

- In the U.S. Pension and retirement funds may take a long time to recover
- This is likely to mark a major change in consumption and savings patterns, at least in the medium term – social changes cannot be ruled out
- As consumption drops, trade may drop – India may not be as affected as China