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ГЛОБАЛЬНЫЙ ФИНАНСОВЫЙ КРИЗИС И ОТНОСИТЕЛЬНАЯ УСТОЙЧИВОСТЬ ЭКОНОМИКИ ИНДИИ (на конкретном примере)

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Начиная с конца 2006 года США вступают в кризис, связанный с субстандартным ипотечным кредитованием. Когда крупнейшая экономика падает, кризис никак не может не распространиться на другие экономики. Глядя на масштабы мирового финансового кризиса, многие аналитики называют кризис на рынке субстандартных кредитов худшим со времен Великой депрессии. В данной работе анализируются важнейшие причины ипотечного кризиса. Также делается попытка проанализировать влияние мирового кризиса на Индию и те факторы, которые помогли стране выйти из кризиса относительно невредимой.

Ключевые слова: финансовый кризис, денежно-кредитная политика.

THE GLOBAL FINANCIAL CRISIS AND INDIA'S RELATIVE RESILIENCE – A CASE STUDY

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ORIGINS

Though the subprime problems began to surface in the US economy in 2006, the origins of the trouble can be traced to 2001-02. This was the time when the 'dotcom bubble' had burst and the US economy was in the grip of a recession. To help the economy pull itself out of this recession, the Federal Reserve, which is the central bank of the US, began reducing interest rates in a bid to fuel consumption and demand. Between January 2001 and June 2003, interest rates were reduced from 6 % to 1 % (Please refer Table 1 for Federal Interest Rates between January 2001 and June 2003).

This rapid fall in interest rates brought down interest rates on mortgage loans and consequently made it easier for prospective home buyers to get a mortgage loan. This, in turn, led to a surge in housing demand and also consequently pushed up property prices. As property prices started rising, speculative property purchases (i.e. property being purchased with the sole intention of selling it in the future at a higher price) also shot up. These speculative purchases further fuelled the price rise.

Table 1

Federal Interest Rates between January 2001 and June 2003

Date	Interest Rate (%)
January 3, 2001	6.00
January 31, 2001	5.50
March 20, 2001	5.00
April 18, 2001	4.50
May 15, 2001	4.00
June 27, 2001	3.75
August 21, 2001	3.50
September 17, 2001	3.00
October 2, 2001	2.50
November 6, 2001	2.00
December 11, 2001	1.75
November 6, 2002	1.25
June 25, 2003	1.00

SURGE IN SUBPRIME LOANS

With rising property prices, borrowers were forced to take larger loans for buying property. This pushed up their Loan to Value (LTV) ratio (the amount of mortgage loan as a percentage of the appraised market value of the property). As LTV ratio was an important component in calculating the credit score of an individual, a high LTV ratio meant that fewer people were assessed as eligible for prime mortgage loans. Therefore, lenders started concentrating on the subprime mortgage market and began offering new options for prospective buyers. This resulted in more borrowers opting for subprime loans.

In the second half of 2004, the Federal Reserve, sensing the formation of a bubble in the real estate markets, started increasing interest rates in order to check the demand in the housing sector, particularly from speculators. The booming economy around this time had started exerting inflationary pressure, which was also one of the reasons for the rise in interest rates. In a bid to control excessive demand and stabilize prices, the Federal Reserve increased interest rates 17 times between June 2004 and July 2006, from 1 % to 5.25 % (Please refer Table 2 for Federal Interest Rates between June 2004 and July 2006).

Table 2

Federal Interest Rates between June 2004 and June 2006

Date	Interest Rate (%)
June 30, 2004	1.25
August 10, 2004	1.50
September 21, 2004	1.75
November 10, 2004	2.00
December 14, 2004	2.25
February 2, 2005	2.50
March 22, 2005	2.75
May 3, 2005	3.00
June 30, 2005	3.25
August 9, 2005	3.50
September 20, 2005	3.75
November 1, 2005	4.00
December 13, 2005	4.25
January 31, 2006	4.50
March 28, 2006	4.75
May 10, 2006	5.00
June 29, 2006	5.25

This sudden rise in interest rates in a very short period of time hit borrowers from both sides. On one hand, the floating interest rates on the loans that they had taken began shooting up. As they had already overstretched themselves by taking larger loans to be able to afford costly property, an increase in interest rates added the burden which now became difficult to bear. On the other hand, increase in interest rates meant lower demand in the economy, which in turn led to a fall in incomes and also in some cases, loss of jobs. As a consequence, the rate of defaults on the subprime loans shot up dramatically.

As more and more borrowers defaulted on their loans, the mortgage bankers repossessed their properties in order to sell them off and recover their dues. This increased the supply of property in the markets. On the other hand, mortgage bankers had now begun applying stricter standards to assess the creditworthiness of customers, which made it difficult for fresh borrowers to get loans. This coupled with the rise in interest rates on mortgage loans and slowing incomes adversely impacted the demand for property. With demand for property falling and supply rising, property prices started tumbling. As LTV ratios were high in the first place, a fall in property prices in some cases led to property values falling below the outstanding loan amounts. The crisis had begun to spread.

SECURITIZATION

One equally important factor responsible for the crisis was the concept of secutitization. The process worked as follows:

Mortgage banks give loans to borrowers and in turn sells these loans to bigger investment banks. The investment banks pay the mortgage banks a commission for this. The investment banks in turn, assemble these loans into pools or bundles as they were termed. This set of pooled loans now takes life in the form of a bond, which is backed up by the security of the original mortgage. The interest that the borrowers pay on their loans is now received by the holder of the bond. The investment bank collects money from investors (like a mutual fund does) and in turn invests it in such bonds.

The idea behind securitization was that it benefits all the parties – the mortgage bank, the investment bank and the investor. The mortgage bank lends money to borrowers and in turn sells these loans to the investment bank, for a commission. So, the mortgage bank gets its money freed and is free to lend again to other borrowers.

The investment bank securitizes these loans into mortgage backed bonds and invests the money of its investors in such bonds. It can charge a fat commission for this activity from its investors.

The investor on the other hand gets a route for investing in mortgage backed bonds.

But then, what if the borrower defaulted on his loan? The markets had found a solution for this too. The securitized bonds were insured with the insurance companies. And the insurance companies were ready to insure such loan funds (technically called as Credit Default Swaps) as they thought house loans are low risk high return investments. All these transactions were based on two assumptions. The first assumption being that the defaulter rate in home loans had always been as low as 2-3 % in the past; and the second being housing prices would always rise. So even if large numbers of people defaulted, the bank/insurance company could just seize the house and sell it to repay the loan; in fact may even make a smart profit out of it.

However, this concept of securitization had a few side-effects. Firstly, the mortgage bankers who were giving out the loans to borrowers had no incentive to look into the creditworthiness of the borrowers as they would be anyway selling off these loans to investment bankers and would not suffer in case of a default. This deteriorated the credit quality leading to loans being given to less creditworthy or subprime borrowers. Consequently when interest rates started rising and incomes started falling, the rate of defaults on such subprime loans were much more than expected. Also, as financial institutions started to sell off properties to recover their dues, housing prices began to fall. Thus, both the assumptions discussed in the preceeding paragraph were violated and consequently investment banks and insurance companies incurred huge losses which drove some of them even to bankruptcy.

With rising number of bankruptcies, liquidity in the money markets dried up as no one was willing to lend to the other, fearing counter-party risk. With money markets freezing up, the crisis soon spread to the entire economy. The Federal Reserve along with the US Government took a number of measures to ease the crisis, but with limited success. As the situation in the US economy deteriorated, the dollar started depreciating. This in turn pushed up crude prices. Also, investors started flocking to crude as a hedge against the US dollar. All these factors, coupled with some speculative buying, led to a sharp rise in crude prices, which touched a high of $147.27 a barrel in mid 2008. This increased the problems for the Federal Reserve. On one hand, an ailing economy demanded severe interest rate cuts. On the other hand, rising crude prices were pushing up inflation, making it difficult to cut rates. However, taking a view that inflation would moderate as the economy slows down, the Federal Reserve decided to give priority to economic repair-work and cut interest rates rapidly. In fact, interest rates were cut 10 times between September 2007 and December 2008, from 4.75% to 0.25%. However, even these efforts were not enough to steer away the economic recession. The GDP of US contracted by as much a 6.3% in the fourth quarter of 2008 – highest contraction in the last 26 years.

THE CONTAGION

The economic problems in US soon spread to the already struggling Europe and pushed the leading European economies like Germany, UK and France into recession. Asian economies were also not spared. The Japanese yen appreciated from 111 to 87 against the from December 2007 to December 2008. This, coupled with the falling US demand, adversely impacted Japanese companies, especially automakers. For example, every time the Japanese currency appreciated by one yen against the dollar, it cost Toyota 35 billion yen in annual operating profits. Sony, on the other hand, reported its first annual loss in 14 years, in January 2009. It also announced 8,000 layoffs and the closure of 10 % of its manufacturing plants around the world. Japanese exports also plunged by a whopping 35 % in December 2008 as compared to December 2007. The Chinese economy also slowed down considerably and expanded by a meager 6.8 % in the last quarter of 2008, the weakest quarterly year-on-year growth rate in 7 years. The South Korean economy also contracted by a painful 5.6 % in the last quarter of 2008. Other South-East Asian economies like Taiwan, Singapore and Thailand which are heavily dependant on exports were also severely impacted.

IMPACT ON INDIA

The crisis in global economies was bound to have an impact on the Indian economy as well. Though the Indian banking system neither had any direct exposure to the sub-prime mortgage assets or to the failed institutions nor did it have any significant off-balance sheet activities or securitized assets, it would be incorrect to argue that therefore the Indian economy should have remained completely unaffected by the crisis. The fact remains that in the era of globalization, it would be irrational to assume that any economy can completely decouple itself from the problems of the larger world. In fact, India's integration into the world economy over the last decade has been remarkably rapid. Going by the common measure of globalization, India's two-way trade (merchandise exports plus imports), as a proportion of GDP, grew from 21.2 per cent in 1997–98, the year of the Asian crisis, to 40.6 per cent in 2008-09. Secondly, India's financial integration with the world has been as deep as India's trade globalization, if not deeper. If we take an expanded measure of globalization, that is the ratio of total external transactions (gross current account flows plus gross capital flows) to GDP, this ratio has more than doubled from 46.8 per cent in 1997-98 to 112.4 per cent in 2008–09.

So how exactly did the crisis spread to India? Firstly, India's financial markets – equity markets, money markets, forex markets and credit markets – had all come under pressure from a number of directions. First, as a consequence of the global liquidity squeeze, Indian banks and corporates found their overseas financing drying up, forcing corporates to shift their credit demand to the domestic banking sector. Also, in their frantic search for substitute financing, corporates withdrew their investments from domestic money market mutual funds putting redemption pressure on the mutual funds and down the line on non-banking financial companies (NBFCs) where the mutual funds had invested a significant portion of their funds. This substitution of overseas financing by domestic financing brought both money markets and credit markets under pressure. Second, the forex market came under pressure because of reversal of capital flows as part of the global deleveraging process. Simultaneously, corporates were converting the funds raised locally into foreign currency to meet their external obligations. Both these factors put downward pressure on the rupee. Third, the Reserve Bank's intervention in the forex market to manage the volatility in the rupee further added to liquidity tightening. Rupee-US$ rate moved up from 40.25 during 2007-08 to 45.92 during 2008–09 and 49.00 during April 01-September 30, 2009.

So far as the real sector is concerned, the transmission of the global cues to the domestic economy had been quite straight forward – through the slump in demand for exports. The United States, European Union and the Middle East, which account for three quarters of India's goods and services trade were in a synchronized downturn. Exports from India had started experiencing negative growth from October 2008. During 2008-09, exports from India rose by 3.6 per cent in US$ terms compared to 28.9 per cent growth in the previous year. Service export growth also slowed down considerably as the recession deepened and financial services firms – traditionally large users of outsourcing services – were restructured. Net capital inflows, which increased sharply to 9.2 per cent of GDP (US$ 108 bn) in 2007-08 from 1.9 per cent of GDP in 2000-01, witnessed a sharp decline to 0.8 per cent of GDP (US$ 9.2 bn) during 2008-09. Portfolio investment declined to outflow of US$ 15.0 billion in 2008-09 from net inflow of US$ 29.6 billion inflow during 2007-08. The current account deficit stood at US$ 29.8 billion (2.6 per cent of GDP) in 2008-09 as against US$ 17.0 billion (1.5 per cent of GDP) during 2007–08. The current account deficit was driven mainly by a sharp slowdown in exports and imports growth outpacing the growth in exports led to a widening of trade deficit to US$ 119.4 billion (or 10.3 per cent of GDP) in 2008-09 from US$ 91.6 billion (or 7.8 per cent of GDP) in 2007-08.

Beyond the financial and real channels of transmission as discussed above, the crisis also spread through the confidence channel. In sharp contrast to global financial markets, which went into a seizure on account of a crisis of confidence, Indian financial markets continued to function in an orderly manner. Nevertheless, the tightened global liquidity situation in the period immediately following the Lehmann failure 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. The credit growth during 2008-09 decelerated to 17.3 per cent from 22.3 per cent in the previous year.

As a result, economic growth decelerated to 6.7 per cent in 2008–09 from high growth of 9.5 per cent, 9.7 per cent and 9.0 per cent in 2005–06, 2006–07 and 2007–08, respectively. The growth rate of the manufacturing sector decelerated to 2.4 per cent during 2008-09 from 8.2 per cent respectively in 2007–08. The slowdown in manufacturing could be attributed to the combined impact of a fall in exports and a decline in domestic demand, especially in the second half of the year.

The above data clearly suggests that the Indian economy too was impacted by the global financial crisis. However, it also reinforces the fact that the impact on India was clearly far lesser than what it was on the other major economies. One important reason for this is that India's recent growth has been driven predominantly by domestic consumption and domestic investment. External demand, as measured by merchandise exports, accounts for less than 15 per cent of India's GDP. This domestic consumption driven growth has definitely helped India to control the damage meted out by the shrinking export demand.

CENTRAL BANK 'CONSERVATISM'

However, all said and done, one cannot ignore the contribution of the Reserve Bank of India (RBI), India's central bank, in ensuring that India's economy stayed on track in spite of the global meltdown. Very often, the RBI has in the past been accused of being non-reformist and too slow on financial sector reforms. However, on this occasion, those very regulations which we have been denouncing as being anti-liberal, helped India to avert a major economic disaster. Financial sector in India has been advocating reforms for a long time, which means easing up of these regulations and policies. However, this time, these very policies helped in thwarting the crisis. For instance, we could take the case of unsecured loans. In India, they aren't easy to get. These loans could be a possible trigger for a subprime crisis.

The RBI's anti-inflation stance also helped matters. The RBI had been favouring inflation control over economic growth for a long time before the global crisis hit. This resulted in tightening of liquidity in the market and a steep rise in the interest rates. This caused a slowdown in demand in the real estate sector as well as some others. RBI's 'non-reformist' approach also included measures such as controlling inflow and outflow of equity into the Indian markets. A prime example lies in the fact that India received an inflow of about $100 billion in the year 2007-08, which in many opinions, is probably about $30 – $50 billion less than what could have been there had RBI been more reformist. This approach on RBI's part deterred extra hedge funds from entering India and in process, saved the country from the blues which Wall Street suffered from. Most of these hedge funds would have been managed by biggies such as Lehmann or Merrill Lynch. And with their going down, the Indian markets could have crashed further had these funds not being restrained. Had these funds been invested in real estate or some other sector, India could have been sitting on a financial disaster. Also, unlike the US and other advanced economies where demand is fuelled by loans and deferred payments, domestic consumer demand in India is more a function of savings than that of debt. This fact has given the RBI more space to manoeuvre its monetary policy. Unlike in the US, where the central bankers have demonstrated desperation on more occasions than one in cutting interest rates in order to fuel borrowing-based demand, the RBI has been able to manoeuvre the interest rates in a much more controlled manner, thus insulating the economy to a large extent from monetary shocks.

CONCLUDING REMARKS

A combination of robust financial sector regulation, sound monetary policy and demographic advantages helped India emerge relatively unscratched from the global financial crisis in 2009. However, as another economic crisis, this time from Europe, threatens the world economies, India too may be put to the test once again. Moreover, with limited maneuverability on reforms and other economic policies due to a difficult coalition government, the onus would most likely be on the central bank once again to contain the possible contagion. How India reacts in wake of the emerging crisis in Europe, will to a great extent determine the viability of the India growth story in the long run.

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