STUDENTS' ECONOMIC FORUM

To kindle interest in economic affairs...
To empower the student community...

Open Access

www.sib.co.in

ho2099@sib.co.in

February 2009

Theme 207

ECONOMIC SLOWDOWN / RECESSION AND STIMULUS PACKAGES - Part II

A monthly publication from South Indian Bank

17th Year of Publication

SOUTH INDIAN Bank

Experience Next Generation Banking

DIAMOND ACCOUNT

NRE SAVINGS

Features

Flexibility

Freedom

www.southindianbank.com

Enjoy the Features, Flexibility & Freedom of Next Generation Banking

- Free and unlimited Any Branch Banking (ABB) facilities. (Customers can withdraw cash and deposit cheques for collection at any branch of the bank. Customers can also issue ABB cheques, which are payable at par at all branches of the bank.)
- Free & unlimited fund transfer to any other bank account in India through RTGS and NEFT by debit to NRE accounts.
- Free & unlimited purchase of Drafts / Payment Orders, by debit to NRE accounts.
- Free International ATM-cum-Debit Card & No Annual Maintenance Charges.
- Free withdrawal of cash through ATMs, including other banks' ATMs in India.
- Free internet banking facility including fund transfer.
- Free Utility Payments & E-Commerce services for internet banking customers.
- Free mobile banking facilities and No Annual Maintenance Charges.
- Enjoy all the above facilities for just an average monthly NRE account balance of Rs. 50,000/-. (Non maintenance of average minimum balance will attract penalty)

SOUTH INDIAN Bank

Experience Next Generation Banking

For further details contact

Any of our branches

or **NRI Cell** at Head Office

SIB House, Mission Quarters

Thrissur, Kerala, Pin - 680 001

Email : nricell@sib.co.in

Tel : 91-487-2429051

or please visit website: www.southindianbank.com

or Call Toll Free-1800-843-1800

SOUTH INDIAN Bank
Experience Next Generation Banking
The South Indian Bank Ltd., H.O. : 'S.I.B. House', Thrissur, Kerala

SIB STUDENTS' ECONOMIC FORUM

FEBRUARY 2009

Theme No. 207 : ECONOMIC SLOWDOWN / RECESSION AND STIMULUS PACKAGES - PART II

How has India been hit by the global crisis?

The contagion of the crisis has spread to India through various mechanisms by impacting financial and real sectors of the economy, as well as affecting the business confidence.

India's financial markets - equity markets, money markets, forex markets and credit markets - came under pressure from a number of directions. 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. The corporates withdrew their investments from domestic money market mutual funds putting redemption pressure on the mutual funds and on non-banking financial companies where the mutual funds companies had invested a significant portion of their funds. The substitution of domestic financing for overseas financing affected money markets and credit markets. The forex market also came under pressure because of reversal of capital flows as part of the global de-leveraging process. Simultaneously, corporates were converting the funds raised locally into foreign currency to meet their external obligations. These factors put downward pressure on the rupee.

Now with regard to the impact on the real sector, the transmission of the crisis has been straight – through the slump in demand for exports. The United States, European Union and the Middle East, which account for three quarters of India's trade in goods and services, are in a downturn. Service export growth is also likely to be affected adversely, as financial services firms – traditionally large users of outsourcing services – are restructured. Remittances from migrant workers also will be downward, as the Middle East adjusts to lower crude prices and advanced economies go into a recession.

The crisis also spread through transmission of business sentiments - the confidence levels. The ongoing turbulence in the global markets prompted bankers to be risk averse and cautious about lending.

The Government and the RBI have responded to the unusual circumstances by way of announcing fiscal and monetary stimulus packages.

What are the monetary stimulus packages initiated by the RBI?
The RBI's policy response aimed at containing the contagion from the outside - to keep the domestic money and credit markets functioning normally and to avoid liquidity and solvency crisis. In particular, the RBI targeted three objectives: first, to maintain a comfortable rupee liquidity position; second, to augment foreign exchange liquidity; and third, to enhance credit delivery so as to arrest the moderation in growth. This implies monetary relaxation in response to easing inflationary pressures.

Accordingly, the RBI reduced the policy interest rates (Repo/Revese repo rates), reduced the reserve rates (CRR/SLR) and expanded refinance facilities for export credit. Measures were announced for managing forex liquidity, upward adjustment of the interest rate ceiling on the foreign currency deposits by non-resident Indians, and relaxing the external commercial borrowing norms.

What are the fiscal stimulus packages announced by the Government?
Over the last five years, both the central and state governments in India made serious efforts to contain the fiscal deficit. However, recognizing the depth and extraordinary impact of the crisis, the central government sought relaxation from the fiscal targets and launched fiscal stimulus packages in December 2008 and January 2009. These fiscal stimulus packages, together amounting to about 3 per cent of GDP, included additional public spending, particularly capital expenditure, government guaranteed funds for infrastructure spending, cuts in indirect taxes, expanded guarantee cover for credit to micro and small enterprises, and additional support to exporters. Also, a post-interim budget 2009-10 stimulus package was announced by the government in February 2009, slashing excise and service taxes which will benefit producers and consumers alike.

What has been the impact of stimulus measures?
The stimulus measures have ensured that the Indian financial markets

continue to function in an orderly manner. The cumulative amount of primary liquidity potentially available to the financial system through these measures is over Rs.3,75,000 crores. This has ensured a comfortable liquidity position resulting in reduction of interest rates. Taking the signal from the policy rate cuts, many banks have reduced their benchmark prime lending rates. As a result, bank credit has expanded. However, there is a marked decline in non-bank flow of resources to the commercial sector. In addition to the massive government spending programmes, a more conducive atmosphere should be created for encouraging private sector investment and revival.

What is the outlook for Indian economy?

There is evidence of domestic economic activity slowing down. Real GDP growth has moderated in the first half of 2008/09. The services sector too, which has been our prime growth engine for the last five years, is on the decline, mainly in construction, transport and communication, trade, and hotels. For the first time in seven years, exports have declined in absolute terms during October-December 2008. Recent data indicate that the demand for bank credit is slackening despite comfortable liquidity in the system. Higher input costs and dampened demand have dented corporate margins. The index of industrial production has shown negative growth and investment demand has decelerated. All these factors suggest that growth moderation may be steeper and more extended than earlier projected.

In addressing the crisis, India has several advantages also. Most notably, the headline inflation, as measured by the wholesale price index, has fallen sharply, and recent trends suggest a faster-than-expected reduction in inflation. The slowing domestic demand has contributed to the disinflation. The decline in inflation will reduce input costs for corporates. Furthermore, the decline in global crude prices and naphtha prices will reduce the size of subsidies to oil and fertilizer companies, thus helping to earmark more funds for infrastructure spending. It is also expected that imports will shrink more than exports keeping the current account deficit modest.

There are also several structural factors to our advantage. First, notwithstanding the severity of the adverse shocks, India's financial markets have shown admirable resilience. The banking system remains sound, healthy, well capitalized and prudently regulated. Second, our comfortable reserve position provides confidence to overseas investors. Third, since a large majority of Indians do not participate in equity and asset markets, the negative impact of the wealth loss effect that is plaguing the advanced economies will be quite moderate. Consequently, consumption demand will prop up in course of time. Fourth, because of India's mandated priority sector lending, institutional credit for agriculture will be unaffected. The farm loan waiver package implemented by the Government will further insulate the agriculture sector from the crisis. Finally, over the years, India has built an extensive network of social safety-net programmes, including the flagship rural employment guarantee programme, which will protect the poor from the extreme impact of the global crisis.

Over the last five years, India clocked an unprecedented nine per cent growth rate, driven largely by domestic consumption, investment and foreign trade. At the heart of India's growth were a growing entrepreneurial spirit, rise in productivity and increase in savings. These fundamental strengths continue to be in place. Nevertheless, the global crisis will dent India's growth trajectory as investments and exports will decline. However, once the global economy begins to recover, India's turn around will be swifter, backed by strong fundamentals. Meanwhile, the challenge for the Government and the RBI is to manage the crisis, taking care of the poor and the vulnerable sections of the population.

Conclusion

According to Amartya Sen, the Nobel laureate in Economics, the present recession in the global economy is more a 'matter of psychology than economics' and no amount of financial stimulus would be enough to turn it around. "We have to get rid of the mindset, the mindset of recession." The economic meltdown gripped the world due to financial mismanagement and lack of regulations by the developed countries. The stimulus packages alone would not perk up the economy and these should be supplemented by coordinated efforts by the developed and emerging economies so that a more participatory and all-inclusive development policy and agenda should be adopted and a more equitable international financial architecture should be visualized and implemented without loss of time.

-Financial crisis is fast becoming a Human crisis-

The World Bank reports:

"The global economic crisis threatens to become a human crisis in many developing countries unless they can take targeted measures to protect vulnerable people in their communities. While much of the world is focused on bank rescues and stimulus packages, we should not forget that poor people in developing countries are far more exposed if their economies falter. This is a global crisis requiring a global solution. The spreading global economic crisis is trapping up to 53 million more people in poverty in developing countries. Almost 40 percent of 107 developing countries were highly exposed to the poverty effects of the crisis and the remainder was moderately exposed, with less than 10 percent facing little risk. Millions already living below the poverty line "will be pushed further below the poverty line" as a result of the global financial crisis".

Stimulus Packages across the Globe....

China announced a huge economic stimulus package aimed at bolstering its weakening economy. China would spend an estimated $586 billion by 2010 on wide array of national infrastructure and social welfare projects, including constructing new railways, subways, airports and rebuilding communities devastated by earthquake.

The US Congress passed a stimulus package worth $ 838 billion, aimed at creating millions of new jobs and steering the economy out of the recession. The move comes in the midst of a recession, which has claimed 3.6 million jobs.

Major economies such as the UK, Germany, France and Japan have already announced Economy Stimulus Packages.

Your comments and feedback on this publication may be sent to Staff Training College, The South Indian Bank Ltd., Thrissur, Kerala 680 001 or by E.mail: ho2099@sib.co.in

www.southindianbank.com

SIB Junior
Grow with aspirations

With a mission to impart Savings Habit among students South Indian Bank has come up with this product - 'SIB JUNIOR', a SB account exclusively for students who have completed 12 years of age and are eligible to open a SB account with any of our branches. Introduction from the Principal, Head Master, HOD etc is sufficient for opening such an account. Now help your child to grow with savings habit from young age.

For further details contact our branches
visit: www.southindianbank.com Email : sibcorporate@sib.co.in

SOUTH INDIAN Bank

Experience Next Generation Banking

Head Office: SIB House, Mission Quarters, Thrissur, Kerala, Pin - 680 001. Toll free 1800-843-1800, 1800-833-1800 (India)