

# **Global Financial Crisis: Indian and International perspectives**

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# Global Scenario

## **Contractionary forces are circular self-reinforcing:**

- Loans are going bust
- Asset prices are falling
- Credit markets are deteriorating
- Financial institutions are going bankrupt
- Business and consumer confidence is deteriorating
- Demand is declining
- Production is plunging
- Job losses are rising
- Economy is shrinking

# Global Economic Outlook

- Global economic outlook deteriorated sharply over the last quarter.
- IMF made a marked downward revision of its estimate for global growth in 2009 in ppp terms – from its forecast of 3.0% in October 2008 to 0.5 % in January 2009
- World trade is projected to contract by 2.8 per cent in 2009
- Global GDP is projected to actually shrink by 0.6 per cent
- All the advanced economies – US, Europe and Japan - having firmly gone into recession, the contagion of the crisis from the financial sector to the real sector has been dramatically severe.

# Global Outlook

- U.S. real GDP dropped at an annualized rate of 6.2% in the fourth quarter, the sharpest rate of contraction since 1982.
- U.S. core rate of inflation is receding, but not as quickly as the overall CPI inflation rate.
- EU 16 economy contracted at a 5.8% annual rate in the 4<sup>th</sup> quarter.
- Central Banks have been pursuing monetary easing and are expected to do so further

# Global Outlook - United States

- Consumer spending tumble more than 4% in 4<sup>th</sup> Quarter
- Fixed investment spending plunged 21 % in the 4<sup>th</sup> quarter.
- Capital spending continues to fall sharply
- U.S. exports to fall due to economic weakness in the rest of the world
- A sharp contraction in inventories appears to be underway as well.

# Global Outlook - United States

- The core rate of inflation is receding, but not as quickly as the overall CPI inflation rate.
- The direct lending programs by the U.S. Treasury and the Fed have helped to stabilize the financial system.
- Lending likely to remain very constrained until banks begin to rebuild their capital bases.
- Slow recovery should begin in the second half of 2009.

# Global Outlook - Eurozone

- The situation has gone from bad to worse.
- 16-country economy contracted at a 5.8% annual rate in the 4<sup>th</sup> quarter.
- It was the 3<sup>rd</sup> consecutive quarter of contraction & latest sign of the severity of the financial crisis in Europe.
- Consumer spending in the Euro-zone dependent on unemployment (now over 8%) & consumer confidence is also at a record low.

# Global Outlook - Eurozone

- The ongoing global recession will keep a lid on export growth for much of this year
- The overall rate of CPI inflation in the Euro-zone shot up to 4% last summer.
- CPI inflation is receding quickly, giving ECB scope to ease monetary policy.
- ECB has cut rates by 225 bps since October 2008
- Current policy rate 1.50% at present
- By summer the main Euro-zone policy rate may reach 0.50%.

# Global Outlook - Eurozone

- Previously high-flying euro declined sharply against the dollar
- Euro likely to trend lower against the dollar in the next few quarters as the ECB continues to cut rates.
- Euro could comeback against the dollar as sluggish economic growth in the United States keeps U.S. interest rates very low for an extended period.

# How Germany is hit

- Real GDP contracted at an annualized rate of 8.2% in the 2<sup>nd</sup> quarter (largest quarterly decline on record)
- Economy is likely to decline in real GDP of more than 5% in 2009
- Unemployment trended lower, dropping to its lowest rate since the early 1990s but is picking up sharply.
- Consumer spending will weaken further in coming quarters.
- German exports dropped a 18.4% in January 2009 year over year

# Global Outlook – Emerging Economies

- Contrary to the 'decoupling theory', hit by the crisis.
- According to it even if advanced economies went into a downturn, emerging economies were not effected because of
  - their substantial foreign exchange reserves
  - improved policy framework
  - robust corporate balance sheets
  - and relatively healthy banking sector.

# Global Outlook – Emerging Economies

Evidence of the last few months –

- capital flow reversals
- sharp widening of spreads on sovereign and corporate debt
- and abrupt currency depreciations - the 'decoupling theory' stands totally invalidated.

# Emerging Economies (BRIC)

## **Brazil:**

- Real GDP fell at an annualized rate of roughly 14% in the 4<sup>th</sup> quarter
- Brazilian “real” depreciated more than 30% since it rose to a nine-year high versus the dollar in August.

## **China**

- Economy slowed over past 6 quarters from a 13-year high of 12.8% in the 2<sup>nd</sup> quarter of 2007
- YOY growth rate slowed to 6.8% in 4<sup>th</sup> quarter of 2008 (slowest rate in nine years)

# Emerging Economies (BRIC)

- The Chinese “renminbi”, is stable since last July.
- The downturn in the rest of the world is having a very harmful effect on the Chinese economy. Exports tumbled more than 17% (yoy) in January

## **Russia:**

- Economy has fallen into a deep recession.
- The Russian “ruble” has lost about 35% of its value against the dollar since mid-July as Russian banks have scrambled for dollar funding

# What is the Outlook for India?

The outlook for India going forward is mixed.

- Economic growth has slowed over the last few quarters.
- 5.3% GDP growth rate in the 4<sup>th</sup> quarter (slowest pace of expansion in more than five years)
- 16% decline in Indian exports in January (YOY change)
- The services sector is slowing, mainly construction, transport & communication, trade, hotels & restaurants sub-sectors.
- 1<sup>st</sup> time in seven years, exports declined in absolute terms for three months in a row during October-December 2008.

# What is the Outlook for India?

- Bank credit is slackening despite comfortable liquidity in the system.
- Higher input costs and dampened demand have dented corporate margins while the uncertainty surrounding the crisis has affected business confidence.
- Wholesale price inflation has receded over the past few months as commodity prices have dropped sharply and as the Indian economy has slowed.
- Reserve Bank of India has cut rates by 400 bps since mid-October. The main policy rate now stands at 5.00%, the lowest rate in at least nine years.

# Emerging Economies – (BRIC)India

- The index of industrial production has shown negative growth for two recent months and investment demand
- The Indian rupee has plunged to an all-time low versus the dollar as the outlook for the Indian economy has deteriorated and as risk aversion has spiked.
- In the near term, the rupee will probably continue to trend lower. However, the rupee could begin to make its way back later this year as economic growth in India begins to strengthen.

# Washington Action Plan (Part 1)

## Strengthening Transparency and Accountability

- Improvement in accounting standards including for provisioning and valuation uncertainty
- Full transparency of exposures to off-balance sheets
- Disclosure of complex financial instruments
- Enhancement of governance of the international accounting standard setting body
- All systematically important financial institutions, markets and instruments are subject to appropriate degree of regulation and oversight

# Washington Action Plan (Part 2)

## Enhanced Sound Regulation

- Regulatory Regimes
  - Development of recommendations to mitigate pro-cyclicality
- Prudential Oversight
  - Highest standards and monitoring for credit agencies
  - International setting for capital requirements for banks
  - Greater standardisation and resilience of credit derivatives markets
- Risk Management
  - Guidance to strengthen banks' risk management
  - Implementation of procedures to ensure better risk management in financial firms
  - Developing new stress testing models (Basel Committee)

# Washington Action Plan (Part 3)

- Promoting Integrity in Financial Markets
- Reinforcing International Cooperation
  - Establishing supervisory colleges for all major cross-border firms
- Reforming International Financial Institutions
  - FSF expansion to broader membership (emerging economies)
  - Stronger collaboration of FSF and IMF
  - IMF to draw up lessons from the crisis
  - Review of adequacy of IMF and World Bank resources

# Finance Minister Meeting March 14

## Restoring Global Growth

- Commitment to fight all forms of protectionism and maintain open trade and investment
- Key priority to restore lending through continued liquidity support, bank recapitalisation and dealing with impaired assets
- Call on IMF for action assessment
- Usage of full range of monetary policy instruments
- Mobilising International Financial Institution (IFI) resources to help emerging and developing economies

# Finance Minister Meeting March 14

## Strengthening the Financial System

- FSF expansion to all G20 members
- All systemically important financial institutions (including hedge funds) are subject to regulation and oversight
- Oversight to prevent build-up of systemic risk
- Buffer building and measures to constrain leverage
- Strengthened international cooperation regulatory Oversight of credit agencies and full transparency to off-balance sheets vehicles
- Emerging and developing economies should have greater voice and representation in international financial institutions

# Measures Taken up in Germany

- Focus on guarantee schemes and strengthening liquidity and the capital basis of financial institutions
- Guarantees amount to about 130 billion €. In addition recapitalised major banks (18.2 billion € for Commerzbank and 525 million € for Aareal Bank)
- Stimulus packages of almost 90 billion € [annual average of approx. 1¾% of GDP in 2009 and 2010] focus on safeguarding jobs and businesses' capacity to invest.
- In addition, Germany will allow the automatic stabilisers to take their full effect.

# Stance on further Measures

- Rather negative in regard of further stimulus
- Instead focus on fiscal solvency to avoid adverse market reactions
- Focus on long-term sustainability and appropriate rules and institutions
- Rule based deficit spending
- Bill to explicitly cap government debt is pending
- Strong position to refrain from protectionist measures
- Focus on coordinated efforts to restore confidence
- Breakthrough in WTO negotiation would be welcome
- Further options if necessary not excluded (impaired asset)