
An analysis of financial sector reforms in India and the challenges ahead



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Are the reforms slow?

Slow but steady



...not to forget the socio economic needs ...

How quickly can all these be solved ?



- High fiscal deficit – financial repression
- Huge public debt
- Monetary policy subservient to fiscal policy
- Constrained and multiple responsibilities on the central bank
- Regulated interest rates
- Passive banking system – directed lending/investment
- Commercially non viable but socially desirable bank expansion
- Democracy and the beneficiaries of the inefficient system
- Then the BoP crisis and securities market scam

The Crisis and opportunity



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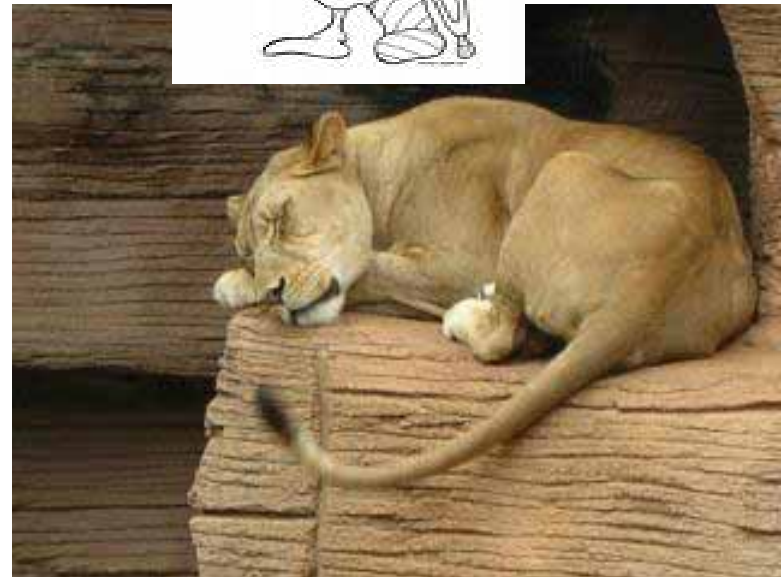
"Out of clutter, find
simplicity.

From discord, find
harmony.

In the muddle of
difficulty, lies
opportunity."

Albert Einstein

Lion in jungle vs lion in cage



Lion or Lame duck?

Sequencing the reforms



- Deregulation of interest rates
- Government's Willingness to borrow at market related rates
- Pressure on banking sector – prudential norms
- Capital infusion into government banks
- Alternative capacity building for government debt & strategies to avoid refinancing risk
- Simultaneous improvements in market micro structure
- Private competition in banking

Sequencing the reforms



- Exchange rate regime
- SEBI (Securities and Exchange Board of India)
- NSE (National Stock Exchange), NSCCL and NSDL
- RTGS (Real time gross settlement)
- CCIL (Clearing Corporation of India Ltd.,)
- NDS (Negotiated Dealing System)

Interest rates and inflation

Year#	Weighted Average interest rate on Central Government securities	Inflation rate as measured by WPI
1980-81	7.03	18.2
1990-91	11.41	10.3
1995-96	13.75	8.0
2000-01	10.95	7.2
2005-06	7.34	4.4

Financing pattern of fiscal deficits

Year	Internal finance				External finance
	Market Borrowings	Other borrowings @	Draw down of cash bal	Total (2+3+4)	
1	2	3	4	5	6
1990-91	8,001 (17.9)	22,103 (49.5)	11,347 (25.4)	41,451 (92.9)	3,181 (7.1)
1995-96	34,001 (56.4)	16,117 (26.8)	9,807 (16.3)	59,925 (99.5)	318 (0.5)
2001-02	90,812 (64.4)	46,038 (32.7)	-1,496 (-1.1)	135,354 (96.0)	5,601 (4.0)
2005-06 (RE)	101,082 (69.2)	22,541 (15.4)	15,037 (10.3)	138,660 (94.9)	7,515 (5.1)
2006-07(BE)	113,778 (76.5)	26,584 (17.9)	0 (0.0)	140,362 (94.4)	8,324 (5.6) ⁹

Growth of commercial banking in India



	1969	1980	1991	2005
Number of Commercial banks	73	154	272	288
Number of bank branches	8,262	34,594	60,570	68,339
Population per office ('000)	64	16	14	16

Net NPAs



Year	SCBs	PSUs	OPSB	NPSB	FB
1996-97	3.3	3.6	3.1	1.0	0.9
2000-01	2.5	2.7	3.3	1.2	0.8
2004-05	0.9	1.0	1.4	0.8	0.4
2005-06	0.7	0.7	0.9	0.4	0.4

Indicators of financial sector (2005)



Indicator	OECD average	India
Bank Deposits/GDP	0.80	0.51
Financial system deposits/GDP	0.84	0.53
Private credit by deposit money banks/GDP	0.99	0.36
Private credit by deposit money banks and other financial institutions/GDP	1.02	0.34
Bank concentration #	0.68	0.37
Net interest margin	0.030	0.034
Bank overhead costs/total assets	0.034	0.024

Indicators of financial sector (2005)..



Indicator	OECD average	India
Stock market capitalisation/GDP	0.75	0.50
Stock market total value traded/GDP	0.68	0.60
Stock market turnover ratio	0.84	1.16
Private Bond market capitalisation/GDP	0.39	0.005
Public bond market Capitalisation/GDP	0.47	0.32
Life insurance premium volume/GDP	0.049	0.025
Non life insurance premium volume/GDP	0.033	0.007

Securities market



- National Stock Exchange – satellite networking, brokers as franchisees, novation, settlement guarantee, screen based trading, online surveillance
- Pre and post trade transparency – to facilitate price discovery and supervisor's capabilities
- Depository and clearing corporation
- Internet trading
- Where are the Indian stock exchanges

Impact cost – equity spot market



	2002	2003	2004	2005
NSE-NIFTY (for Rs. 5 million)	0.12	0.10	0.09	0.08
NSE –NIFTY Junior (for Rs.2.5 million)	0.41	0.32	0.31	0.16

Primary markets –Resources raised



(Rs. billion)

	2002	2003	2004	2005
Debt	45.49	52.84	23.83	0.66
Equity	24.20	28.91	334.75	303.25

Government bond market



(Rs. billion)

	2002	2003	2004	2005
Gross issuance	1,202.13	1,130.00	1,195.00	1,293.50
End year market capitalisation	6,551.48	9,599.03	9,963.41	10,515.21
Turnover ratio	197.48	16.48	107.48	71.42

Other developments



- Negotiated dealing system
- Clearing Corporation of India
- Real Time Gross Settlement
- Shift to market based monetary policy tools
- Exchange rate regime and forex reserves
- Insurance and pension industry

Issues and challenges

- Use of technology – the flip side
- Global imbalances - counter cyclical policy measures
- Common standards – BASEL
- Compliance costs
- Liquidity overhang and enhanced risk appetite
- Dominance of financial sector
- Hedge/Private equity funds- cost of regulation
- Micro finance and poverty alleviation
- Financial education

Issues and challenges

- Derivatives market
- Bond markets
- Innovation vs financial system stability – Regulatory dialectics
- Deregulation vs enhanced surveillance
- Financial inclusion
- Synchronisation of financial sector reforms with sectoral and fiscal reforms

Data sources



- Reserve Bank of India
- Economic Survey, 2005-06 – Government of India
- Federation of World Exchanges
- World Bank

Thank you