

# **Capital Flows & Financial Crisis: The Indian Experience**

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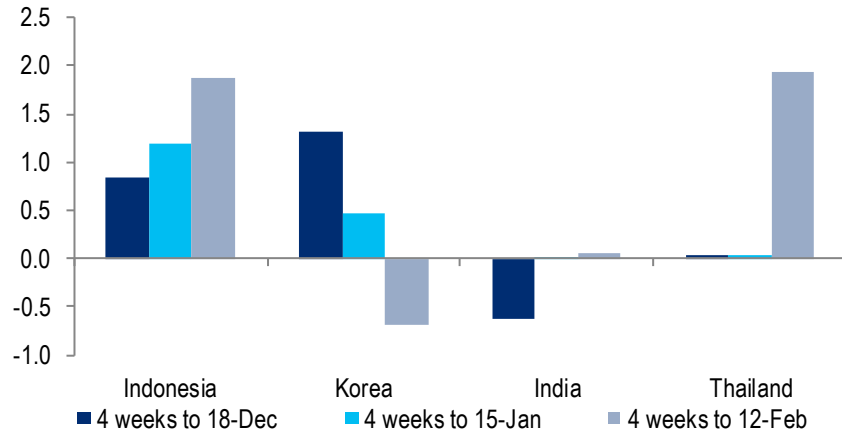
# Asian economies Recent developments...

- 8 years have passed since GFC in 2007- pre-GFC growth rates not restored
- Facing waning domestic demand, exports, and credit momentum, under-pressure asset markets
- Industrial countries are engaged in ever more aggressive monetary policy moves
- Normalizing policy rates in the US
- China started showing signs of weakening
- Surges of capital inflows one day when investors go into “risk-on” mode only to see outflows the next as they switch risk off.
- Rapid capital inflows or outflows not fully supported by fundamentals

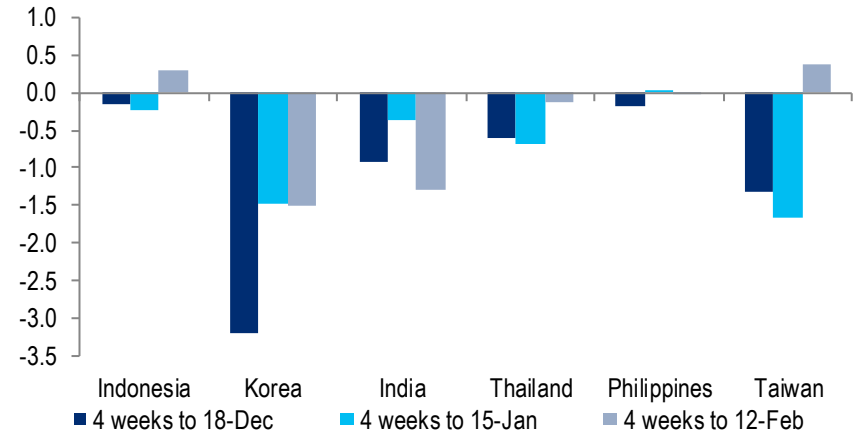
# EM Asia

## High frequency equity and debt flows data

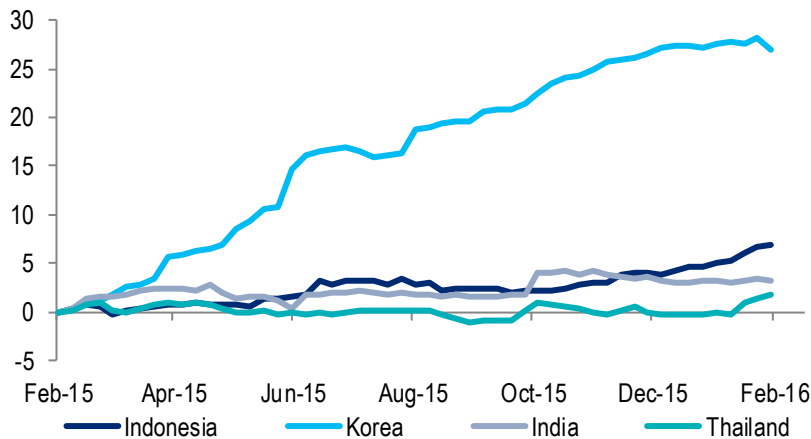
Momentum in foreign investments in bonds, USD bn



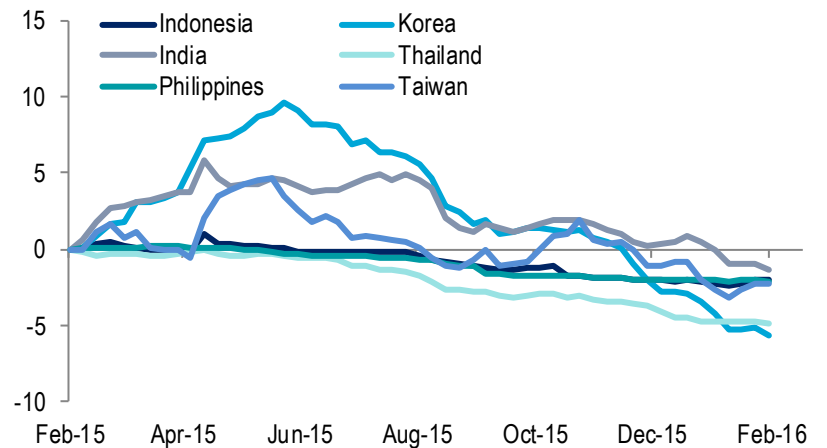
Momentum in foreign investments in equities, USD bn



Foreign investment in bonds, USD bn



Foreign investment in equities, USD bn

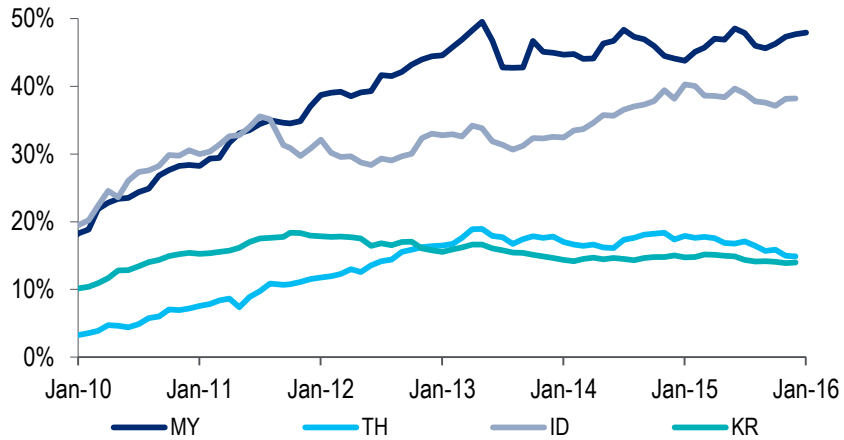


Source: Bloomberg, Central bank, Debt management and bond market association websites, Citi Research; data as of 15 Feb 2016

# EM Asia

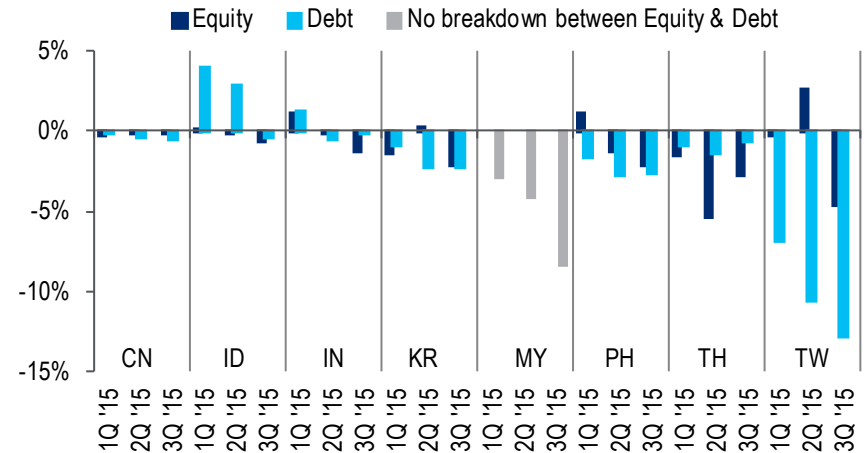
## Portfolio flows

Foreign ownership of local currency government bonds



Source: Bloomberg, CEIC, Haver Analytics, IMF, Citi Research; data as of 15 Feb 2016

Portfolio inflows as % of GDP



# US FRB have any impacts

- Federal Reserve pulls back from four rate hikes, expects to raise rates twice this year
- Element of surprise not there- the rate hike is communicated extensively – Asian Economies are better prepared
- The first increase in US interest rates in almost 10 years has not resulted in a large-scale crisis in emerging markets, but there are still risks.
- Differences between countries on their ability to weather the impact of higher interest rates.
- The timing of the hike -Asian markets are struggling with the slowdown in China- low commodity prices and increasing geopolitical risks
- Capital outflow but the trend reversed.
- The most vulnerable countries are who have high external borrowing requirements and relatively low buffers.

# Anatomical Taxonomy of External Financial Crises

<i>Crisis Type</i>	<i>Originating Countries</i>	<i>Origin of problem</i>	<i>Manifestation</i>	<i>Trigger</i>	<i>Exchange Rate Regime</i>	<i>Remarks</i>
Latin American	Emerging markets (Latin America 1982; India 1991); Small advanced country (Greece 2010 onwards)	Government borrowing	Current account deficit	Speculative attack and exchange rate collapse	Fixed rate	Greece was part of euro, so trigger was sharp rise in interest rates.
Asian Financial Crisis	Emerging markets (East Asia 1997-9; Eastern Europe 2008; Fragile Five 2013); Small advanced country (Spain 2010)	Corporate borrowing	Asset price bubbles; High corporate leverage	“Sudden stop” of capital flows and exchange rate collapse	Fixed rate	Fragile Five had flexible exchange rates. Spain was part of euro.
Japan	Systemically Important	Corporate borrowing	Asset price bubbles; High corporate leverage	Asset price collapse	Floating exchange rate	Yen <i>appreciated</i> after crisis.
Global Financial Crisis	Systemically Important (US 2008)	Bank and consumer borrowing	Asset price bubble in housing	Correction in asset prices	Flexible exchange rate	US dollar <i>appreciated</i> .

# How could the next crisis happen?

- Systemically Important
- Corporate borrowing
- Rising debt, asset price bubbles
- “Sudden stop” with potential for sharp exchange rate decline
- Managed float
- Crisis country’s currency could depreciate substantially

# Indian experience...

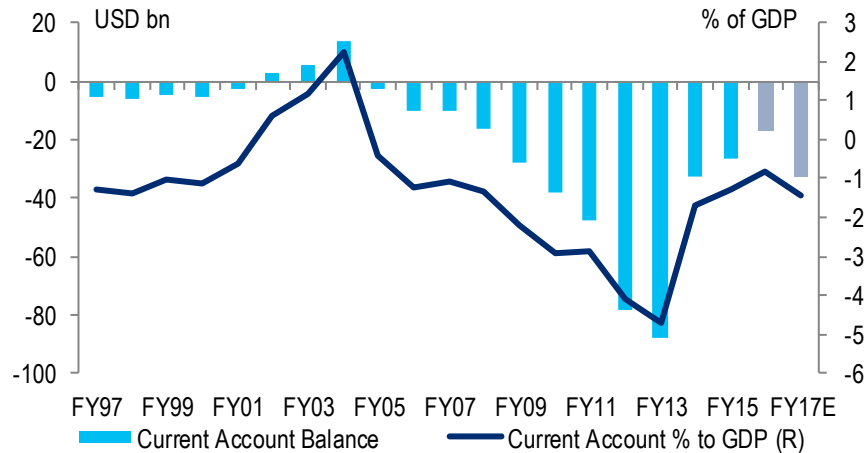
- India stands out as a haven of stability and an outpost of opportunity.
- Its macro-economy is stable- commitment to fiscal consolidation and low inflation.
- A reorientation of government spending toward needed public infrastructure.
- Focus on attracting stable capital flows that will stay for the long run.
- Not be tempted by cheap finance!
- Draw in the risk-bearing capital we need to finance our growth.
- We intend foreign investors to get decent returns and we do intend to continuously ease both entry into and exit from the country



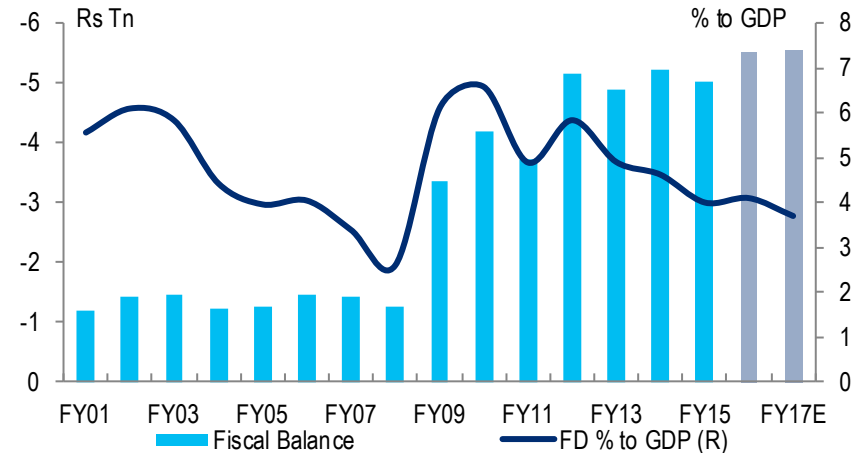
# India

## The deficits, reserves and capital flows

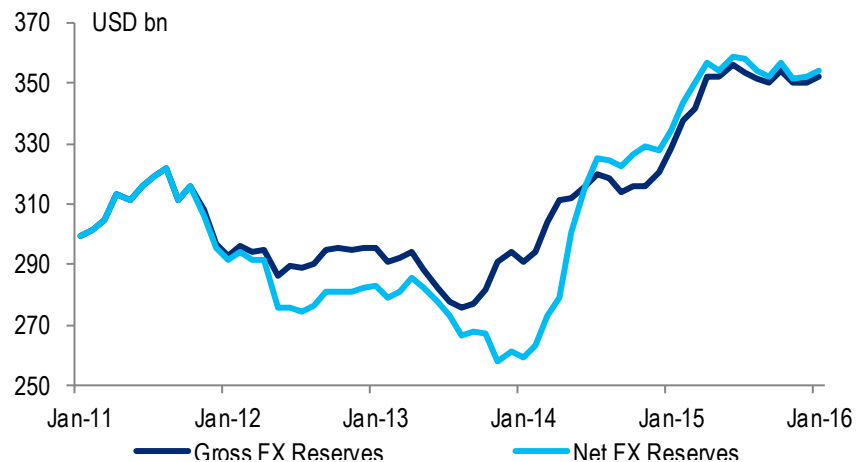
Current account balance (USD bn, % of GDP)



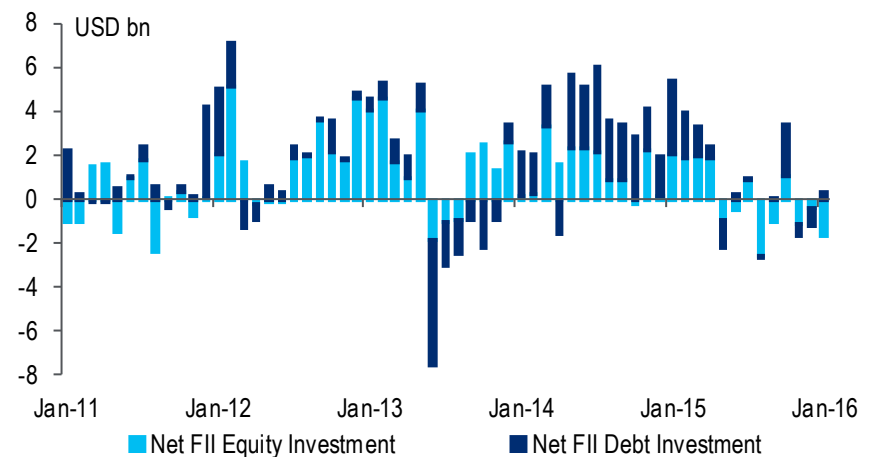
Fiscal deficit (INR tn, % of GDP)



FX reserves

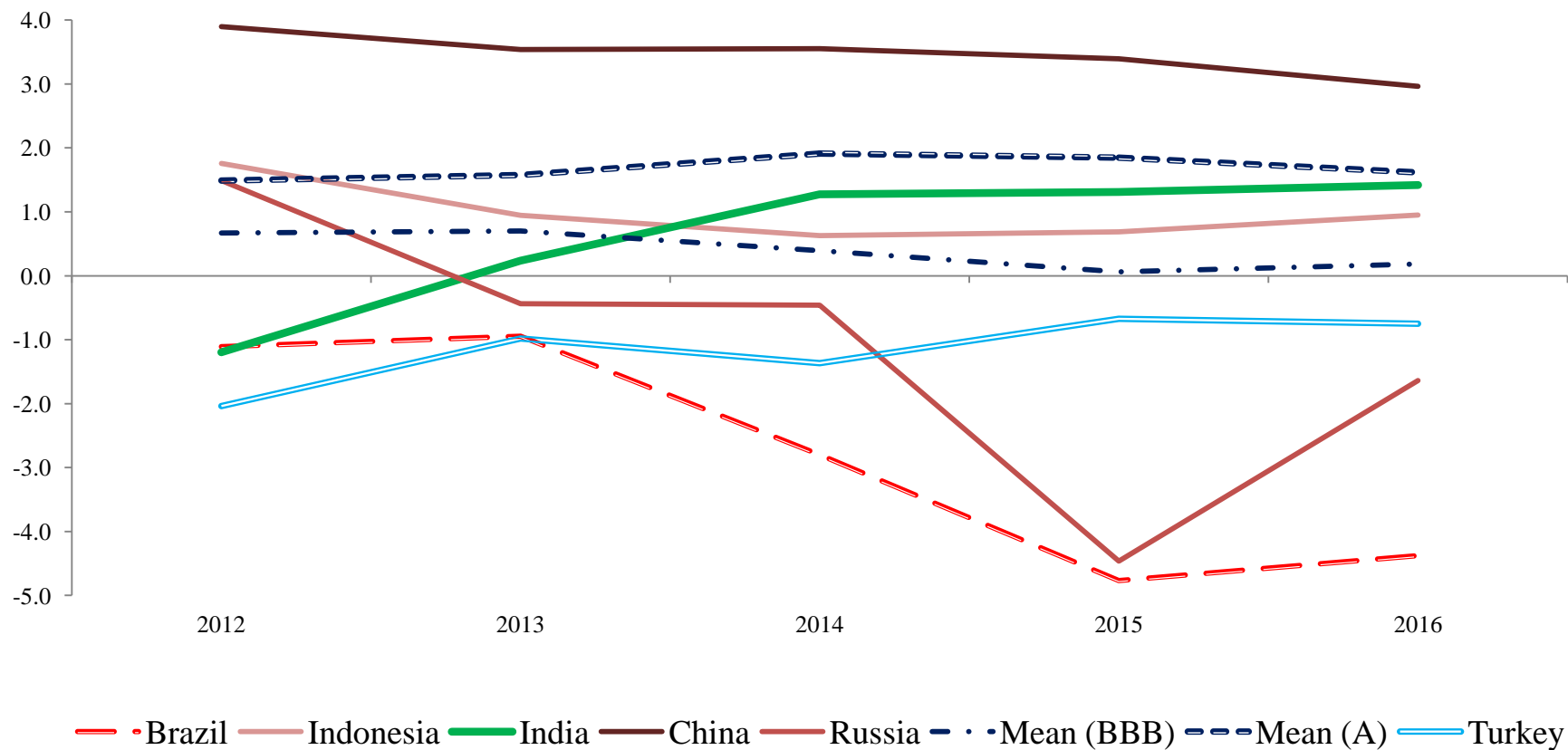


Net FII investment in equity and debt



Source: RBI, CEIC, CSO, Haver Analytics, Citi Research; data as of 15 Feb 2016

# Rational Investor Ratings Index 2012-16



# Major Sources of Capital Flows

(amount in US\$ billion)				
Source	2012-13	2013-14	2014-15	2015-16
Net FDI	19.8	21.6	31.3	31.7 (Apr-Jan)
Net FPI	26.9	4.8	40.9	(-) 15.3 (Apr-Mar 4)
Net NRI Deposits	14.8	38.4	14.0	12.7 (Apr-Jan)
(Source: Reserve Bank of India)				

Thankyou for listening.....