**Union Finance Minister Shri Pranab Mukherjee's's Address**

**at**

**Global Economic Turmoil, Indian Economy and the Role of Banking Sector**

ASSOCHAM Conference, November 13, 2001, Kolkata

Distinguishes Participants,
Ladies and Gentlemen,

It gives me great pleasure to be here in Kolkata and share my thoughts on a subject that has occupied centre stage since the outbreak of global financial crisis and its impact on economies around the world. I welcome this initiative of ASSOCHAM to dwell on this issue with a view to draw lessons for future. As an important business forum, ASSOCHAM has strived to empower Indian enterprise by inculcating knowledge and facilitating the Indian industry to upscale and modernise and emerge as a competitive player in the international market.

2. India, unlike most other economies, was not seriously affected by the financial turmoil of 2008 in the developed world. For us the adverse effects were primarily limited to the equity markets because of the reversal of portfolio flows, the concomitant effects on the domestic

foreign exchange market and the resulting liquidity conditions in the economy. There was also some indirect impact through trade channels. A detailed study undertaken by the RBI on the impact of the sub-prime episode on the Indian banks had revealed that none of the Indian banks or the foreign banks in India had any significant direct exposure to the sub-prime markets in the USA or other markets.

3. At the same time, we were not completely immune from the crisis and the post-crisis developments in the real economy. The timely fiscal stimulus measures implemented by the Government helped in moderating the impact on economic growth and facilitated a rapid recovery. The indirect effects on our financial system were also effectively addressed with timely and appropriate policy response from the Reserve Bank of India and the Government.

4. Following the sub-prime crisis, Banking Regulators across the world took a series of measures. Let me inform this august gathering that some measures considered globally as part of the regulatory reforms, in response to the crisis, were already in practice in India even before the crisis. These included restrictions on exposure to sensitive sectors, liquidity risk management measures especially on prescription of holding of liquid assets by way of Government securities, counter cyclical prudential measures on sectoral basis, not recognising in Tier I

capital many items that are now sought to be deducted internationally, prohibiting originator from booking profits upfront at the time of securitisation, not reckoning unrealised gains in earnings or in Tier I capital.

5. The current heightened global uncertainty on account of lingering Euro Zone crisis has implications for emerging market economies including India. It has impacted the Indian economy essentially through the financial market channel, the equity and foreign exchange markets, due to the risk averse nature of global capital flows. While there are some similarities in the present developments with that of 2008, the present one is in the nature of an ‘after-shock’. Our assessment is that the on-going Euro-zone crisis is not expected to have any significant impact on Indian banks as they do not have any presence in the southern peripheral European countries, though they have limited presence in Belgium, France and Germany. Indian banks do not have any significant bond exposure to these countries. The Indian Banking System continues to remain stable and efficient, but the continued uncertainty in the world economy has thrown new challenges for the real economy.

6. The impact on the real economy has been largely through depressed domestic business sentiments on account of poor global cues and slowdown in global demand for Indian exports. This is holding back growth in private investments. After recording a rapid recovery from the slowdown in 2008-09 when the GDP grew at 6.8 per cent, the economy posted an average growth of over 8 per cent in the past two years. The current global developments are casting a shadow on our growth prospects for the fiscal 20011-12. GDP growth has moderated to 7.7 per cent in the first quarter of 2011-12 and is more likely to remain around 8 per cent for the year. This should not dishearten us. A less than expected growth performance will still be among the fastest in the world. However, our challenge is to regain a high, sustainable, balanced and inclusive growth in the medium to long-term period.

7. Our pre-crisis growth experience and our economic fundamentals suggest that the Indian economy has the potential to grow at over 9 per cent. This has implications for banks in India as the Indian financial system is bank-dominated. The role of Indian banking sector in the post-crisis period would be to support such a growth trajectory while adapting and adopting to the evolving regulatory and institutional framework for banks.

8. Though there are no robust estimates available for the credit-intensity of Indian growth, it is generally believed that to support 9 per cent growth, bank credit needs to grow around 20-21 per cent. In this context, the issue of capital adequacy necessary to permit such growth of credit acquires importance. We have asked Public Sector Banks to improve their efficiency parameters, including recovery, so as to generate adequate surplus from internal sources to meet a part of the capital requirements. Govt is also committed to infuse additional capital in Public Sector Banks. In my Budget Speech 2011-12, I had announced a provision of Rs. 6000 crore to enable PSBs to maintain a minimum Tier-I CRAR of 8 per cent. We have already released Rs. 1000 crore and the balance will be released during the current year.

9. Up-scaling of financial inclusion efforts is essential for banks as it embodies the potential for augmenting growth prospects in terms of enhancing bank savings and financial deepening. We have launched an ambitious plan ‘Swabhiman’ under which 73000 habitations of the country having a population of over 2000 are to be provided access to banking facilities by the year 2012. By the end of July, 2011, 36,677 villages have been covered. The remaining villages will be covered during the current financial year by March, 2012. Banks will have to gear up to meet this challenge. So far Banks have issued over 10 crore Kisan Credit Cards (KCC). Banks have also introduced General Credit Card

(GCC) facility up to Rs 25,000 in their rural and semi-urban branches to provide hassle free credit to customers based on the assessment of cash flow without insistence on security or end-use of the credit. So far banks have opened nearly 10 lakh General Credit Card accounts. Similarly, banks have opened 75.47 lakh Saving Bank accounts for Self Help Groups(SHG) with a collective savings of Rs.6,925 crore with the banks. During the year 2010-11, the Banks have disbursed an amount of Rs.14, 773 crore as loan to 12 lakh SHGs. While Banks have played a significant role under financial inclusion initiative, there are vast opportunities for tapping banking business, particularly in the rural and semi urban areas that need to be harnessed.

10. Growth of banking services is critical for sustaining high growth trajectory that we have set for ourselves. It was in that context, I had indicated the issue of new banking licences to private players by RBI in my Budget Speech. Entry of new banks, both Indian and foreign, does increase competition in the banking sector with attendant benefits in the form of improved efficiency in banking intermediation and encouraging product innovation and development. These in turn would aid in sustaining the growth momentum. Indeed, the role of banks in future would greatly be governed by how Indian banks position themselves to face up to the impending intensification of competition in the Indian banking sector.

11. Changes in the banking scenario would also necessitate changes in regulatory regime, particularly to minimize the transmission of adverse effect of crisis originating elsewhere in the global economy. The regulatory measures initiated in the post-crisis period for furthering financial sector reforms are aimed at institutional and market development and strengthening resilience of the financial system. These measures would have far reaching impact on the role that banks would play in the years ahead.

12. Globally, from a macro-prudential perspective, there is a realization that banks should build up provisioning and capital buffers in good times i.e. when the profits are good, which can be used for absorbing losses in a downturn. It was therefore decided by RBI that banks should augment their provisioning cushions consisting of specific provisions against NPAs as well as floating provisions, and ensure that their total Provisioning Coverage Ratio (PCR), including floating provisions, is not less than 70 per cent with reference to the position as on September 30, 2010.

13. In distilling the lessons from the global financial crisis, an international endeavour known as Basel III is underway to reform global financial regulation. Some of the main elements of Basel III reform relate

to enhancement of capital and liquidity regulations, ensuring macro-prudential regulation overlay to micro-prudential regulation and extending the perimeter of regulation to ensure that all systemically important institutions and market infrastructure are captured. I do not intend to go into the details of other initiatives relating to regulatory and institutional reforms, but let me just mention that these measures are necessary for a sound banking system. Banking system in India has shown great resilience in the post-global crisis period and I am sure it will rise to meet the challenge of sustaining high inclusive growth that we have set for ourselves.

14. I have been watching the corporate sector some of whom have shown great responsibility towards the society and have developed a sort of interface to reach the bottom of the pyramid through innovations in product and marketing and through initiatives on corporate social responsibility. I urge all of you to emulate the example set by some in your fraternity. Let me also impress upon the captains of industry that they need to proactively propagate, support and participate in the financial inclusions endeavour because this is necessary for the country to achieve a higher growth trajectory as much as it is necessary for the industry to sustain their growth through broad based demand for their products.

15. Let me conclude by suggesting that notwithstanding the short term effects on India of current global developments, the inherent strength of our economy will keep our long term success story intact. I would also like to emphasize that when the western world is suffering and adjusting to the shocks of global meltdown and the after effects of crisis in Greece, our industry leaders must consolidate and leverage their position for a better tomorrow.

I wish you all the very best in your endeavours.

Thank you

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