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Regulatory diligence by the liquidity of financial institutions in solving financial crisis – Some suggestive measures

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Abstract

India is one among the fast developed economies in recent times even in the midst of international financial crisis. To adjust international monetary disequilibrium in our economy the higher monetary authority namely RBI is essentially followed certain regulatory diligence especially the usage of liquidity of financial institutions under the overall instructions. All over the nation have met financial crises but India evaded from this lacunae because of its own homemade savings of the households/larger sections of the society. Very recently the most developed country like USA is under the grip of inflationary sequences. To adjust the monetary disequilibrium the federal bank of USA is going to raise the rate of interest of commercial banks from 4.6% to 5.1%. In the case of India our rupee is gradually diminishes with the tune 81.64 per US dollar in the international transactions. In this context it is a most wise and essentially to adhere certain regulatory diligence like minimal usage of liquidity of financial institutions, reducing the volume of nonperforming assets of our financial institutions and so on. The author made an attempt to analyze the sequences of regulatory diligence of our financial institutions like public sector banks and other lending institutions in adjusting monetary disequilibrium in a very detailed approach in this paper.

Subject Classification: *90B 50, 90 B60, 90 B 70.*

Keywords: *Financial crisis, Liquidity, Financial institution, International sequences, Suggestive measures.*

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Introduction

Global financial crisis and its sequences in all over the world have resulted unwanted and untoward happenings in the international markets. India is also not free from its own sequences but at the same time the extent is lesser as compared with other countries because of our own internal savings. Our family system encouraged the habit of thrift and savings amongst households to face the future contingencies. Most of our financial institutions are very carefully utilizing the liquidity of financial institutions in overcoming the financial crisis. The global financial meltdown artificially discourages consumption activities but encourages tend to spend more and more on durable items[17]. Financial institutions like public sector banks, term lending institutions like LIC, GIC and non-banking financial institutions are instructed to utilize the quantity of liquidity under the overall regulatory measures of RBI in solving financial crises. The present international financial crisis has much more negative influence on India's growth diagnosis more than expected. According to the decoupling theory (Akin and Kose 2007; The Economist 2008), the current rapid growth of intra-regional operations, more savings rate and a emerging supply of foreign funds that contributed to the decoupling of business cycles in some rising markets from those in highly developed countries. Even as the US sub-prime catastrophe was in the beginning to take outline, this point was made in the year 2007 [01]. It was supposed that India will stay cut off from US developments for two major reasons. Initially, neither the harmful sub-prime mortgage assets nor the buckled banks directly affected the Indian banking sector. The second is an increase in the inside demand, predominantly capital development is responsible for a large portion of India's recent development. Just 20% of India's GDP was obtained from exports of products and services to convince external demand (GDP). It is worthwhile to mention that how far the US economy and banking institutions collapsed during the great depression of 1930s was largely discussed by the 2022 Nobel laureate in economics by former Federal Reserve Bank chief and Yale university professor Diamond and others. The collapse of the banking system was due to the global melt-down in US economy which resulted many more depositors of the bank were forced to withdraw their money from the bank because of the insecurity and instability of the monetary system. Especially in India during 2007-2008 surpassed financial crisis which created unwanted happening in the financial sector. India's position in the international arena largely acclaimed by all sections because of its household saving habit which would tend to stabilize the banking sector. Most of financial institutions in India are in a position to follow and adopt suitable monetary regulatory measures like CRR, BR and others to stabilize the monetary situations. One more example in this context is to cite that the outbreak of the Ukraine war also created a slight sluggishness in the international monetary transactions.

National and International Scenario

Despite these considerations, the global crisis had a significant impact on India, which saw its fall in the development rate from 10.6% in Q3 2017 to 5.8% in Q4 2018. India's growing global integration was a major factor in the growth rates decline. India's intensity on the international incorporation, as determined by the summation of financial and trade flows, went from 47% during 1997–1998 to 117% during 2007–2008, in spite of having a low export to GDP ratio. The slow and calculated approach taken by Indian officials toward the deregulation of this sector helped to reduce the impact of the worldwide financial crisis on India's financial sector. Several countercyclical measures were also used by Indian officials during the credit expansion before the crisis. Additionally, a number of actions were done to strengthen the sector's resilience to upcoming crises throughout the post-subprime crisis period. As a result, the crisis had an adverse effect on India with decreasing the business sector's access to international monetary markets which decreases local liquidity and triggering a turn down in stock prices.

Statement of the Problem

Several finance industries those considerably reliant on, as well as real estate, exports, and Micro and Small Medium Enterprises (MSMEs) were also forced by the financial crisis. Given that some of these industries need a lot of labour, the international financial crisis has a noteworthy impact on the employment. The sluggish and intended approach taken by the Indian officials towards the deregulation of this sector helped to decrease the impact of the global financial crisis on India's financial sector. Several countercyclical measures were also used by Indian officials during the credit expansion before the crisis. Additionally, a number of actions were done to strengthen the sector's resilience to upcoming crises throughout the post-subprime crisis period. Several classification techniques, like univariate methods (Beaver 1966), multivariate methods, linear multiple discriminate methods (Altman 1968), multiple regression method (Mayer and Pifer 1970), and logistic or probit regression methods, have been proposed to forecast the financial agony using ratios and data creating from these statements (Martin ; Ohlson 1977; Lin and Chen 2006) [2,3,4,5,6]. For the early warning model of financial trouble, Pan 2008 proposes Probabilistic Neural Networks as the precursor constructions [7].

Scope of the Study

The subprime crisis had a little direct impact on India's financial system, mostly because of the country's low exposure to complex derivatives and some prudential regulations that had been put in place. India's approach to financial sector liberalization, especially capital account convertibility, has contributed to the nation's relative resilience. India has emphasized specific agents and flows in the liberalization process and taken a measured, gradualist approach to opening its capital account .It was clear from the start of the liberalization practice that, for India to weather the crisis, its policies would have to shift from encouraging debt-creating flows toward encouraging debt-reducing ones, enforce strict guideline of peripheral profit-making borrowings (especially those with temporary maturity), discourage volatile flows from NRI and slowly relax outflows. As a result, India didn't have to resort to excessive reliance on foreign borrowing or see the dollarization of its economy.

Significance of the Research

India is still in its infancy, and its origin-to-distribute paradigm differs greatly from that of advanced markets (Reddy 2008). Indian regulations on securitization prohibit the quick recognition of profits by household inhabitants who invest in such yield issue overseas. There is a tremendous need for following certain regulatory measures to curb the menace financial disequilibrium which ruins monetary adjustments [14]. It is worthwhile to mention that certain obligatory as well as regulatory measures to be followed for the strong base of our financial system and strengthen its future course of actions. In this context it is better to mention the role of RBI by certain statutory measures like OMO (Open Market Operations), Cash Reserve Ratio, Statutory Liquidity Ratio ,BR (Bank Rate) policy and frequent changes of Repo interest rates and so on in adjusting the liquidity of public sector banks. This research mainly focuses the impact of financial crisis and to follow certain suggestive measures to revamp the existing monetary system. Frequent changes of Repo and reverse repo interest rates are the best monetary tools in the hands of supreme monetary authority of India to achieve the desired growth rate.

Aims and Objectives

This research is intended to find out the following major aims and objectives.

- To understand the need for following certain regulatory diligence to overcome monetary crises.
- To analyze the need for minimal usage of liquidity of financial institutions and methods to reduce the volume of NPA.
- To investigate the need for following some suggestive measures to revamp our financial institutional setup.
- To bring out the real picture of our financial institutions in the current level and follow future projectory measures.

Analysis and Discussion

In order to diversify products and use derivative instruments as a risk management tool, they have been introduced gradually and prudently. The fact that local investors own the majority of the Indian financial sector contributes to its durability as well. Additionally, public sector banks hold almost 70% of the banking system's assets (Figure 1) [12] [13]. Banks in the public sector now dominate after the private sector was nationalized. Both the Reserve Bank of India and the State Bank of India (SBI) were nationalized in India, one in 1949 and the other in 1955. Several more large private banks were nationalized in 1969 and 1980. This cautious approach has been attacked for its alleged negative effects on competitiveness, efficiency, non-performing loans, and productivity in Indian banks and the financial sector more generally. This is the case despite the fact that the public sector banks' supremacy and encouragement framework did not promote excessive risk-taking and, consequently, did not allow for overly risky exposures.9], [10], [11].

The presence of international banks was considerably less prevalent, which reduced the direct effects of the emergency on India's local economy. Foreign banks are frequently vulnerable to a reverse in capital flows as a result of issues in the organizing country, the parent bank, or the nation of foundation (Ram Mohan 2009). [8]

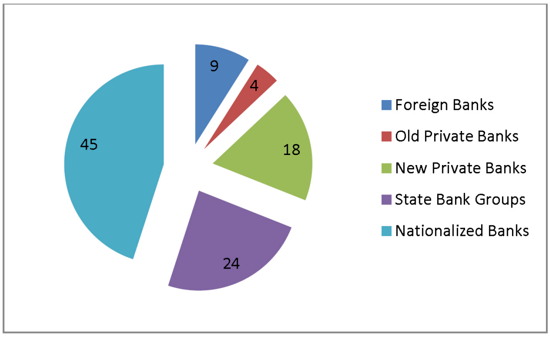

Figure 1

The indian banking system's decomposition (Assets)

During times of crisis, liquidity concerns might multiply, thus India set in place a variety of safeguards to lessen these risks in the near term. By setting prudential restrictions on banks' acquired interbank obligations and tying these limits to the firm's net worth, it was possible to dissuade banks from relying on borrowed money and promote stable sources of funding. The interbank obligations of the banks were capped at double their value as of March 2007. Banks that had capital adequacy ratios (CRAR) that were 25% greater than the required minimum of 9%, or 11.25%, were eligible for a higher inter-bank liabilities cap of 300%. The detection of overheating was aided by careful monitor of incremental credit aggregate, especially the credit-deposit proportion.

In the Indian context, a high supreme credit deposit quotient of roughly Seventy percent combined with an increasing credit-deposit quotient of hundred percent is typically referred to as "overheating." The emphasis on the CDR also motivates banks so as to increase their deposit base and decrease their reliance on acquired capital. Leverage levels in the banking system were decreased through the use of statutory liquid ratio and a focus on the credit deposit quotient.

The purchase of non-government securities is likewise subject to regulation. Commercial paper and certificates of deposits are the only short-term investments that banks can make. Additionally, unlisted government securities can only make up 10% of the total non-SLR investment portfolio and must be fully disclosed.

To tighten capital requirements, a small overview of credit-conversion variables, risk weights, and conditional regulations has been ongoing in India. Additionally, some of the more complicated arrangements, such artificial securitization, is not yet approved. Additionally, the Reserve bank of India has provided comprehensive guidance for implementing the Basel II framework. The Basel norm is 8%, but the minimum CRAR for banks in India is 9%. Additionally, starting in April 2010, the banks were required to maintain a minimum Tier I capital level of 6%. Currently, the Tier I ratio is at 9%, but the standard CRAR for scheduled commercial banks is over 13%. Additionally, India did not include things that are currently seen as being deducted worldwide, such as intangible assets and deferred tax assets.

Regarding exposures to particular industries, the RBI imposed additional prudential measures to reduce risks. These measures included developing specific rules addressing coverage limit, collaterals to be taken into account, borders to be maintain, etc.

Suggestive Measures

- To improve the financial position and accountability of these institutions the researcher recommended certain specific policy measures.
- Efforts must be made to minimize the risk in sanctioning of the loans and also frequent changes of interest rate like bank rate will help them to stabilize the monetary situations.
- Priority must be given to the high return projects like IT and attractive remunerative earnings.
- Collateral securities of the institutions must be made more normal and expected rate of returns will be an increasing path by the proper guidelines of the monetary authorities.
- As far as loan policies are concerned the higher authorities must be act as very vigil and such a statutory measures must be made as mandatory process.
- Banks and other NBFC's must come forward to take actions for protecting the interest of the depositors as well as shares would create a good image among the other investors.
- More specifically foreign institutional investors FII interest must be protected and encourage to invest more and more quantum in home countries which enables them to deepen their financial inflow into the home countries.

- Foreign Direct investment and foreign portfolio investors must be channelized in a proper way by the favorable policy of the RBI to inject foreign capital in our economy.
- This would definitely create a good impression among the foreign investors as well as transnational corporation to establish their investment projects along with home countries.
- To face the unforeseen contingency in the field of monetary sectors a separate corpus fund must be formed to face the financial crisis.

Conclusion

From the above foregoing decision on global financial crisis one can strongly come to the conclusion that there is an urgent need for following regulatory measures to stabilize the monetary conditions in India [15,16]. Very recently India witnessed tremendous growth of financial info and foreign capital made by the FII and transnational companies because of the good atmosphere prevailing in India for their investments .the supreme monetary authority of India namely RBI must carefully analyzing the situation in the entire financial sectors by following certain mandatory policies. The Economic survey report of the GOI under the ages of ministry of finance clearly reveals that financial scenario of India is comparatively good in all the four quarters of the financial year of 2021 which is registered 6.1 % of GDP growth of our economy whereas in USA the rate of growth and its projection was only 3.9 in the same period. The Strides made by the Indian govt. in stabilizing monetary scenario of the financial institutions is highly appreciable.

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