Global Financial Crises and Its Impact on India's Portfolio Investment

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ABSTRACT

A foreign portfolio is a fundamental source of assets and acts as a backbone of the Indian economy since 1991. It enables the country better economic stability and credibility at international level. This study has analyzed effect of the global financial crisis of 2008 on India's portfolio investment than government policies toward capital market. A comprehensive and critical review of the existing evidence on the subject was carried out, and descriptive statistical analysis of data from 2003 to 2013 was performed which leads to conclude that the policy of FDI liberalization has proved to provide diversification and sustainable development to the Indian economy which is considered to be one of the significant pillars of economy.

Keywords: Global Financial Crises, FDI, FPI

1. Introduction

In the era of 1980, the path of global development was dramatically changed with the economic liberalization policy of British Prime Minister Margaret Thatcher and the Chicago School economist Milton Friedman as economic adviser. Their policy started the race of globalization of trade and opening up their own economies for capital flows. These policies mostly affected the policies of developing economies because most of the developing economies opened economies for trade and capital flows after 1980, (one of the countries who adopted this policy was India). After the acceptance of globalization policy in 1991, India admitted the importance of foreign investment inflows. This investment fulfills the needs of foreign currency of the country other hand increase saving and investment of the country (Patnaik, Shah and Singh, 2013). India's forex reserve was US $ 5834 million in 1990-91 which increases by more than five thousand times and reaches at 304233 million US $ in 2013-14 and saving and gross domestic capital formation which were 22.9 and 26.0 percent in 1990-91 reach at 30.1 and 34.8 percent of GDP at current market price 2012-13 respectively (RBI Data, 2014). These changes occurred mainly because of increased foreign investment inflow which was 103 million USD in 1990-91 and 26386 million USD in 2012-13 by US $ 46710 in 2012-13 (including net FDI and FPI). The ceiling of investment by FIIs, NRIs and PIOs is kept 24 and 10 per cent of total paid up capital of Indian companies but this limit is 20 percent for public sector banks including SBI.

2. Literature Review

With adopting economic liberalization in 1990 India has opened the door for economic variables to accelerate economic growth. By this policy India achieved approximately 9 per cent growth during 2003-04 to 2007-08. On the other hand, the pursuit of incremental reform and prudent regulation has minimized the negative impact of both the Asian and, more recently, the trans-Atlantic financial crises (Baru, 2009). This policy gave the chance to India to become the global player in term of output, growth and investment. This policy one hand to protect India from Asian crisis (and it will benefit India due to this there is very less effect of Asian crises on India), after 2000, India changed its policy and it became more globalised with passing FEMA Act 1999 and integration of Indian capital market with international market. As a result, with the combination of Indian market with the world market it generated a risk of financial disturbance in India (Ozkan and Unsal, 2012). The major weakness of Indian economies such as lack of social and economic infrastructure, inadequate investment, less regulated market and banking system remain constant. Some countries are not well equipped to take the expansion of the world trade and capital flows during globalization and therefore risk becoming marginalized from the world economy (Camdssus, 1997). Gradually globalization policies protest India from global disturbance. But the US crisis which started from 23 September 2008 with the collapse of Lehman Brothers affected immediately. Like the financial crisis model results this crisis firstly to output growth, currency and inflation. Secondly, the effect on exports as a result of the decline in world demand dramatically in 2008. Any immediate adjustment in global imbalances may affect corporate, banks and households in India, even though the impact may be less than in some other emerging economies (Reddy, 2011).

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Research Objective:

To show the effect of this crisis on India's portfolio investment inflow than government policies toward capital market.

3. Research Methodology

Descriptive strategy has been chosen due to the limitation of available data and empirical options, as inferential statistics is not appropriate considering the face that pre-liberalization there was not much FDI to analyze. The data from 2003 to 2013 on under analysis variables of interest are collected from the secondary sources based on reports of Department of Industrial Policy and Promotion (DIPP), SEBI handbook of statistical and Bulletins of Reserve Bank of India and international bodies like, United Nation Conference on Trade and Development (UNCTAD), and World Trade Organisation.

4. Analysis & Observation

Trends of Foreign Portfolio Investment Inflows during Financial Crisis

There has been enhancing the mobility of international capital from last decade. In this trend the private capital flow has become dominate. These trends which started from globalization increases higher return on portfolio investment and stimulate the policies of financial reforms. On the contrary these trends also enhance the risks of financial crisis and come out the question mark on the financial linkages among countries. The portfolio capital flows opened with the beginning of liberalization increases the supply of funds as well as market efficiency due to expansion of market size and improves liquidity. This integration among markets creates high volatility in the market. The link between local and foreign market strengthens the progressive integration of financial market can potentially increase the risk of volatility spillover (Kohli, 2003). Number of financial restrains ceased to financial market work efficiently. This co-integration of capital market with world mostly effected from US financial crisis. This US financial crisis also gave the birth to another Euro zone crisis which started in May 2010, with the announcement of financial problems by Greece. The reasons of the Euro zone crisis were easy credit conditions, real estate bubble, high risk lending and contagion of financial markets. With Greece announcement the other European countries like Ireland, Portugal and Spain debt situation also uncloaked. The major fallout of Euro zone crisis has been its dampening effect on international capital flows (Due and Tuteja, 2013). These two financial crises which emerged mostly same cause effected India's portfolio investment inflows and outflows.

The following table 1 demonstrate the effect of financial crisis on portfolio investment (in portfolio investment include GDRs/ADRs, FIIs and Offshore funds and others) from 2006-07 to 2012-13. The data reveals that the inflows of investment has peak level in 2007-08 at 22271 million US $ which is for time more than previous year. In this years the share of GDRs/ADRs, FIIs and Offshore funds is 24, 74 and 1 per cent respectively. But in next financial year 2008-09 due to the financial crisis the portfolio investment decreases with –150 percent and reaches at -13855 million USD however portfolio investment by India is 177 million USD. But in coming next years the positive monetary operations such as reduction in repo rates cash reserve ratios and sales of foreign exchange expands the money in the market. On the other hand with positive fiscal policy responses like economic stimulate package of nearby 4 billion US $ in terms of 4 per cent cut of excise duty, support to exports, increases of planned expenditure, cuts in services tax from 12 to 10 per cent provide boom to market. With these positive initiatives of monetary and fiscal policy the investment get tremendous growth in next two years from 2009 to 2011. In 2009-10 the investment inflows is 32376 million USD.

Table 1: Portfolio Investment Inflows from 2006-07 to 2012-13 ($ millions)

Items	2006-07	2007-08	2008-09	2009-10	2010-11	2011-12	2012-13
A. GDRs/ADRs	3776	6645	1162	3328	2049	597	187
B. FIIs	3225	20328	-15017	29048	29422	16813	27582
C. Offshore funds and others	2	298	-	-	-	-	-
D. Portfolio Investment by India.	56	-163	177	-20	1179	239	878
Net Portfolio Investment (A+B+C-D)	6947	27434	-14032	32396	30292	17171	26891

But in 2010 with the announcement of Greece financial crises the effect of euro crisis disturbs Indian market. So the investment decline with approximately two time and reaches at 17171 US $ million in 2011-12. The euro crisis effected India's capital flows but the stimulate package which is provided by government from 2008 to become less deepen effect of Euro zone crisis. The Indian stock market seems to be displaying bullish activities during euro crisis (Due and Tuteja, 2017). So, in the 2012-13 the investment starts to recover which increases from UD $ 17410 to US $ 27769 million due to more increases in FIIs than GDRs/ADRs. The table shows that outflows of investment also increase in 2012-13. In 2011-12 this is 239 million US $ increases 639 in 2012-13.

The effect of financial crisis can be seen on stock market fluctuations (Table 2). The following table presents annual average of Sensex 30 and Nifty 50 companies and market capitalization of these companies position during crisis period. With the effect of financial crisis, the components of stock exchange decline such as Sensex drop out 25 per cent and Nifty by 23 per cent in 2008-09. This crisis decreases the market capitalization of BSE and NSE companies which are 51.38 and 48.58 lakh crores in 2007-08 to 30.86 and 28.96 lakh crore respectively in 2008-09. The other drop out happens in 2011-12 when Sensex declines by 6.35 per cent and Nifty by 6.11 per cent. On the other hand, BSE capitalization decreases 6.24 lakh crore and NSE capitalization decline 6.06 lakh crores in 2011-12 (Table 2).

Table 2: - Annual Average of share prices indices and market capitalization

Years	BSE Sensex	Annual growth of Sensex	S&P Nifty	Annual growth of Nifty	Market Capitalization of BSE	Market Capitalization of NSE
2006-07	12277		3572		35,45,041	33 , 67,350
2007-08	16569	34.96	4897	37.09	51,38,014	48 , 58,122
2008-09	12366	-25.37	3731	-23.81	30,86,075	28 , 96,194
2009-10	15585	26.03	4658	24.85	61,65,619	60 , 09,173
2010-11	18605	19.38	5584	19.88	68,39,084	67 , 02,616
2011-12	17423	-6.35	5243	-6.11	62,14,941	60 , 96,518
2012-13	18202	4.47	5257	0.27	53,48,645	52 , 32,273

Source: - SEBI Handbook of Statistics 2013.

We can also the month wise effect of crisis on Sensex and portfolio investment in Table 3. When Lehman Brother becomes bankrupt market share of India has declined of 24 per cent in October 2008. This is the largest drop out in this financial year. On the other hand, portfolio investment also decreases -5243 million USD in this month. After this shock the market and portfolio investment are declining continuously. The next financial crisis is 2011-12. However, the Euro crisis starts with the US crisis but the effects world market in 2011-12. In August 2011, European Commission admonishes that sovereign of debt crisis is spreading beyond the periphery of Euro zone. The Sensex declines in this financial year by 10 per cent. With less growth of Euro zone nearby 0.2 per cent in 2011, cuts the rating of France and Italy in 2011-12, less growth of service sector and cuts the growth forecast of European countries by IMF. But the data shows (table 3) that Euro zone crisis has no deepen effect on Indian market and Portfolio investment.

Table 3: - Month wise changes in Sensex Nifty and Portfolio Investment

	Monthly average of Sensex		Portfolio Investment Inflows (USD million)	
Months /Years	2008-09	2011-12	2008-09	2011-12
Apr	16291	19450.1	-880	3545
May	16945.7	18325.5	-288	-1584
Jun	14997.3	18228.9	-3010	789
Jul	13716.2	18616.4	-492	1560
Aug	14722.1	16887.5	593	-1797
Sep	13942.8	16694.8	-1403	-1147
Oct	10549.6	16822.8	-5243	-432
Nov	9454	16664.5	-574	76

Dec	9513.6	15960	30	2302
Jan	9350.4	16357.6	-614	5422
Feb	9188	17836.3	-1085	9228
Mar	8995.5	17415.9	-889	-552
Total	**12366**	**17423**	**-13855**	**17410**

Source: - SEBI Handbook of Statistics and for Portfolio Investment RBI

5. Conclusion

Foreign capital has a key task to carry out in the financial advancement of India. There are a few manners by which capital streams and financial development are connected. Discussion based on findings leads us to conclude that encouragement and facilitation of international investors in India have created ample opportunities. With the coming of FPI in India there has higher return on portfolio investment and at that time the inflows of investment has at the peak level. Portfolio capital flows opened with the beginning of liberalization increases the supply of funds as well as market efficiency due to expansion of market size and improves liquidity. But, Euro zone crisis has no deepen effect on Indian market and Portfolio investment.

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