US banking crisis, global slowdown and its impact on India

Why in news?

Sajjid Chinoy, Chief India Economist, JP Morgan, and part-time member, PMEAC spoke about the US banking crisis, global slowdown and its impact on India.

What are the differences between 2008 economic crisis and 2023 bank stress?

- The Economist pointed out few differences between the banking stress witnessed in March (2023) and that in 2008.
    1. The mid-sized US banks primarily faced a liquidity crisis in March 2023 whereas in 2008 the banks faced solvency concerned.
    2. The second difference between 2023 and 2008 is the sheer resilience of the global economy in 2023.

What is the US banking crisis?

- **US Banks -** The massive fiscal and monetary stimulus after COVID led to a huge surge in bank deposits.
- Banks invested much of these in government bonds to avoid credit risks.
- Meanwhile, the fiscal and monetary stimulus interacted with adverse supply shocks led to the highest global inflation in 50 years.
- To control inflation Central banks followed aggressive monetary tightening cycle.
- Consequently, the bond prices fell sharply and the US banks were left with 'unrealised bond loses'.
- **Silicon Valley Bank -** Wholesale depositors began to rapidly withdraw deposits to avoid losses, forcing the bank to realise the losses.
- The bank created a self-fulfilling deposit run and the central bank came to rescue.
- The central bank created expansive liquidity facilities and de facto insured all deposits creating moral hazard for the medium term.
- To know more about US bank crises, click here - Silicon Valley Bank crisis, Credit Suisse Crisis

How resilient is the present economy?

- The global economy likely grew at 4% last quarter (2023).
- The pace at which global economy is accelerating in 2023 reflects the resilience of private sector balance sheets in advanced economies.
- Globally, banks are much better regulated and capitalised than they were in 2008.
- The central banks will now have to pursue two objectives to avoid any recession:
    - Contain inflation using interest rate policy while managing financial stability.

What are the impacts of US bank stress on India?

- **Soft-landing -** A soft landing is a cyclical slowdown in economic growth that avoids recession.
- Soft landing is unlikely in the US because it will necessitate sharp increase in wage inflation without noticeable rise in the unemployment rate.
- At some point the global economy will be forced to slow, to generate the needed disinflation, and that will impact India.
- There are multiple transmission channels from current global events to impact India.
- The channels are exports, commodity prices, capital flows, US bond yields on Indian bond yields, etc.

What is the impact of global slowdown on the Indian exports?

- **Indian Exports -** Software services and other IT-enabled services have shown dynamism.
- Increased digitalisation and work-from-home during the pandemic has increased offshoring and made services previously deemed non-tradeable into tradeable.
- The surge in service exports and the softening of commodity prices has also contributed to the dramatic compression of the current account deficit.
- Thus, exports have been key to India's recovery and a sharp global slowdown will slow down its recovery.

What are the natural hedges that India has?

> A natural hedge is a strategy that seeks to mitigate risk by investing in assets whose performance is negatively correlated through some intrinsic or natural mechanism.

- As a commodity importer, India benefits from several natural hedges
- **Oil prices -** Oil prices are typically inversely correlated with the US dollar Index
- When the dollar index strengthens, oil prices typically soften.
- Due to this natural hedge, India gets adversely impacted on the capital account but favourably impacted on the current account.
- **Imports-Exports -** If there's a demand shock in the world and global growth slows, India's exports will be hit.
- As a commodity importer, India can benefit from improving 'terms of trade' when the commodity prices depress due to slow in global growth.
- **Bond Yields -** Decline in US bond yields in response to the banking crisis, pushed down bond yields around the world, including India.
- In India, and other emerging markets, financial conditions eased due to the fears of weaker US growth.

What are policy changes prescribed for India?

- Public investment should be pushed to mitigate slowing exports.
- Crowding in of states and PSU capital expenditures (capex).

- Keeping inflation under control, continuing with fiscal consolidation and building buffers.
- India should keep a very close eye on financial stability.

References

1. IE - Macroeconomic stability is the bedrock for sustained medium-term growth