

Indian Financial Markets – Navigating through Shifting Tides

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colleagues from the RBI, banking and primary dealers, ladies, and gentlemen.

I want to thank the organisers for this opportunity to address all of you here in this beautiful city of Bali. India shares a deep-rooted and multifaceted relationship with Indonesia, particularly with the island of Bali, shaped by centuries of historical, cultural, and civilizational ties. The relationship between India and Indonesia dates back over two millennia. Maritime trade routes across the Indian Ocean facilitated not only the exchange of goods but also of ideas, philosophies, and religions. Indian cultural and religious influences, particularly Hinduism and Buddhism, left a profound imprint on Indonesian society. The *Ramayana* ballet, frequently performed in Bali, reflects this shared heritage and continues to draw parallels with Indian classical forms.

I would like to extend my sincere thanks to FIMMDA for the opportunity to attend Governor Malhotra's insightful address in person. It is also an opportunity for me to have meaningful interactions with peers from the fixed income, money, and derivatives markets.

Role of FIMMDA

Since its inception in 1998, FIMMDA has played a pivotal role in the evolution of India's fixed income markets, serving as a vital link between the industry and regulators, and contributing significantly through the development of valuation methodologies for a range of financial instruments. FIMMDA has also taken a leadership role in introducing new benchmarks and interest rate derivative products, promoting global best practices including the adoption of a code of conduct, and acting as an impartial arbitrator in resolving disputes.

As a representative of the banking sector, I would also like to express my appreciation to the Reserve Bank of India for its continued engagement with industry stakeholders, and for its thoughtful consideration of our feedback in shaping regulatory frameworks.

Given the dynamic changes unfolding in the Indian economy and financial markets — FIMMDA's role has become more vital than ever and I am confident that the association will continue to meet future challenges with the same commitment and excellence it has demonstrated thus far.

Shifting Tides

Coming to the theme of the conference: Navigating through Shifting Tides. Given what has happened in the last few weeks, and especially since the beginning of this month, we must admit to the clairvoyance of whoever picked this theme, as the changes in the global economic and trade rules do feel like a massive shifting of the tide. Actually since 2020's pandemic, it feels like the financial markets have been buffeted with so many shifting tides – the shutdowns, the different monetary and fiscal responses by different countries, the supply chain disruptions, the Russia-Ukraine war, the troubling incidents in the Middle East, the systemic issues exposed by the failures of the Silicon Valley Bank, Signature Bank, and Silvergate Bank in the US, and even the challenges being presented by climate change. Now over the past few months, with US frequent changes import

tariffs on the rest of the world, we are facing what could be one of the major challenges for the global trade ecosystem.

The global trade ecosystem had, over the years, developed various imbalances, with certain countries persistently running surpluses, and certain others running persistent deficits. China's goods trade surplus in 2024 reached nearly a trillion US Dollars, while US had a deficit of 1.2 trillion US Dollars in the same year. And these imbalances were increasing on a yearly basis. The need for reforms, especially in the form of increased consumption by large economies running massive trade surpluses, was well recognised even before the tariffs announced by US, as such trade imbalances were unlikely to be sustainable.

Whether tariffs are the best solution to deal with these imbalances or not is for the economists to debate on, but the imposition of substantial import tariffs by the world's largest consumer economy and largest importer country has the potential to lead to massive turbulence for not just the global economic order, but also for financial markets. We have seen the reaction of global equity and debt markets in the last few weeks.

On a nominal basis, US consumer market alone is larger than the whole of EU, China and Japan combined. With US deciding to look inwards, can these three large economic blocs rapidly replace the US consumer by encouraging domestic consumption in their economies? The answer to this question could be the most important one for the global economy over the next few years. Let me try and explore the possibilities.

Search for Alternatives

The population of Eurozone is nearly the same as that of US, i.e. ~350 million. Eurozone has a per capita income of around 40,000 Euros vs USD 90,000 for US. Germany, the largest economy in the EU, has a per capita income of around 55,000 Euros. But with growth stagnating for decades - as per Eurostat, annual GDP growth rate in the Euro Area

has averaged 0.37% from 1995 until 2024 – it is unlikely to, at least on its own, replace the US consumer as a source of global demand. Of course, recent announcements by the incoming German coalition government on fiscal spending for infrastructure and defence, has given hope that the German growth engine will once again not just start pulling its weight, but also lead the rest of the EU nations into injecting momentum into European growth revival.

Japan has been in a similar situation, with decades of growth stagnation, though its efforts to boost growth, the so called Abenomics¹, championed by the late Japanese Prime Minister Shinzo Abe, is now more than a decade old. Since the beginning of Abenomics, Japanese economy has been able to avoid economic contraction in all years except 2019 and 2020. Nikkei, which was down 79% from its peak in early 1990 till 2012, has since rallied more than 300%, with even legendary investors like Warren Buffet taking interest. But, with a declining population – Japan’s population peaked at 128.5 million in 2010, it is unlikely to be the demand growth engine. The US consumer market is supported by the third largest population among all countries.

China of course has the population, and its government has often spoken about the need to boost domestic consumption and to move away from its dependence on investments and exports as growth engines. But any efforts to boost consumption have had limited success, at least in terms of contribution to GDP. As a percentage of GDP, private consumption in China had increased from 36.5% to 39% between 2014 to 2023. But given the rise in China’s trade surplus during this period, it may be fair to say a lot more efforts may be needed by the Chinese government for it to become a demand growth engine for the world.

¹ Abenomics is the name given to the three pronged economic policy launched in 2012 by Shinzo Abe’s government. The three “arrows” of Abenomics include increasing the money supply, undertaking government spending to stimulate the economy, and undertaking economic and regulatory reforms to increase competitiveness.

Indian Markets

Indian debt market story has been different over the years. Given the massive size of our populace and the economy- it was a mammoth task to wade through the tides - be it the 2008 crisis or the challenges posed by COVID - we not only faced it, tackled it, but we grew up stronger-honed our markets to be innovative, stronger and cutting edge.

We innovated with the JAM Trinity to boost our savings and bring Indians into the formal economy. With UPI we moved away from being a cash based economy. Post covid, the strengths we built in the past year have helped our equity markets to be resilient with the strength of our domestic investors who have held up the markets despite the FPI outflows. When inflation pressures ruled over the world, when global central banks were accused to be behind the curve, RBI was always hitting the right spots.

The story had only begun. With our inclusion into global bond indices, we were looking at both opportunities and risks. Adeptly moving towards fiscal consolidation, we remain a beacon of stability in the world.

The tides are shifting- and we face a time when we yet again have to innovate, we have to rely on the strengths built in the past decade. The tariff wars, the trend to break away from age of globalisation pose questions on how much we can continue to rely on domestic savings and investments to tide over the crisis. The onus lies on debt markets - our banks and financial institutions to find our path in the journey. RBI has been our guiding light - be it during signs of overheating in certain lending activities, or liquidity tightness - prudent steps were taken to avoid any shocks to the functioning of the markets.

Indian banks also remain in the cusp of change. There has been a pattern of change in the savings behaviour. Like many mature markets, savings have taken the form of investments in other assets - mutual funds, insurance, pension funds. Banking sector has always been the champion of lending to targeted sectors. With the changing pattern of savings - ensuring flow of funds to the priority sectors will also demand the

contribution of other financial players, especially in an age of deglobalisation and tariff wars-when we have to look at our internal strengths.

We also need to provide more support to our states- make our State Development Loan market more liquid - on par with the discipline of our G-Sec market. Much has been spoken about the corporate bond market. Nothing prevents our states from being as suited for investment in the eyes of foreign investors.

We have seen massive growth in the Government securities market over the last five years in terms of size. But in terms of secondary market turnover, the volumes have not increased proportionately during this period. For State Government securities or SDLs, the secondary market remains quite illiquid. With insurance companies, and pension and provident funds holding around 53% of the outstanding securities, we are unlikely to see G-Sec level of volumes, but the current activity surely needs to pick up.

Secondary market liquidity in the corporate bond market is another area which has remained elusive for the market. Although liquidity in the corporate bond market is still low, various measures have been taken in recent past such as reduction in the number of ISINs. Face value of the securities have been reduced from Rs. 10,00,000 to Rs. 1,00,000 and further to Rs. 10,000 to promote retail participation. The market is still dominated by top rated issuers. Lower rated Issuers get better rates from alternate sources and need to be incentivized to tap capital markets. Although the size of the corporate bond market has increased manifold, the volume in secondary market has not grown in proportion due to “Buy and Hold” nature of large investors such as insurance companies and pension funds. To develop an efficient secondary market, deeper participation of all market players needs to be encouraged. RBI has issued draft guidelines which will permit Regulated Entities to extend partial credit enhancement to improve credit rating of certain bonds. This will enable entities up to BBB- to access corporate bond markets with better ease while instilling confidence in investors to expand their horizon of investments. This is expected to boost funding to the lower-rated infrastructure companies. Market participants will await final details to better

understand the nuances and impact of the proposed guidelines, which will help in further deepening of corporate bond markets.

Probably the biggest shift in tide for domestic markets in recent months has come from RBI, especially its stance on banking system liquidity. Since January this year, RBI has injected around Rs 7 lakh Cr worth of long-term liquidity through OMOs and long term Buy/Sell FX swaps. In addition, we have also seen longer term VRRs (Variable Rate Repos) and a 6 month Buy/Sell FX swap. RBI's measures improved liquidity in March which is now in surplus of more than Rs. 1 trillion. However, uncertainty around US tariff measure has now started weighing on financial assets as well as global growth. As noted by the Governor, quantification of adverse impact due to the ploy of current events is difficult. We are of the opinion that India's stable financial matrix has given breathing space to navigate the global head winds. Additional measures announced by RBI in last MPC will go a long way in improving credit flow to real economy.

Conclusion

I would like to reiterate my deep gratitude for the opportunity to address you here today in this scenic city of Bali. As we navigate these shifting tides, both globally and domestically, it is clear that the challenges we face require innovation, resilience, and collective action. The evolving dynamics in global trade, the impact of changing economic policies, and the shifting tides in financial markets present us with both risks and opportunities. India, with its diverse and dynamic economy, must continue to leverage its strengths its people, its institutions, and its markets to navigate these changes successfully.

We must recognize the critical role that institutions like FIMMDA, along with our regulatory bodies and financial markets, play in maintaining stability and promoting growth. Our resilience over the years, whether in times of crisis or transformation, has been a testament to our capacity to adapt and evolve. As we move forward, we must build on this strength and continue fostering innovation, liquidity, and sustainable growth.

A thought that resonates deeply with the challenges and opportunities ahead, I'd like to share a quote by *Mahatma Gandhi*:

"The future depends on what we do in the present."

As we stand at the crossroads of change, let us take this moment to shape a future that is resilient, inclusive, and prosperous for all. Thank you.