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Session: 30

**Developments and Reform in the
Securities and Capital Markets of India**

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Developments And Reforms in the Securities and Capital Markets in India

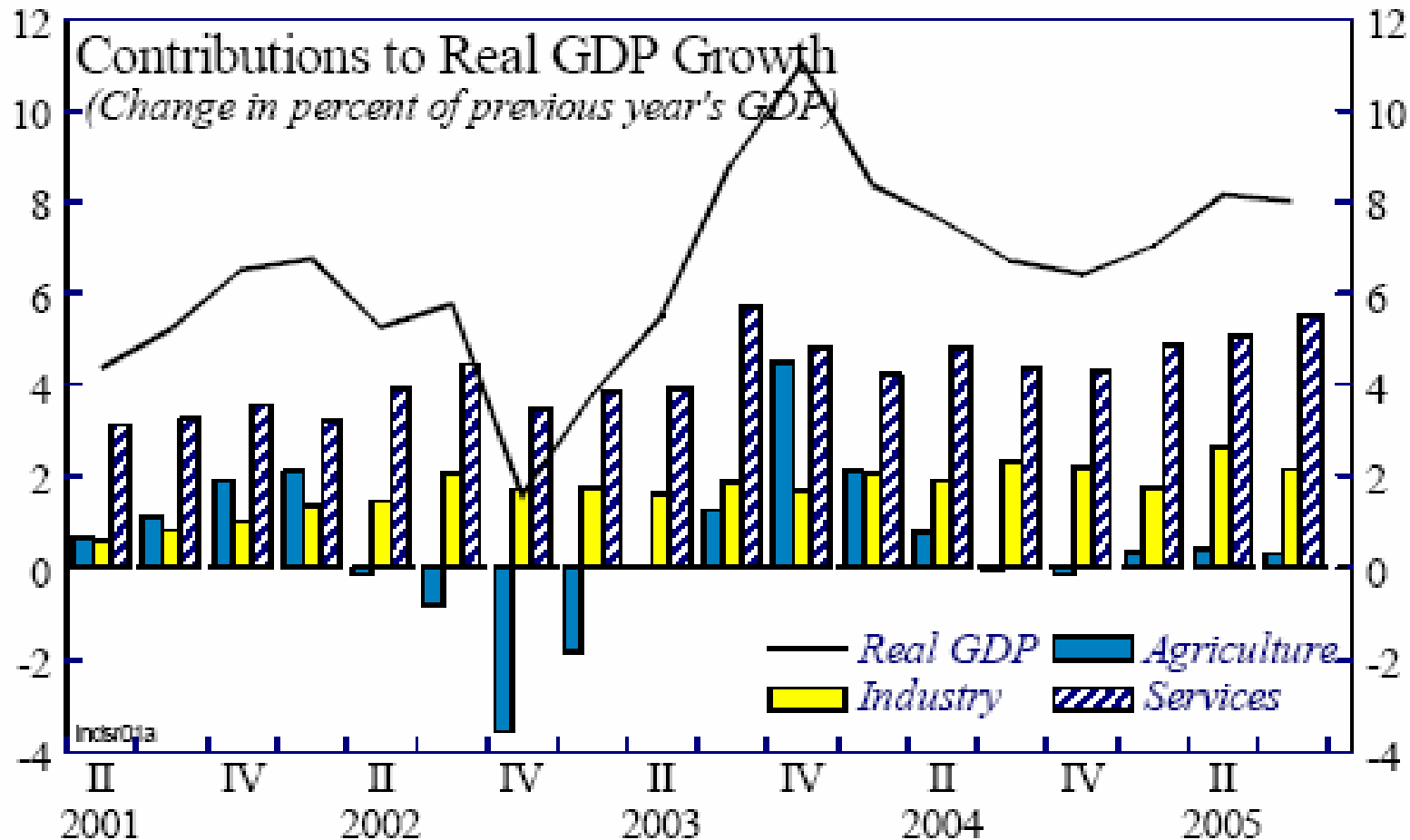
Ceyla Pazarbasioglu
International Monetary Fund

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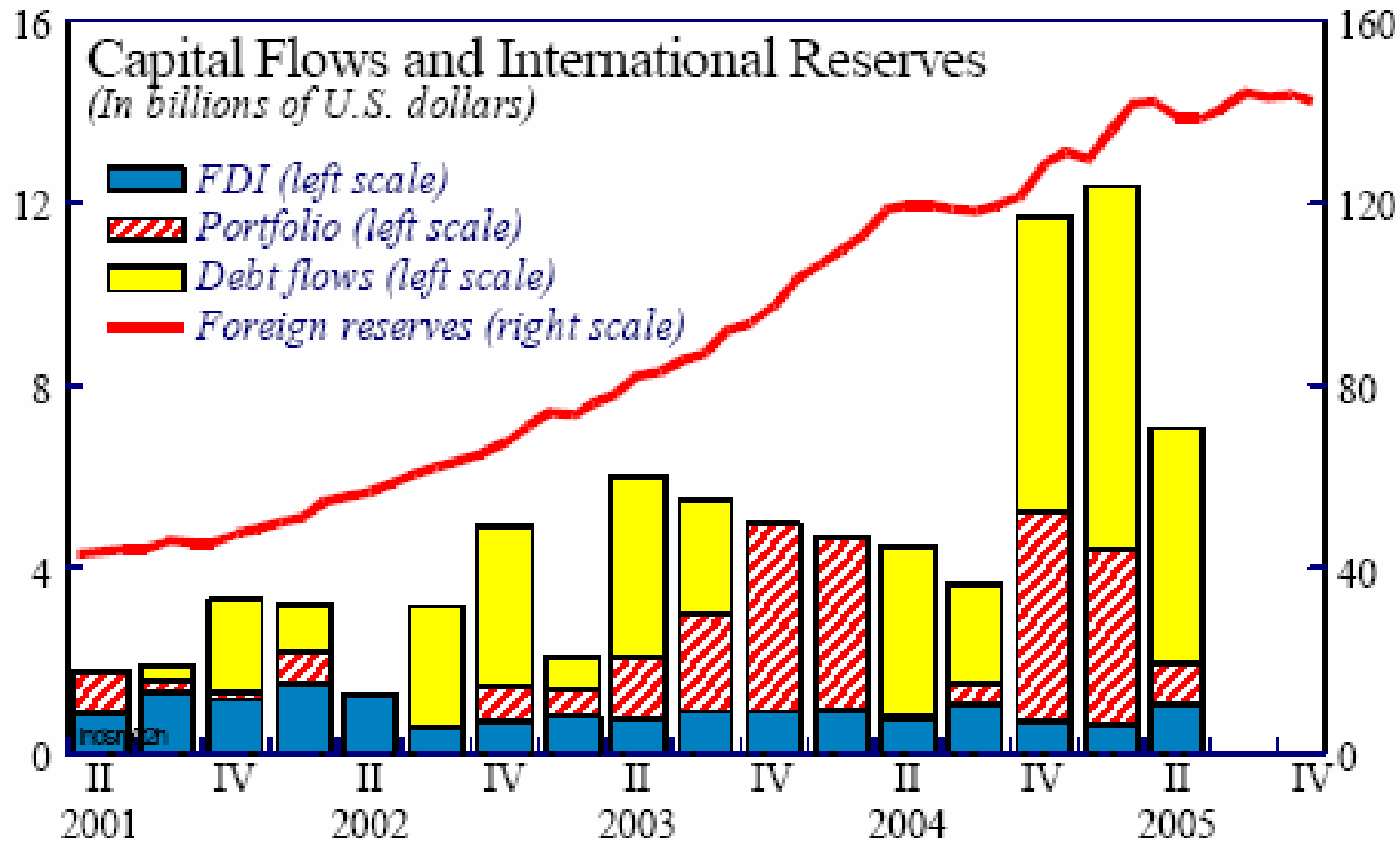
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- Recent Developments
- The Banking Sector
- Capital Markets
- Towards Market Reforms
- Conclusion

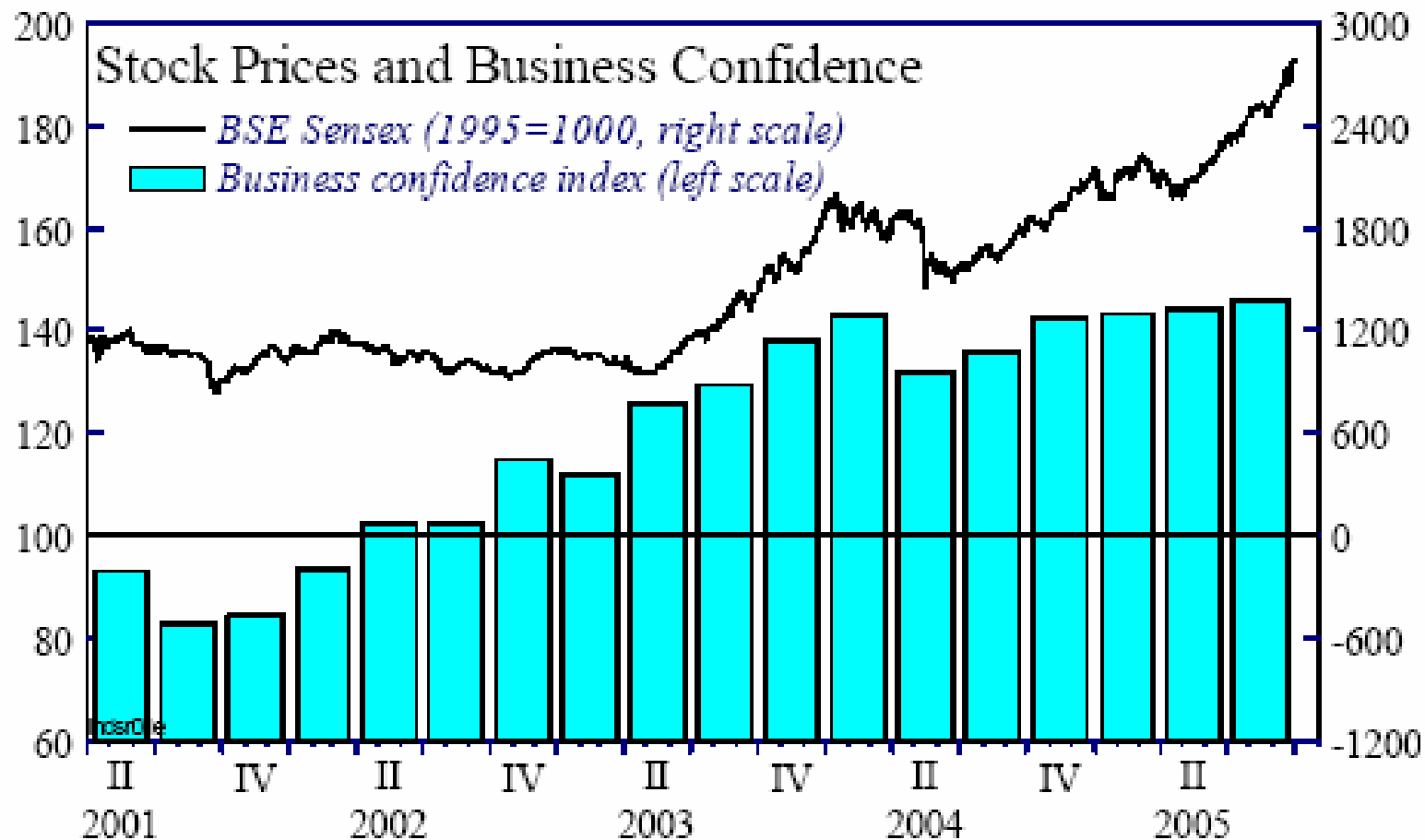
India's Growth Story Is Impressive Led By The Services Sector



Private Capital Flows Have Surged



Dynamics Partly Reflected In Market Indicators



India's Financial sector is Still Developing

Outstanding Domestic Debt Securities, Stock Market Capitalization, and Bank Credit, 2005

(In billions of U.S dollars)

	Total Bond Outstanding	Stock Market Capitalization	Bank Credit
Emerging markets	3,531.6	5,874.7	5,350.5
Hong Kong SAR	49.8	1,055.0	259.9
India	279.1	553.1	330.0
Korea	123.5	180.3	152.6
Malaysia	655.7	718.2	726.5
Mature markets	37,690.7	26,584.8	23,446.2
Japan	8,370.3	4,949.9	4,465.6
United States	20,554.8	15,707.7	7,274.7

Sources: Bank for International Settlements (BIS); Bloomberg; Standard and Poor's; and IMF staff estimates.

Government Bonds Dominate Debt Markets

Distribution of Outstanding Domestic Debt Securities, 2005 (In billions of U.S. dollars)

	Governments Securities	Financial Institutions	Corporate Issuers
Emerging markets	29.2	9.3	4.4
Hong Kong SAR	9.9	14.6	3.5
India	34.7	0.9	0.5
Korea	39.4	18.8	36.2
Malaysia	28.7	35.2	19.4
Mature markets	64.8	58.6	16.5
Japan	144.6	23.2	15.4
United States	47.5	95.8	21.7

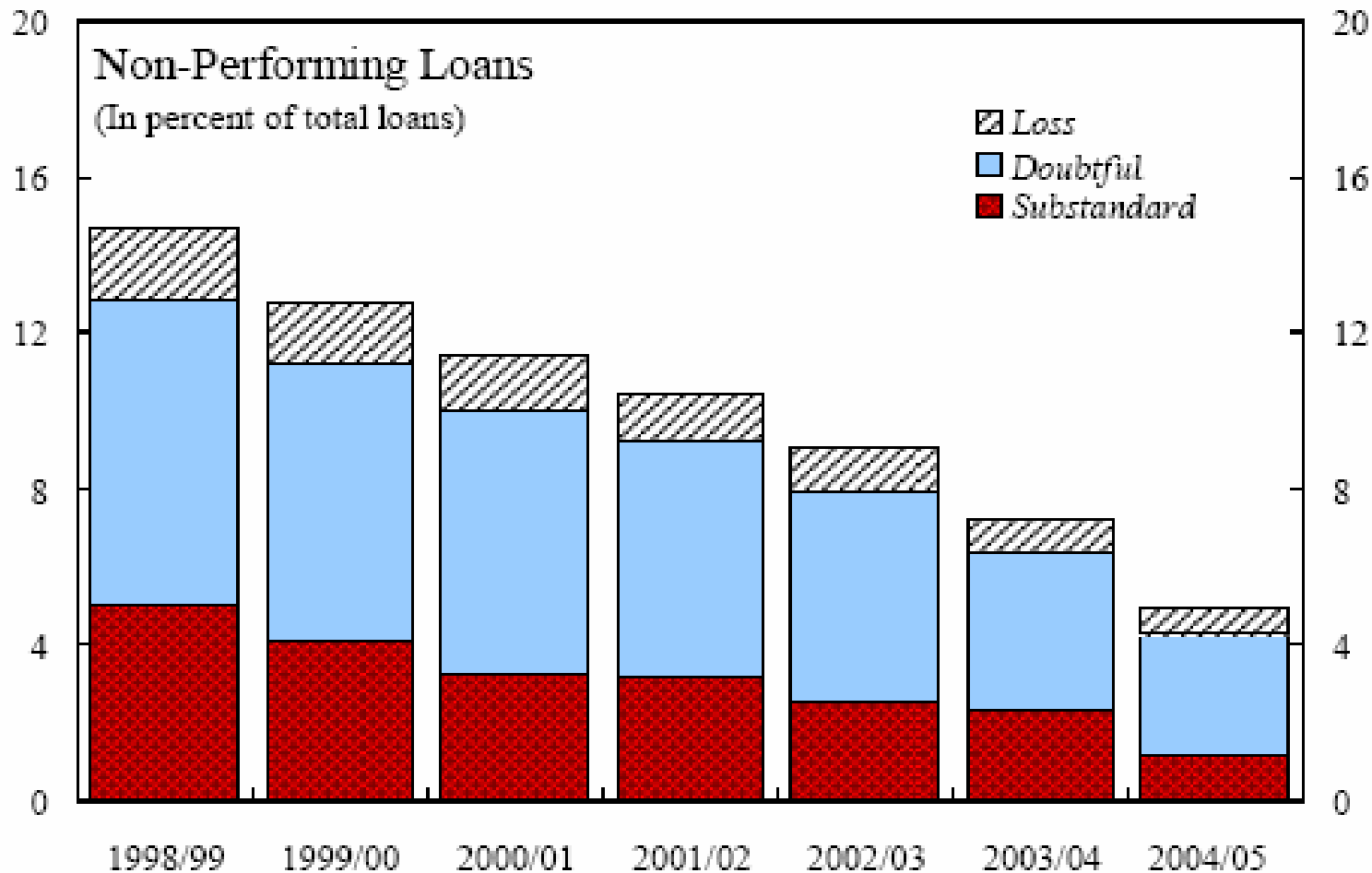
Sources: Bank for International Settlements (BIS);
Bloomberg; Standard and Poor's; and IMF staff estimates.

The Banking Sector

Banking Sector Reforms

- Based on the philosophy to allocate resources more efficiently.
- Competition enhancing measures:
 - Operational autonomy and disinvestment of public ownership in public sector banks;
 - New private banks;
- Prudential Measures:
 - Phased implementation of best international practices (CAR, provisioning, NPL norms, etc.)
 - Strengthen risk management
 - Roadmap to Basel II

... As a Result, Marked Improvements in Asset Quality

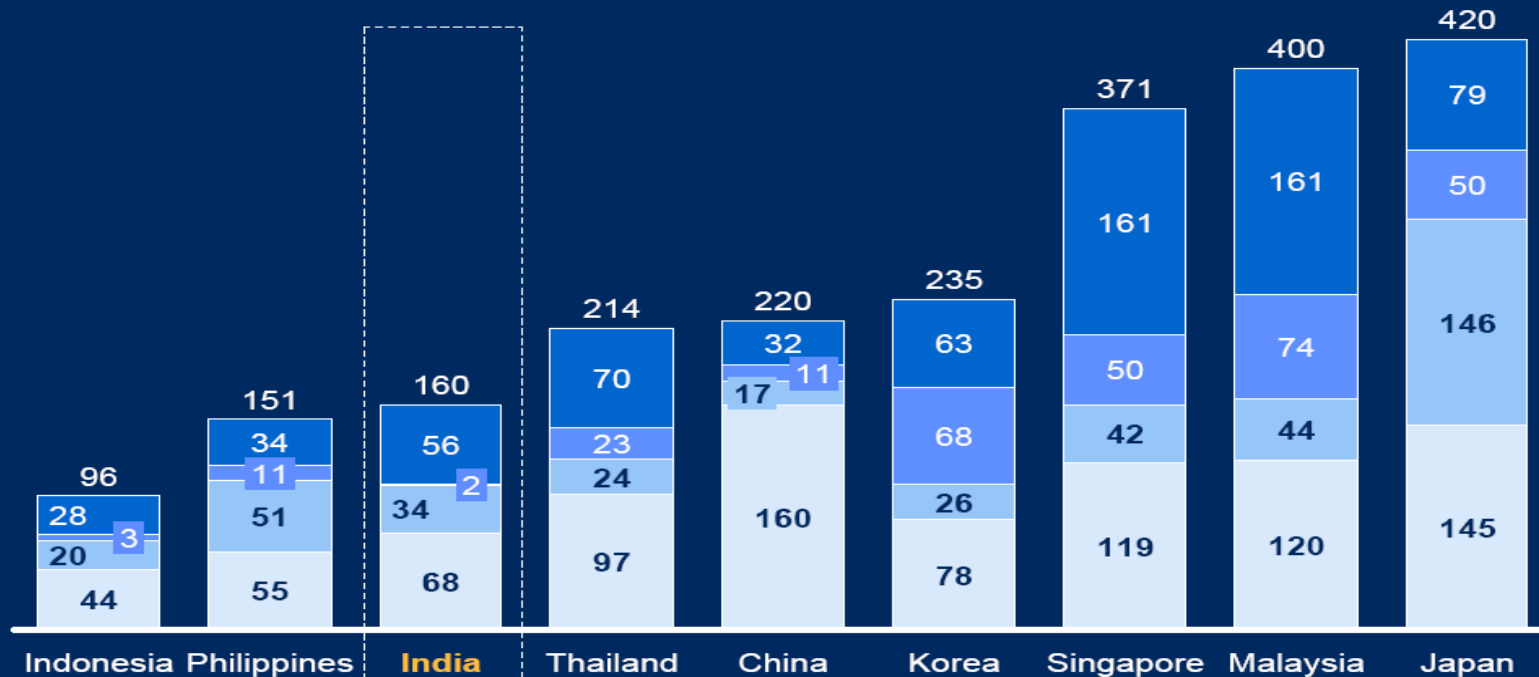


...But India's Financial Depth is Still Low

INDIA'S FINANCIAL DEPTH IS LOW COMPARED TO OTHER ASIAN NATIONS

Financial assets as a percent of GDP, 2004

- Equity
- Corporate debt
- Government debt
- Bank deposits and currency



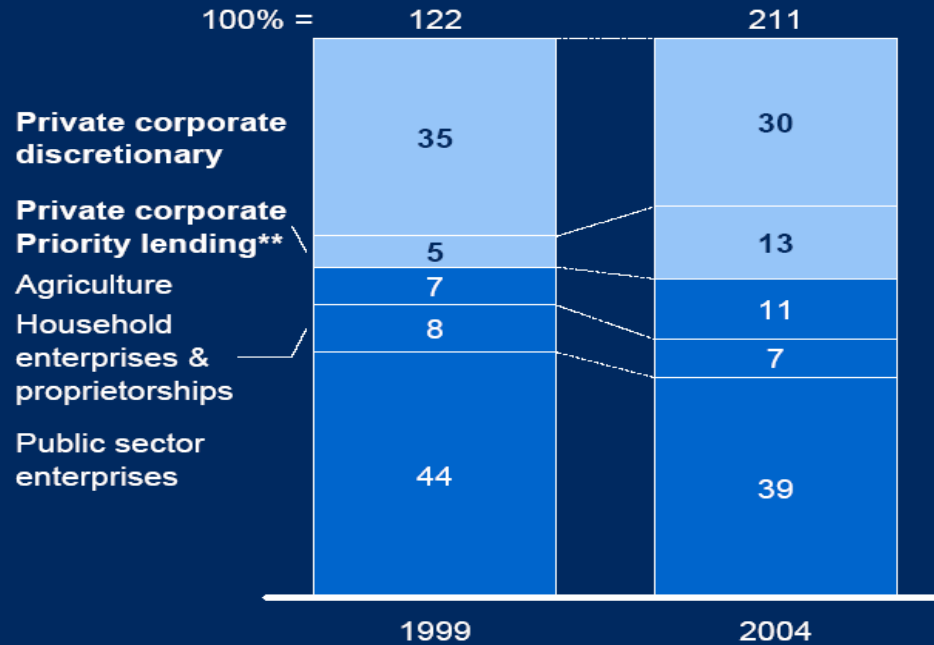
Source: McKinsey Global Institute Global Financial Stock Database

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Credits To The Public Sector Dominate

LESS THAN HALF OF COMMERCIAL CREDIT GOES TO INDIA'S PRIVATE SECTOR

Distribution of commercial credit*
\$ Billion, percent



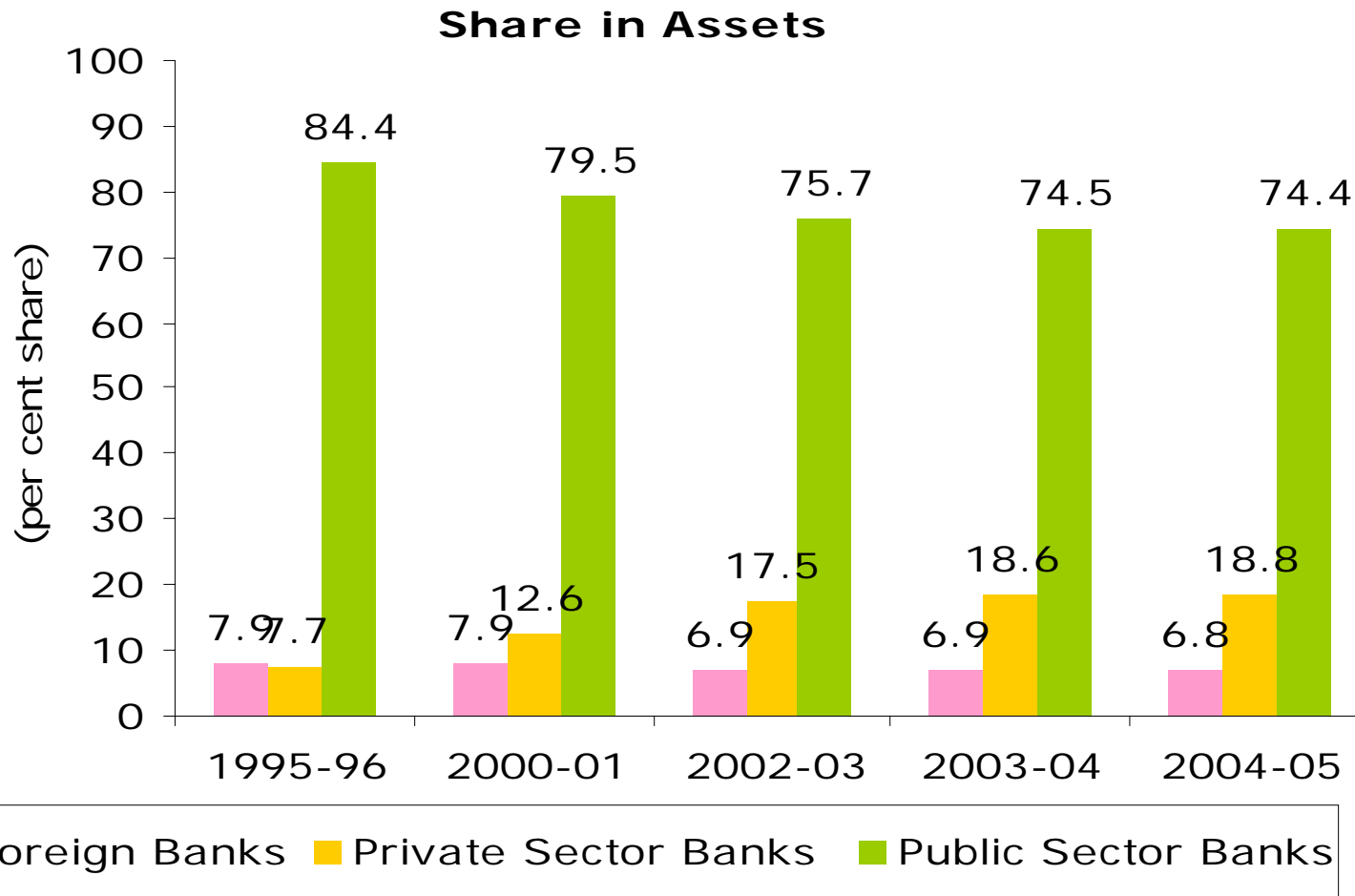
* Gross bank credit excluding financial companies; Includes corporate bonds and private placements, loans and investments from the government to public sector enterprises.

** Estimate of lending to small corporations equals "other" priority sector lending outside of agriculture and SSI

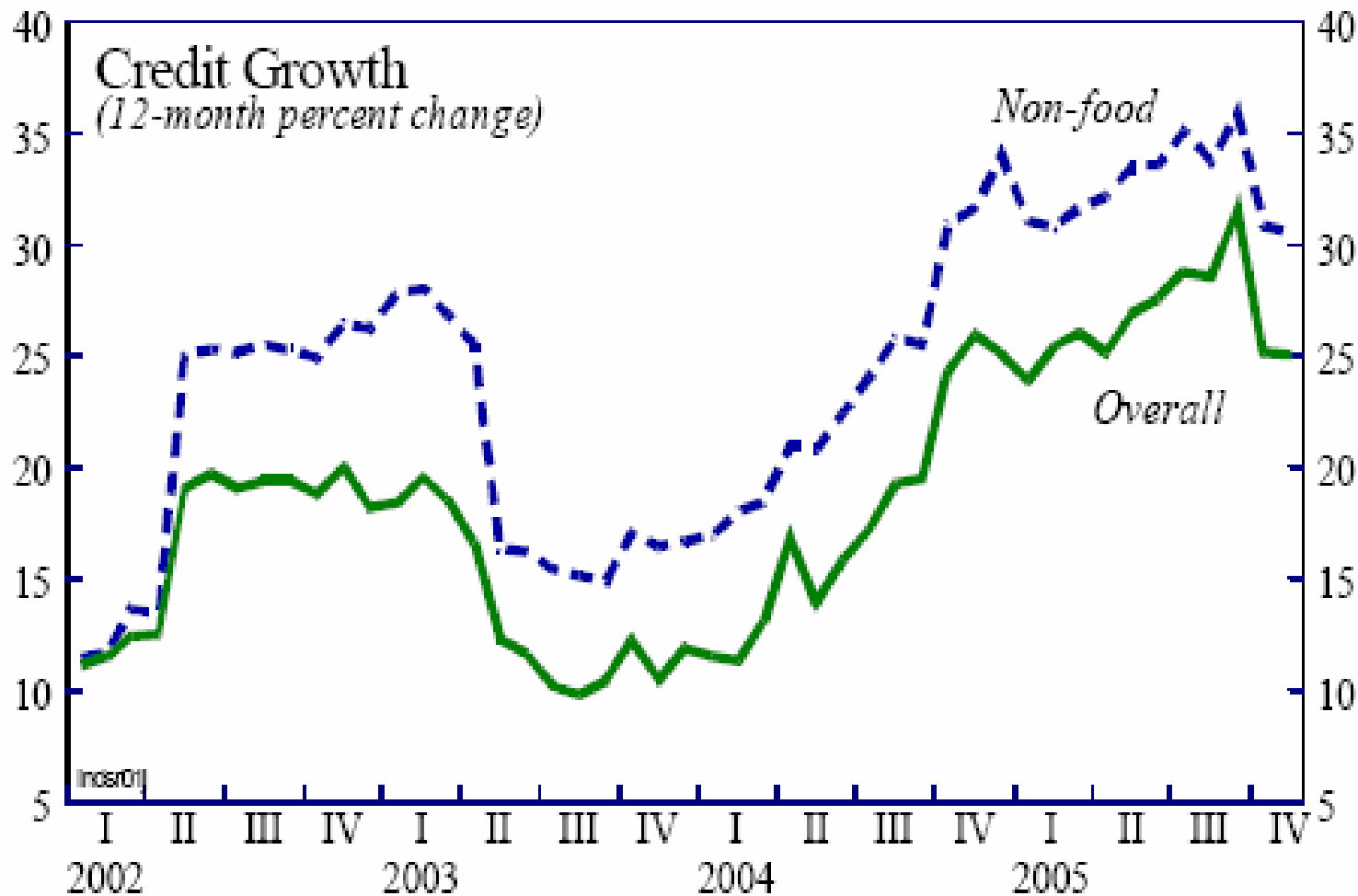
Source: CSO; RBI; MGI; Public Enterprise Survey

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...But Reforms Are Gaining Some Traction



Credit To The Private Sector is Growing Rapidly

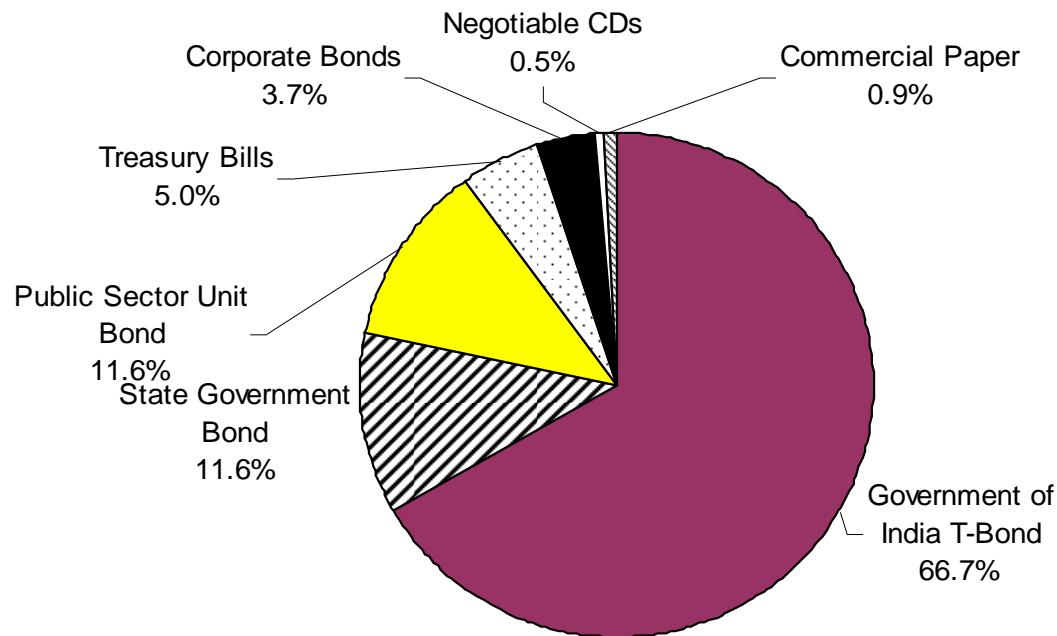


Capital Markets

The Government Bond Market Continues to Dominate Debt Capital Markets

The Bond Market in India

(In percent of total)



Sources: Deutsche Bank Research; National Stock Exchange of India; Reserve Bank of India; and IMF staff estimates.

Note: Total outstanding volume (March 2005): 13.3 trillion rupees (\$257 billion).

... But Key Reforms in The G-Sec Market

- Market determined interest rates
- RBI withdrawal from primary market
- Permission of short-sales
- Introduction of new instruments (T-Bills of varying maturity, Zero Coupon Bond, etc.)
- Improved trading, clearing, payments and settlements arrangements

Equity Issuance Is Also Significant

- Asian finance remains bank-dominated but stock markets are also an important source of corporate finance. (\$814 billion in new capital through initial and secondary public offerings in 2005).
- Indian corporates account for 20% of the total Asian issuance (second to Hong Kong SAR)

Figure 3. Financial Assets, 2000
(In percent of GDP)

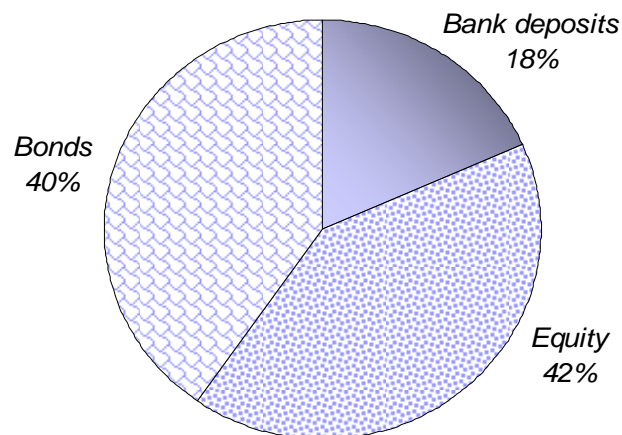
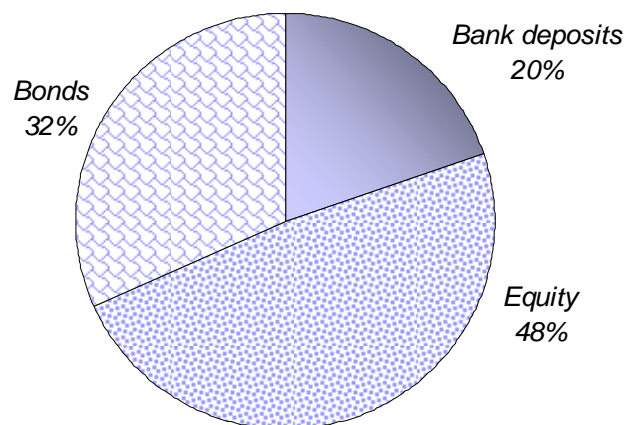


Figure 4. Financial Assets, 2005
(In percent of GDP)

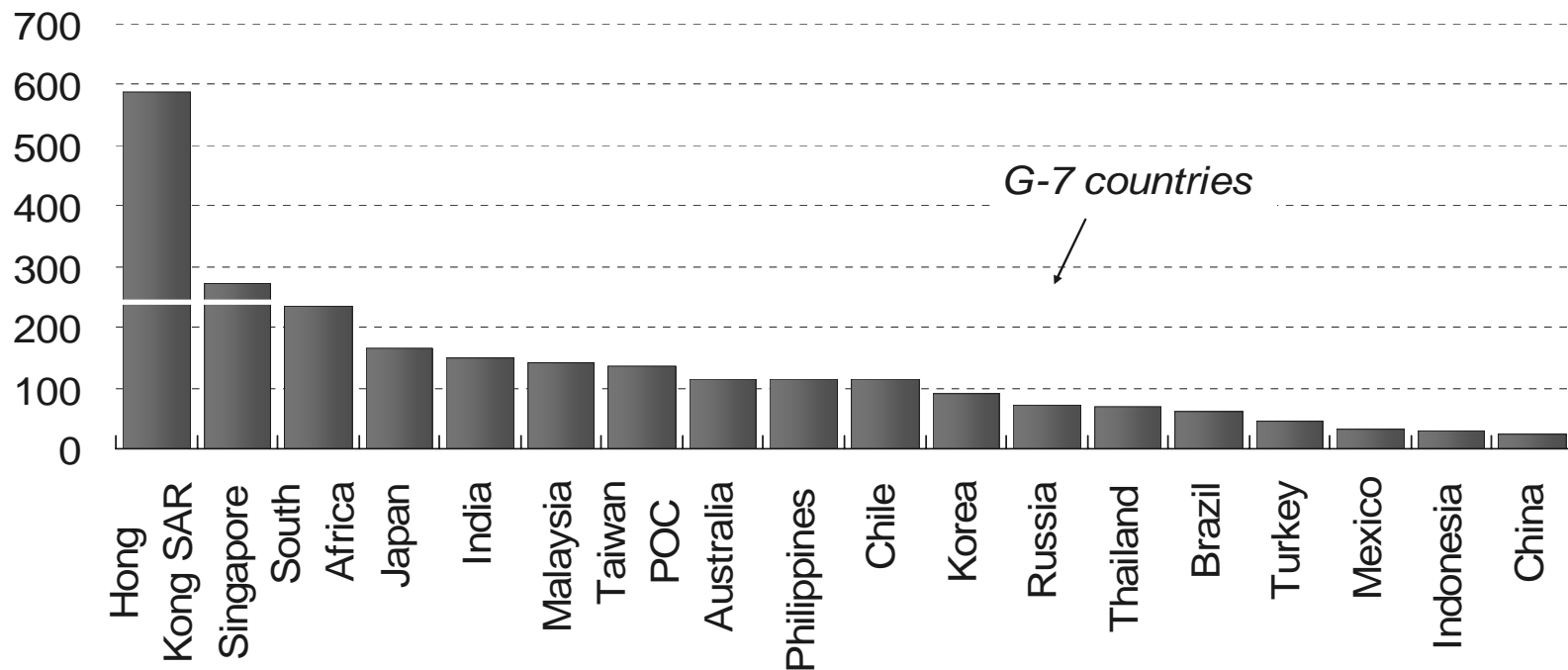


Sources: Federation of World Exchanges; IMF, IFS database; IMF, WEO database; World Bank, WDI database; and IMF staff estimates.

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Equity Markets In India Are Well Developed

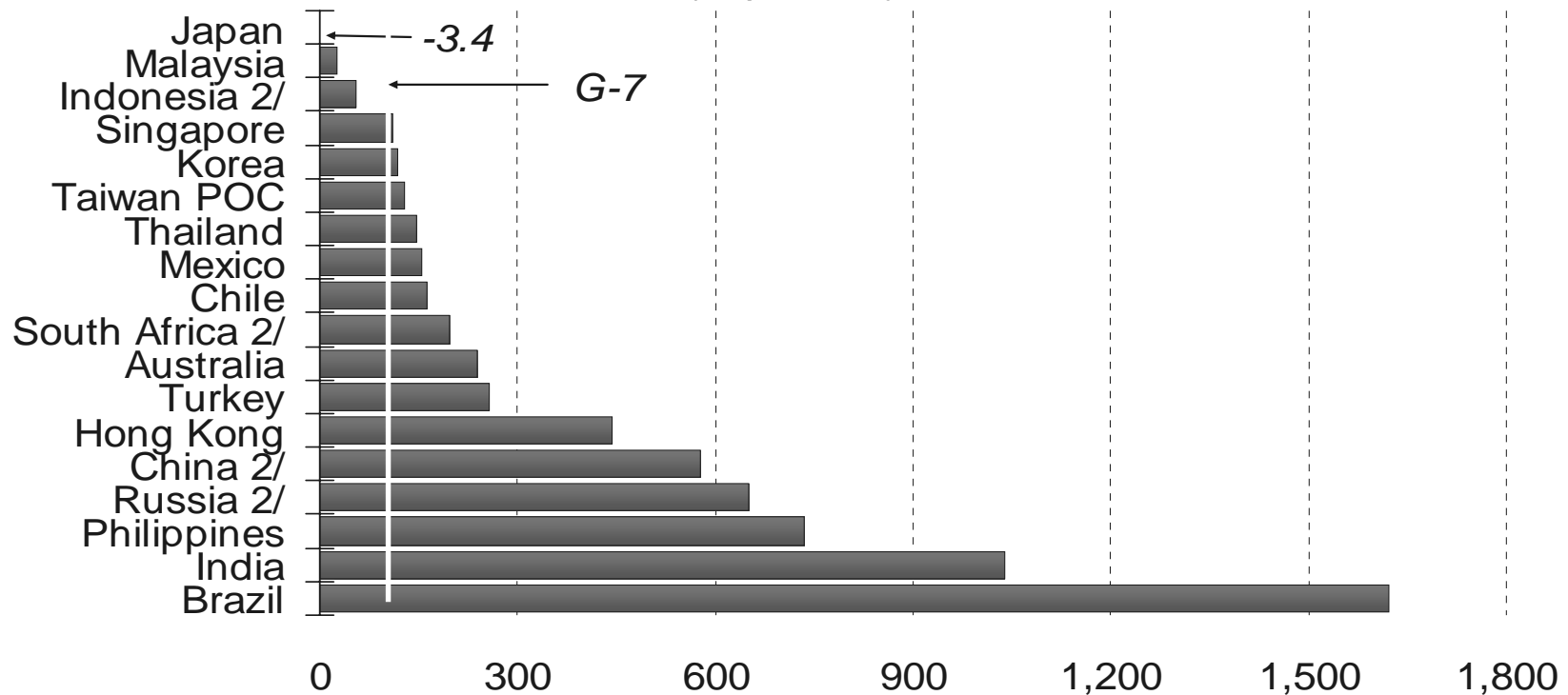
Figure 1. Comparison of Equity Market Size in Asia and Other Emerging Markets, 2005
(In percent of GDP)



Sources: CEIC Data Company Ltd; S&P, Emerging Market Database; and IMF, APDCORE database; IMF, World Economic Outlook; and, IMF staff estimates.

...With Phenomenal Increase in Depth Over the 1990s

Figure 2. Growth in Depth of Equity Market, 1990–2005 1/
(In percent)



Sources: CEIC Data Company Ltd; S&P, Emerging Market Database; and IMF, APDCORE database; IMF, World Economic Outlook; and, IMF staff estimates.

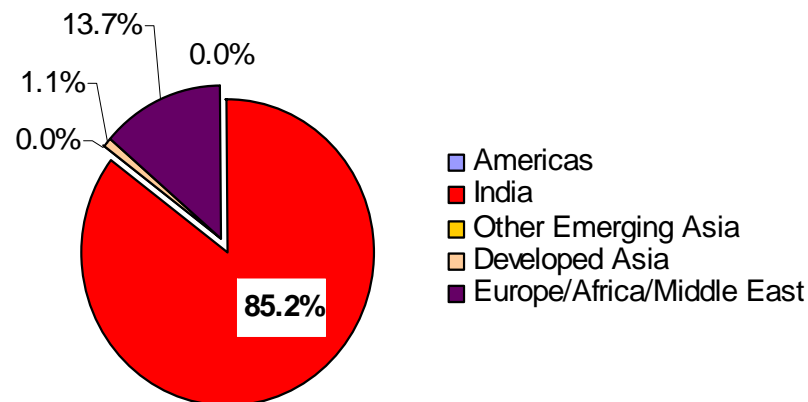
1/ Change in market capitalization to GDP.

2/ Data on Indonesia starts in 1993; data on China, South Africa, and G-7 start on 1992; data for Russia

India's Equity Derivatives Market Has Significant Global Share

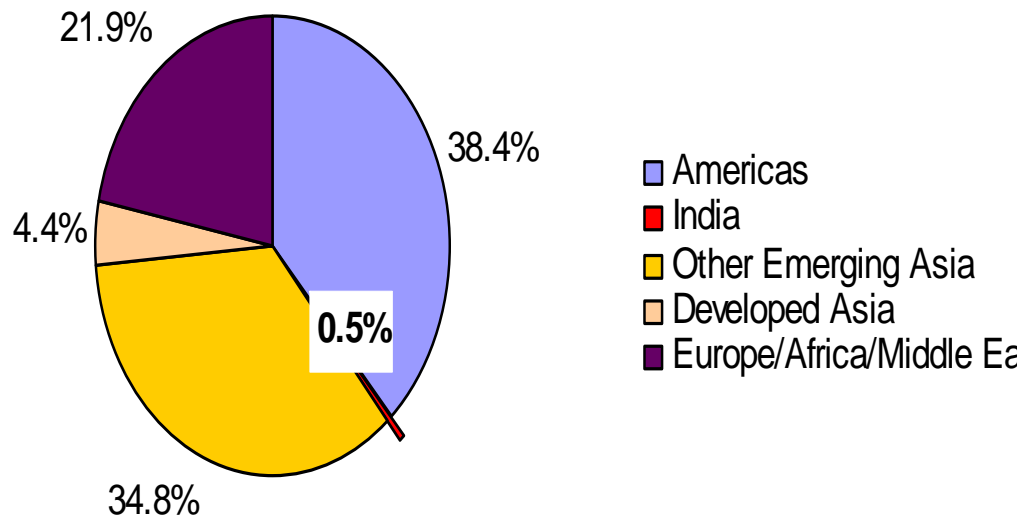
- Equity derivatives have flourished in a few markets in Asia. Trading in Emerging Asia: from \$16.5 trillion (2002) to \$40.3 trillion (2005) (or 35.3 percent of global trading).
- India's equity derivatives market is significant in size (regionally) and dominates global trading in equity futures.

Global Exchange-based Trading of Equity Futures (2005)
- by notional amount -
Total U.S.\$ 599 billion

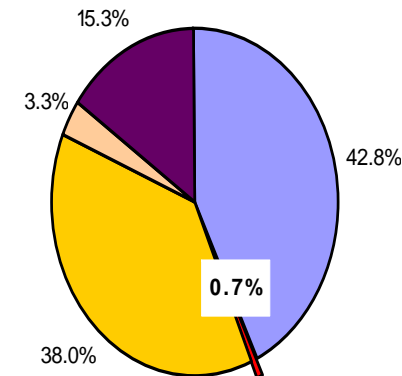


However, overall trading in India still lags behind Korea, Hong Kong and Taiwan and is still small by global standards

Global Exchange-based Trading of Equity Derivatives (2006)
- by notional amount -
Total U.S.\$ 114.1 trillion



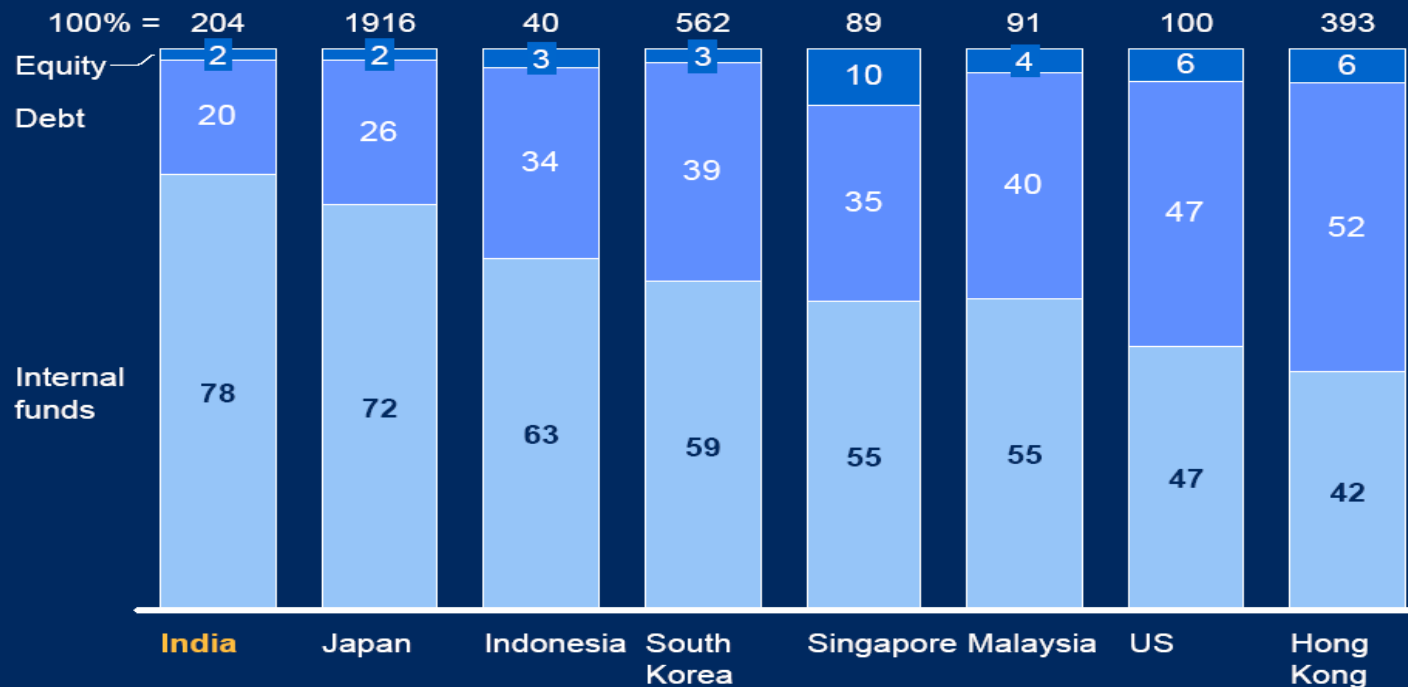
Global Exchange-based Trading of Equity Derivatives (Year-to-Date, Aug. 2006)
- by notional amount -
Total U.S.\$ 96.1 trillion



Corporates Have Generally Not Turned To The Bond Market

INDIAN FIRMS RELY HEAVILY ON RETAINED EARNINGS

Sources of funds raised
\$ Billion; percent, 2000-05*

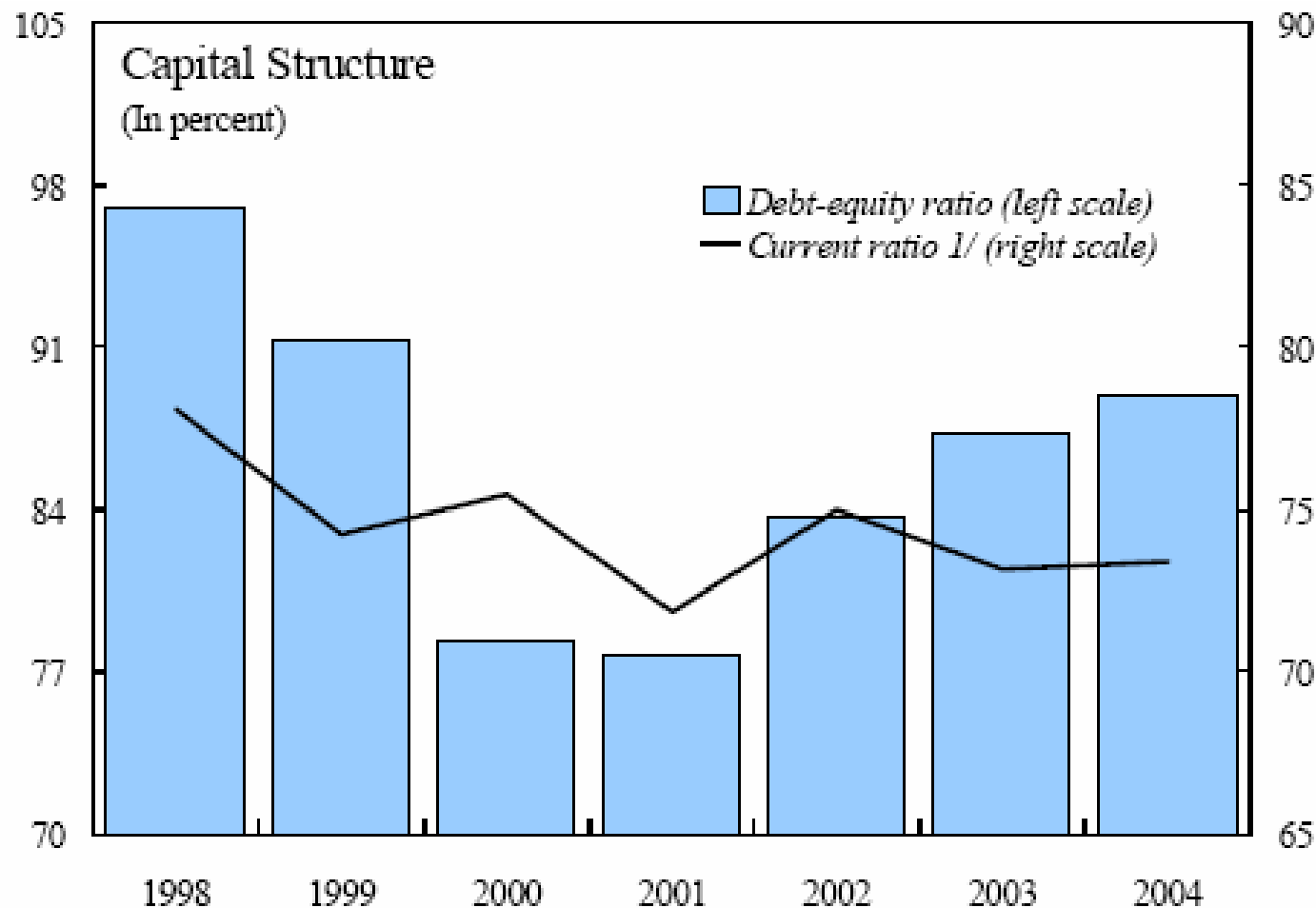


* Based on sample of 160 companies per country outside of US. Companies were ranked by gross sales, and 40 companies from each quartile were taken as the sample. US sample...

Source: Bloomberg, MGI

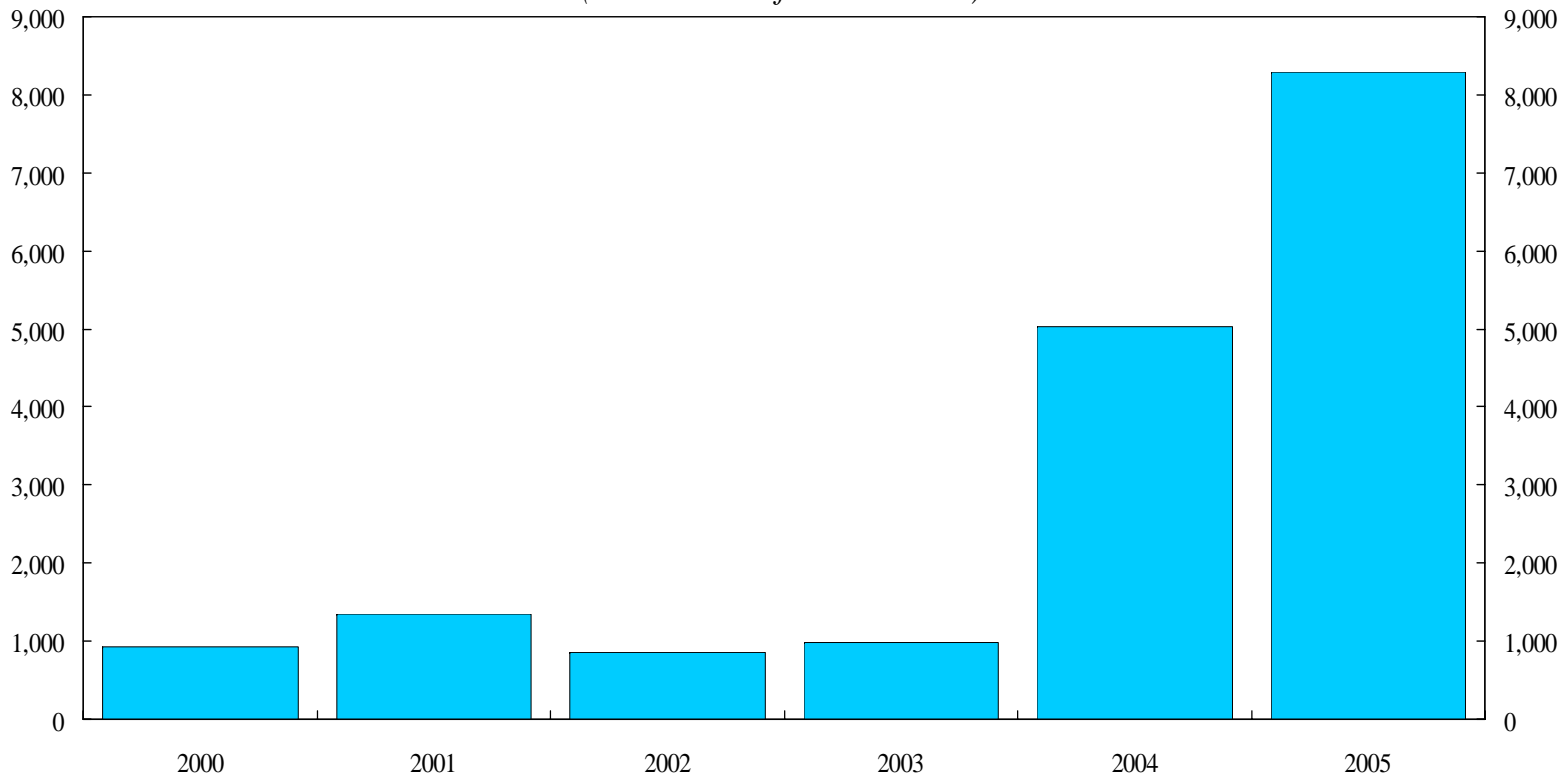
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...But Corporates Are Increasing Their Leverage



Corporates Have Been Borrowing Abroad

India: Total Private Corporate Sector External Debt Issuance¹
(In millions of U.S. dollars)



Sources: Dealogic; and IMF staff estimates.

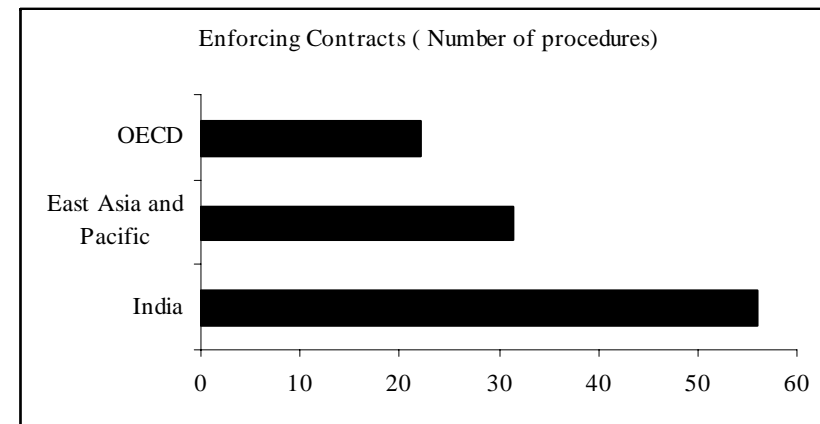
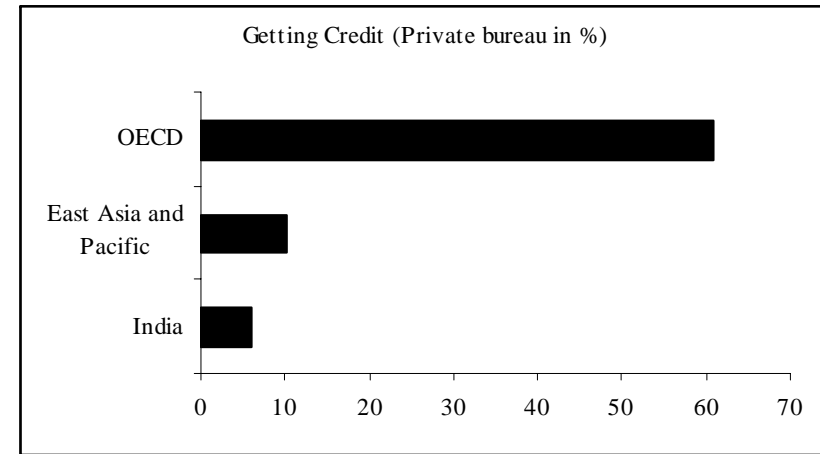
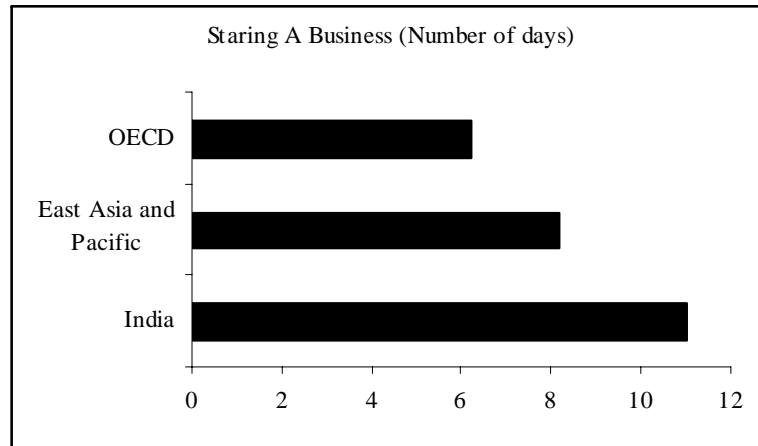
¹Debt includes both bond and loan.

Corporates Can Hedge FX Risk

- Capital account liberalization measures:
 - Unlimited hedging for genuine forex risk
- Hedging instruments:
 - Interest rate and currency swaps
 - Forex-rupee forward market
 - Forex-rupee options market
 - Non-deliverable forward market (offshore)

Market Reforms

India has To Improve Its Business Environment



Source: World Bank, Doing Business.

Corporate Governance Needs To Be Enhanced

Corporate Governance Ratings, 2000-2004

	2000	2001	2002	2003	2004
China	3.6	3.4	3.9	4.3	4.8
Hong Kong SAR	7.1	6.8	7.2	7.3	6.7
India	5.6	5.4	5.9	6.6	6.2
Indonesia	2.9	3.2	2.9	3.2	4.0
Korea	5.2	3.8	4.7	5.5	5.8
Malaysia	3.2	3.7	4.7	5.5	6
Philippines	2.9	3.3	3.6	3.7	5
Singapore	7.5	7.4	7.4	7.7	7.5
Thailand	2.8	3.7	3.8	4.6	5.3

Source: Asian Corporate Governance Association.

Capital Markets Regulations Need To Be Streamlined

- Encourage Growth of Domestic Institutional Investor Base By Removing Barriers to Participation:
 - In India institutional investors' assets account for under 15 percent of GDP, less than a third of that in better-developed markets. In India structural barriers hinder their participation.
 - restrictions on the types of investments that can be made by insurance and pension companies (India requires institutional assets to be invested in government securities or bank deposits);
 - competition from government guaranteed savings schemes (e.g., India's small savings schemes);
 - legislative hurdles (e.g., outdated legislation and stamp duties).

Manage Capital Account Liberalization

- Manage volatility of capital flows amid calibrated capital account liberalization.
- Address vulnerabilities of financial intermediaries to a more open capital account through regulatory capacity building.
- Maintain financial stability.

Conclusions

- Market rather than government needs to play more of a role in allocating credit
- Capital markets would have to be ready to meet the large financing demands for infrastructure investments
- Further develop corporate bond market
- Improve environment to do business
- Broaden long-term investor base