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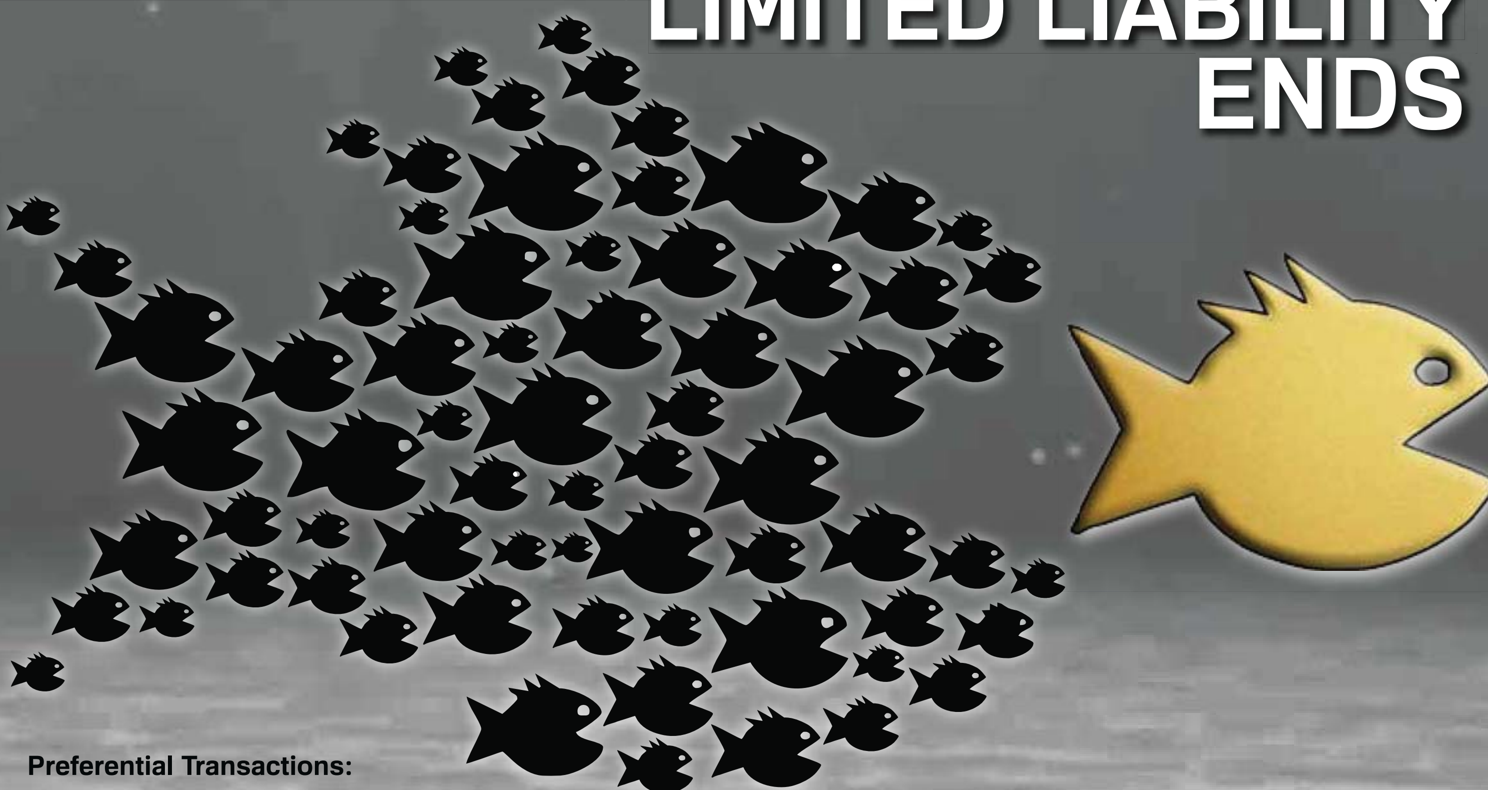
P.84

FTIL-NSEL MERGER LIMITED LIABILITY ENDS

Ethical Dilemma
Scope Of Investigation

Emerging Risks
In India - 2018



Preferential Transactions:
Potential Interpretations Based On
US Bankruptcy Code

The Black Hole Of
Interim Finance Under Insolvency And Restructuring Regime

In Conversation With
TRAI's Chairman
RS Sharma
about Net Neutrality and why it is the need of the hour for India

EMERGING RISKS IN INDIA 2018

The key risks faced by Indian financial institutions, households, and the economy in 2018 are categorized as macroeconomic, climate change, cyberattacks, protectionist approach, and regional conflict

This article discusses the key risks that may be faced by Indian financial institutions, households, and the economy in 2018 and beyond. These risks are identified as macroeconomic risks, climate change risks, cyberattacks, protectionist approach risks, and regional conflict risks. Though there is a general election in 2019 that may have some pro-people announcements by the government, this is not taken as a risk. The key risks that are coming out are from climate change and other factors forcing the economy to grow at a slower rate than anticipated. There could be some risks to the Indian job market due to a protectionist approach adopted by some of the developed countries. One of the key emerging risks is the explosion of the digital world without adequate protection. Regional conflict is a continuous risk for the country.

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Macroeconomic Risks

The Indian economy is expected to witness cyclical growth recovery, with real GDP growth likely to accelerate from 6.4% this year to 7.5% in 2018 and further to 7.7% in 2019. The expected increase in GDP growth rate will not be without challenges coming from the agriculture sector, which is largely dependent on monsoon. The Indian economy is expecting a slash in the interest rate, which is kept stagnant for the last two quarters of 2017 with fluctuating inflation. The much-awaited reduction in the interest rate by the central bank has kept the real-estate sector on the hook. The central bank's fifth bi-monthly review for the current fiscal in December kept the repo rate unchanged at 6% and reverse repo at 5.75%. The inflation predicted by the International Monetary Fund for the year 2018 is 4.9%.

The risk is that the actual inflation may turn out to be higher than the expected rate of 4.9%; higher inflation will not help the central bank in its endeavor to reduce the interest rate to fuel growth. If this is the case, the flow of money from the household sector to financial institutions and the stock market may face roadblocks impacting the overall growth of the economy. This is a possible scenario and not at the very extreme end of the spectrum.

One of the key areas of concern for Indian banks is high non-performing assets. Though the Moody's Investors Service awarded a positive outlook to India's financial institutions, there is a piling-up of non-performing assets (NPAs) that threatens to hinder growth and jeopardize the health of both state-owned as well as private banks. As it stands, stressed assets held by Indian banks amount to around $150 million. This position may further worsen due to the introduction of risk-based capital where banks may require additional capital to maintain its solvency.

The Financial Resolution and Deposit Insurance (FRDI) Bill is the latest attempt by the government to address bad loans of banks. The bill is aimed at using the money of the depositors of a bank in case of an eventuality where the bank has to be liquidated. The draft bill is pending with the Standing Committee of Parliament. The impact of such a bill could be far-reaching on how do people in India keep their savings.

To a certain extent, the performance of the stock market in India during 2018 may depend on the foreign inflow of money. This depends on tightening of the US monetary policy that may hurt portfolio inflows into India. A recent post by the International Monetary Fund on tightening of the monetary policy may reduce portfolio flows to emerging markets by about $70 billion over the next two years. During 2017, India attracted $7.7 billion global capital into its financial markets. Such external unprecedented events may impact the mutual fund business and unit-linked business in the insurance sector as they are market linked.

Climate Change Risk

One of the greatest risks to India is a change in the climate that may have both direct and indirect impacts. The direct impact comes from the loss of lives and property, while the indirect impact comes from an adverse effect on agriculture, economic growth, resources, etc. During the last couple of years, some parts of the country have observed excessive rain and unprecedented hot weather both during summer and less cool winters. A recent study published by the Massachusetts Institute of Technology (MIT) states that if climate change continues like this, a large part of South Asia may be too hot to survive in by the end of this century. Global warming may also adversely impact Indian rivers such as the Ganges, which provide essential water for agriculture. The other impacts of global warming are reduction in snow, rising sea level, changes in acidity of the sea, extent of drought, stronger tropical weather, and increased frequency of heavy and extreme rainfall.

The current climate change may adversely impact the country's efforts towards economic development, as on one hand, the country needs energy for economic development which is largely taken through coal and fossil fuel, and on the other hand, the country has to cut carbon emission. On an aggregate level, Asian countries are among the major emitters of greenhouse gases. The consequences of a change in the climate will be severe for India. During 2016, a record number of deaths was reported due to extreme weather, suffering a loss of more than USD 21 billion, which was almost 1% of the GDP. The study from reinsurance company Munich Re's NatCatSERVICE and socioeconomic data prepared by IMF indicated evidence of linkage between global warming and extreme El Niño effect impacting monsoon in India. The IMF study also indicated that corresponding to a 1-degree Centigrade increase in temperature, the per capita output was expected to fall by 1.33%. In contrast, in developed countries, such impact is negligible. The overall impact on China's growth is also negligible. On the other hand, the increase in temperature in Russia, Norway, and Canada is expected to improve growth.

The impact of global warming on India's economic growth could be multifold. The first adverse impact could be on Indian agriculture, either due to excessive rain or excessive heat, or both likely to kill the foodgrain growth. If due to global warming, monsoon dries up, there will be a shortage of food, which will directly increase inflation and have an overall impact on economic development. This will thwart the government's efforts in bringing down the interest rate to boost economic development. Such increase in the interest rate will adversely affect the real-estate market, mutual fund, and insurance business. This will further dry up funds to the stock market. These are the plausible stress scenarios that may happen, given the current change in the climate. It has been witnessed in the past that our economy has shown less resilience towards extreme weather, with a few days of excessive rain or extreme heat or very cold conditions crippling lives. Extreme weather conditions are likely to bring additional expenditure on the government to restore the normalcy in lives. The sea is getting more acidic due to excess of carbon emission damaging coral reefs, slated to be a lifeline for aqua lives raising sea temperature.

In 2018 and beyond, there is a greater risk of damage to the Indian economy from extreme climate than anything else.

Cyber and Digitalization Risk

With an increase in digitalization and focus on online transactions, there is an increasing risk of cyberattacks and increase in digital fraud. In fact, the entire world is sitting on the time bomb of digital explosion. Ever since

"In 2018 and beyond, there is a greater risk of damage to the Indian economy from extreme climate than anything else

the ransomware attack on the global market, Indian companies are getting cautious, looking for a cover from the cyberattack. Though Indian general insurance companies are busy in manufacturing such insurance products which on one hand is an opportunity for business growth, simultaneously, there is a greater risk of loss of valuable data. The mushrooming of the digital world in every nook and corner of the country has helped increasing penetration of online transactions; this has also increased the risk of high-profile digital fraud. The news of the leakage of data is not new in the newsroom.

On one hand, there are many advantages of the digital world; however, this is an untested market in comparison to the paper world. A serious global effort is required towards securing the world from total hijack.

Protectionist Approach Risk

There is an emerging risk from the protectionist approach taken by some developed countries to the job market of the Indian workforce. This is an emerging risk for India and a close watch on this situation is needed. In today's world, much of the Indian workforce income is dependent on the developed market either directly or indirectly through back office jobs. In the last two decades, the Indian population has turned global. The world has extracted this benefit in their respective home countries. However, with the western economy slowing down, there is pressure on their job market and some countries have already started taking a view of the "country first" approach. If this approach continues, there could be a serious threat to the job market in India, which may have a ripple effect on the Indian financial system, similar to the 2008 economic crisis. If India does not develop its own capacity of increasing production to engage the workforce, this risk of job erosion will always be there.

Regional Risk

India's geographical location presents ongoing risks of regional conflict; any increase in border tension may precipitate border clashes, which may have adverse impacts on economic development. The political establishment in the country is mature to handle regional conflicts; however, it is always uncertain given tension with China during 2017. Along with the border, terrorism is another threat to the country that may seriously disrupt peace and growth.

Summary

The risk to economic growth is from an increase in inflation during 2018 from the expected rate of 4.9% which will not help RBI in its effort to reduce the interest rate to fuel growth. This can have an adverse impact on the overall growth rate of GDP.

In the banking sector, the country is passing through the worst phase of Non-Performing Assets in their balance sheet. This has also been highlighted by many international agencies in the form of warnings from NPAs. Though the government is making efforts to address this risk by the introduction of the FRDI bill, the bill may further cause possible confusion to depositors who risk losing their savings. If the bill is passed by the parliament in its current shape and implemented, the extent of help that it may render is a question. In some countries, such efforts have not been successful.

The performance of the stock market in India during 2018 may get impacted due to tightening of the US monetary policy that may hurt portfolio inflows into India.

Global warming and the resulting climate change are serious threats to the growth of the Indian economy. Due to the limited resilience of the economy, extreme weather conditions may disrupt the country's effort to grow at around 7%.

Digitalization has taken over the paper world giving ease of operation on the click of a button; however, it has been witnessed during 2017 that this digital world is not free from attacks. With many of the world's operations dependent on soft files, this presents the risk of collapse of the world in one click. Moreover, this new world is not time-tested.

In the coming time, India may face serious risks to its job market due to the protectionist approach taken by some of the developed markets. Regional conflict and terrorism are risks the country continues to live with.

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