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SHRI RAM COLLEGE OF COMMERCE

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STRIDES

A STUDENTS' JOURNAL OF SHRI RAM COLLEGE OF COMMERCE

VOLUME 2 ISSUE 1 2017-18

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Dr. Santosh Kumari
Ph.D., M.Phil., M.Com., M.A. Educational Leadership and Management
(University of Nottingham, England, United Kingdom)

Assistant Professor
Department of Commerce
Shri Ram College of Commerce
University of Delhi
Delhi-110007
India

E-mail: strides@srcc.du.ac.in

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All correspondence relating to publication of the Journal should be addressed to :

The Principal
Shri Ram College of Commerce
University of Delhi, Maurice Nagar
Delhi - 110 007 (India)
e-mail: principaloffice@srcc.du.ac.in

Principal's Message

The mission statement of the College, signifying the existence and its road map to the achievement of its vision, reads as:

"To achieve and sustain excellence in teaching and research, enrich local, national and international communities through our research, improve skills of alumni, and to publish academic and educational resources"

To achieve and promote excellence in publications and applied research, the College has taken the initiative to launch a new journal exclusively to publish students' research papers and articles. It will be an add-on to the enriched catalogue of College publications and academic literature.

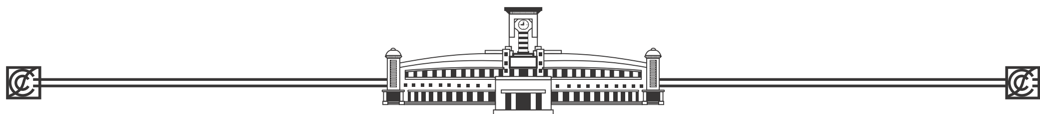
The journal has provided an opportunity to the students of our college to focus on research. Since the students were not opened to the research methodologies at the undergraduate level, they were mentored by experienced senior faculties of our College. Simultaneously, their articles were also reviewed by the referees and tested for plagiarism before publication. After reporting all the suggestions recommended by the referees, the articles were revised and then finally published. The College had successfully released the foundation issue of the journal **"Strides – A Students' Journal of Shri Ram College of Commerce, Volume 1, Issue 1, 2016-17"** on the occasion of 91st Annual Day of College held on 13th April 2017. The Journal was released by Shri Prakash Javadekar, Honb'le Minister of Human Resource Development, Government of India.

The college has already applied for seeking International Standard Serial Number (ISSN) for the Journal. The application for ISSN is still under process.

I would like to congratulate the students whose papers are published in this issue of the journal and simultaneously encourage all the students to contribute their research papers and articles for the successive issues of the Journal.

Best wishes for their future endeavors.

Prof. Simrit Kaur
Principal



Editor's Message

Shri Ram College of Commerce is well known for its academic excellence and dedicated approach towards dissemination of knowledge in the academic world. The College appreciates the role of research in education and is committed to developing an inclination towards research in both faculty and students. In this pursuit, the College has taken the initiative to launch a new Journal named 'Strides – A Students' Journal of Shri Ram College of Commerce' to encourage students to pursue research under the guidance of the faculty of Shri Ram College of Commerce.

It is a bi-annual journal launched exclusively to publish academic research papers and articles by the students on contemporary topics and issues in the area of commerce, economics, management, governance, policies etc.

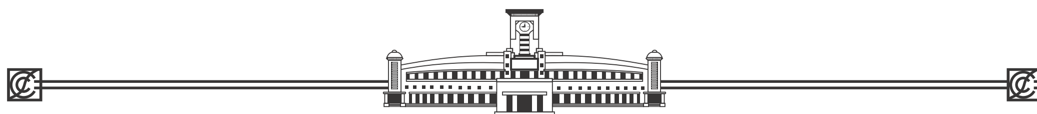
In order to maintain high standards of publication, the Committee on Publication Ethics (COPE) has been constituted. The COPE shall be the apex authority to take all decisions related to publication of research papers and articles in Strides. The decision of the COPE shall be final and binding.

To maintain high academic standards, academic ethics and academic integrity, a rigorous process of double blind review of research papers is followed along with screening for plagiarism of each manuscript received by the college for publication. The research work published in Strides is original and not published or presented at any other public forum.

The foundation issue of the Journal i.e. **"Strides – A Students' Journal of Shri Ram College of Commerce, Volume 1, Issue 1, 2016-17"** was successfully released on 91st Annual Day of the College held on 13th April 2017 by Shri Prakash Javadekar, Honb'le Minister of Human Resource Development, Government of India.

The successive Issues of 'Strides – A Students' Journal of Shri Ram College of Commerce' shall be bi-annually released.

Dr. Santosh Kumari
Editor



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Are Central Banks creating the next Financial Crisis?

Simranjeet Singh
B.Com (Hons.)-IInd Year
Shri Ram College of Commerce
University of Delhi

This paper aims at identifying the Internal and External problems Central Banks are creating and analysing the consequences of their action. Since the 2008 Financial crisis hit the world economy, central banks of both developed and developing countries are fighting to revive growth, push demand for credit as well as consumption. In the hindsight, the tools which they have used have either backfired or not delivered the requisite results. In this paper we shall discuss about the problems and consequences of the actions which Central Banks have taken both in developed and developing countries. For developed economies, we have chosen US, Japan and Euro zone which were the worst hit by the 2008 crisis. The measures which they adopted were Ultra-low interest rates (some had negative interest rates), Quantitative Easing and Extensive Bond Buying to revive demand. The situation in developing economies is no different although, the problem is more serious and chronicle. Countries like India, Italy and Europe and Central Asia (Excluding High Income Countries) has one of the highest NPA in the world, as high as 10% of total gross loans. The paper identifies the internal and external problems central banks are creating and analysis the consequences of their actions.

Mentor

Ms. Renu Bansal
Assistant Professor
Department of Economics
Shri Ram College of Commerce

INTRODUCTION

The basic function of any central bank in any economy is to monitor and control the supply of money so that inflation is under control. Apart from this, the secondary functions of central banks includes Full

Employment, Stability in Exchange rates with Foreign countries, Moderate long term Interest rates, Sustainable economic growth rate. This can be done through different ways like altering the Interest Rates, Open Markets Operations of buying and selling Government Bonds, Reserve Requirements changes to control the supply of money in the economy.

Apart from this, central banks keeps a check on the functioning of different subsets of capital markets like the bond markets and helps in the development of bond markets if it's underdeveloped like India. Alternatively, they keep a check on the functioning of commercial banks in the economy by laying out different guidelines so that they are not indulged in some unfair practices.

What central banks in developing countries are collectively doing wrong?

For developing countries, we have chosen India, Italy and Central Asia (Excluding High Income Countries). The problem in these economies is not of growth as they have revived themselves from the shocks and aftermath of the 2008 financial crisis. However, these economies have one of the Highest NPAs (as high as 10%) and these have now become a hurdle from the economy and a hindrance for growth. Table 1 shows the NPL as a % of the total loans in the banking system

Table 1

Country	Non performing Loans (%)
India	9.2
Italy	17.1
South Asia	9.6
Japan	1.5
Australia	1.0
North America	1.0

Source - theglobaleconomy.com

The NPL problem here is centric to developing countries only where there is one more commonality i.e. the bond markets in these respective countries is underdeveloped which is one of the reasons of such High NPL. Although, there are other country specific reasons also for these high NPL like political influence in India, the divergence of monetary and fiscal policy in Italy.

Developed countries on the other hand have developed bond markets and hence low level of NPL in their economy. Table 2 here exhibits the bond market size of different countries, total of the world global bond market share

Table 2

	Bond Market Size
India	<5%
Italy	<5%
South Asia	<10%
Japan	14%
Australia	10-12%
US	33%

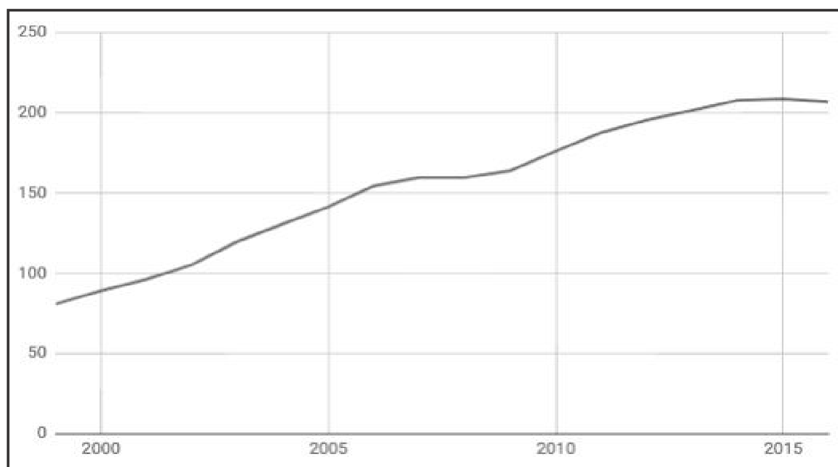
Source- www.fred.stouisfed.org

There is direct negative correlation between the size of NPA and the bond market size, this is because if the corporate bonds would have listed in the markets, then any negative news with respect to the company like default in interest payment or a breach of any negative covenants would drag the price of the bonds and increase the yields for that bonds classifying it as risky bonds. This would hamper the goodwill and credibility of the company in the market and the company would not raise funds in the future.

Moreover, if companies opt for bond market to raise capital, this would help banks to not service the credit requirement of corporates as they have high funds requirement and bank's loan portfolio will be centric to few big corporate, this will not minimize the bank's risk with respect to the default risk.

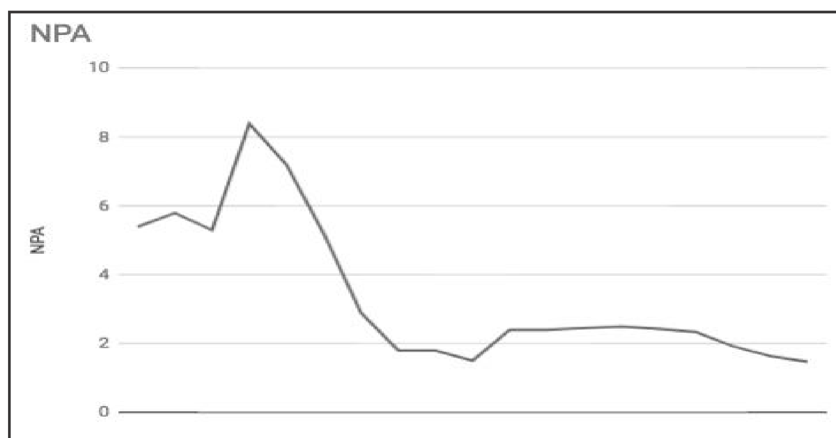
Japan- A perfect example

Figure 1- Bond Market as % of GDP



Source-www.theglobaleconomy.com

Figure 2- NPA as % of total deposits



Source- www.globaleconomy.com

As we can observe in the above figure a significant rise in the development of Bond Market has led to the fall in NPA of the banks, as this has given a platform to the Corporate Giants to raise a substancial capital from that source apart from raising money from Banks and if there is any Bad news about the company that has came up in the market it has been corrected in the Market itself apart from hindering the Loan profile of the Company.

Although there are several other factors for a sharp decline in NPAs but this can be considered as one of the prime example where Japan had seen a development in their bond markets and a sharp decline in the bank's NPA.

What Central Banks in Developed Economies collectively doing wrong?

There has been various Crisis in the past ranging from the The Great Depression to the 2008 Global Financial Crisis which have left have a chronic impact on the functioning of the major economies on the globe. But the question which arises here is that have the Central Banks Learned from this?

Whenever a country is being Hit by a crisis all its Population looks at the Central Bank, as the lender of the last resort and think now only they can bail out us out from this situation. Central Banks of both the Developing and the Developed countries fight to revive growth push demand for both credit as well as consumption and Investments so as to provide a sustainable future for its people. In this Hindsight we will highlight the major shortcoming of the tools which they have used have either backfired or not delivered the required results and would also throw some light on the current picture of their policies and workings which would lead to another devastating situation.

2008 SUBPRIME FINANCIAL CRISIS

Going 10 years back in the history we find the disastrous crisis hitting the world economy ie, SUB PRIME CRISIS. During the early 2001 US economy experienced a mild, short lived recession so in order to keep recession away the Federal Reserve lowered the Federal Funds rate 11 times from 6.5% in May 2000 to 1.75% in December 2001 thereby creating a flood of Liquidity in the economy. As due to this measure it was an easy prey for rest less bankers to lend to more restless borrowers who had Less Income, No Job and even No Assets.

So when living a dream of acquiring a house for such people was becoming a reality facilitated by ease of obtaining Credit from the market then there has to be a great appreciation in the prices of such houses and exactly the same thing happened, the market was getting filled with Loans of Bad Credit Risk. Fed still didn't got the smell of such disaster and kept on slashing the Interest rates to record low in 45years to 1%. The whole picture of Financial Market was being getting resembled to a Credit Market where everything was being easily obtained at Huge discount and without any Down Payment. Unfortunately there was no one to warn the Federal Reserve about the turmoil which was likely to arise later.

The Bankers then decided to repackage these housing loans and pass the Debt to another player in the market in the form of Collateralized debt obligation. The game was going was going on very nicely until when Fed just seemingly woke up and raised the Interest rates to 5.25% on June 30, 2004 which remained constant till August 2007 and home ownership at that time reached to a Saturation point.

The early signs of decline could have been discovered when house ownership peaked almost 70%. Further during end of 2005, housing prices started to fall which led to a 40% decline in the US Home Construction Index, due to this many subprime borrowers began on defaulting on their loans due to higher interest rates. Then in 2007 the situation even worsened that every month, one Subprime lender or another was filing for bankruptcy and this domino effect flooded the whole markets with default after another. Various Big Organisations like Lehman Brothers, Indymac bank also collapsed. By October 2008, the Fed funds rate and discount rates were reduced by 1% and 1.75% respectively. Central Banks all over the world also resorted to rate cuts to aid the world economy but such, liquidity support and rate cuts in itself were not enough to stop such a widespread Financial meltdown.

JAPANESE DEFLATION

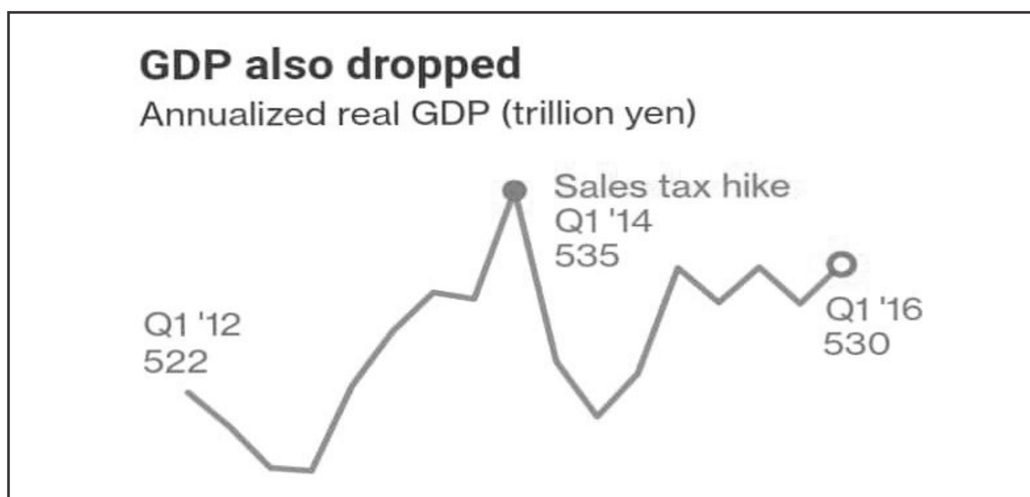
At the end of 2012, the Japanese Central Government was under 997 trillion Yen in Debt. The interesting part here is that it is about 200% of their GDP and more than $80000

Debt per Capita. There is a very little chance of it ever being paid back and the situation is every time is getting even worsened.

So let's trace back in time and let's see how Japan landed up in such a situation and how Japanese Central Bank failed to bail it out from that. It's necessary to understand how the Japanese government firstly accumulates such a high debt at the very first place. The tax received by the government in the past few decades have been less than the expenses incurred by it, so it started borrowings from the external sources to meet its revenue expenditure. The Japanese Government used to borrow money by issuing IOU to the foreign institutional investors. In the initial years it was good going for the govt and the Bank of Japan but they ignored the consequences that would be generated later. As time passed the Debt got increased overtime and the investors started to worry about their investments, now here is when the Bank of Japan came into the picture, BOJ during the successive years lowered the interest rates, which basically means it would print currencies until the interest rates would hit its targets satisfying the investors that their investments are safe. Successively the investors keep buying the govt. IOU and the debt accumulated during the course of action.

During 2011, when the investors saw that the government Tax revenues are not even enough to meet its interest expenditure they started selling their bonds thereby raising the interest rates in the markets, Now after this the Japanese Government tried to increase their tax revenue by raising tax, but the outcome which generated was that it increased the inflation growth in the economy.

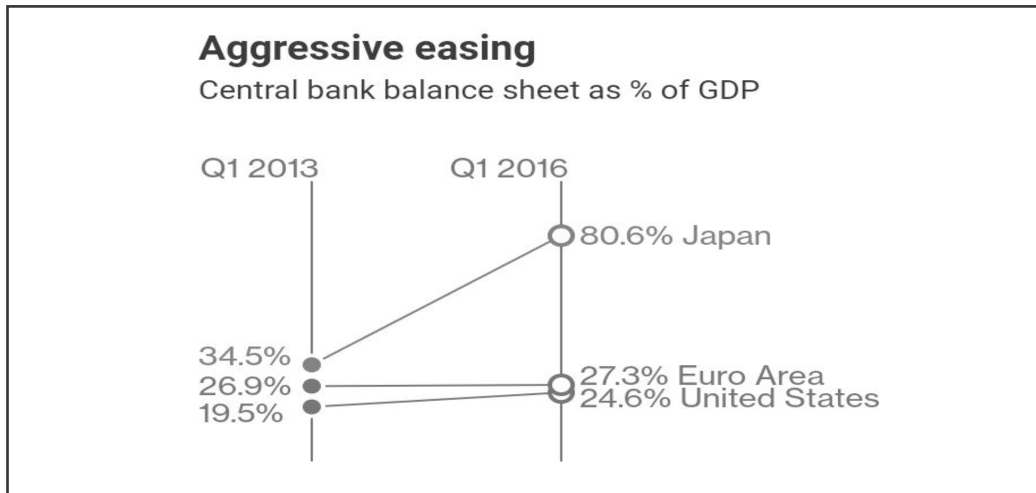
Figure 3- GDP Growth in real terms



Source- www.bloomberginternational.com

The Central Bank's policies to overcome Debt burden in 2014 backfired completely to the country of increasing the Sales Tax due to which the Consumer Spending and the Gross Domestic Product fell, sending the economy into further recession as the inflation rate clipped 0% indicating the failure of BOJ to overcome Deflation.

Figure 4- Bank of Japan Balance Sheet



Source- www.bloomberginternational.com

The quantitative easing measure further adopted by BOJ, further failed to produce the goods for the economy as the Japanese Yen appreciated to 80.6% in the first quarter of 2016 as compared to 34.5% in 2013 as the exports were facing a Bullish time along with the stock market until 2013 as afterwards the monetary stimulus lowered the exports as they became expensive in the International Market and began further widening the gap in the Fiscal Deficit this Aggressive easing measure adopted by the govt. also made it impossible for it to attain the 2% interest rate target.

Conclusion

Central Bankers across globe are well equipped with the resources both monetary and human but have failed to tackle the crisis which persist in their respective economics. These central bankers have not learnt from the mistakes done by their peers as shown by the example of Japan in both cases. Moreover, the policies adopted are unconventional monetary policy tools which don't have any positive results in the past and have majorly backfired.

Central Banks needs to understand the crisis which they knowingly or unknowingly are creating by using fancy and new tools to tackle the problem statement. Once a learned

man rightly said that, “it's very difficult to teach academicians the basic foundations of their respective fields.” It's time central bankers should stick to the basics of monetary policy or we will be witnessing another crisis with greater magnitude of 2008

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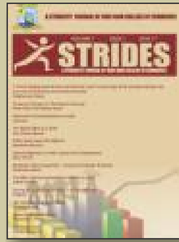

RELEASE OF FOUNDATION ISSUE OF STRIDES

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SHRI RAM COLLEGE OF COMMERCE
University of Delhi, Maurice Nagar, Delhi - 110 007
Phone: 011-27667905 Fax: 011-27666510