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INTEGRATION AND EFFICIENCY OF FINANCIAL MARKETS IN INDIA

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Abstract:
An effective and cohesive financial system serves as the foundation for economic growth. Preferential financial institutions, H: distorted prices for financial assets, high financial repression for savings, negative or even uncertain rates of return and for investment resources and ineffective resource allocation constrain development. Over time, with development in this new financial structure, In order to spur economic growth, households abandoned holding onto useless non-monetary physical assets they didn't use for their own benefit, which reduced the overall real supply of credit and increased the quantity and quality of investments. In this context, underdeveloped financial structures indicate that demand for financing operations is low, with increment in real redeploying sectors. Financial integration, therefore, captures the extent of interaction and coupling, where individual economies have achieved standard convergence in their markets and where mutual complementarity assists in the identification and determination of balance within sub-sectors. An essential precondition for the successful functioning of the real economy is a robust, well-established, and financially sound financial sector. Given the state of the global economy today, achieving financial stability has become the primary goal in the recent past only.With this concern, this present study aims at investigating the impact of financial integration coupled with depth and growth and inflation and per capita income on the sustainability of financial integration in India with benchmarking other countries. The research uses only the collected secondary data from highly credible sources that include World Banks, IMF and RBI, among others. Based on key statistical metrics, it ties the Indian economy's financial integration and macroeconomic growth to the study's aims. The report highlights the significance of the scales and their potential impact on India's financial integration in the future.

Keywords: Economic Growth Rate, GDP Per Capita Growth, Financial Stability, India.

Introduction:

Financial integration refers to the strong synchronized link among the financial markets across the global, and the nature that sustainable in the long run across segments of the different markets. It is accomplished by (a) eliminating barriers to international finance movements that affect financial institutions, (b) facilitating the direct sourcing of funds or borrowing by businesses and (c) engaging in unfettered bond and stock investment flow. But conversely it is important to understand that legal barriers exist primarily in response to market failures that hinder financial integration. Lifting such constraints but not the inefficiencies could in fact, have adverse effects to the global economy.

The second way of financial integration can be through formal international cooperation with the purpose of stabilization of devastating financial shocks on regional and especially on the world scale through coordinated actions of regulation and policy. The level of financial integration is derived from drivers such as gross capital flows, foreign asset and liability positions, international stock return synchronicity, global real interests rate differences, and financial liberalization. Gross capital flows simply take surplus and deficit into consideration, but two-way capital flows, including capital import and export, are more relevant to the study of financial openness, according to some viewpoints. One example of a country that does not meet the criteria for full financial integration is one that has a high capital income but no capital expenditures.

Financial Integration in the Global Context

As a whole, the member nations' structural changes began in the late 1980s, when most domestic EMFs liberalised. It was believed that developing countries should strengthen their own financial systems in response to the increasing dominance of rich countries in international trade. However, in order to access international investment at a lower cost, these so-called "developing" economies had little choice but to open their markets to global finance. Thus, financial liberalization enhance the domestic financial structure as well as linked global economy with domestic economy. On the other hand, this integration has been criticized for occasionally admission of short-term unstable debt flows, and freely transferable speculative capitals which certainly foster more of systemic risks.

Clients aim at achieving high income from securities purchase and sale and interest operations, which encourages people to engage in the purchase of financial products. Since the primary goal of financial liberalization is to reduce systemic risks, this tendency has sparked a greater discussion about the financial integration process. Meanwhile financial integration ostensibly designed to distribute risks over more investors has resulted in devising of new credits and derivatives. Despite these changes having lowered particular institutional risks, they have also upped overall global systemic risks. While such complex financial products are mostly traded in the developed countries, Asian countries represent a large pool of investors including India.

Whether or not financial integration influences and or leads to economic growth is still an open question. On the downside, the ability to integrate for efficient utilization of funds and investment depends on elements such as market transparency, quality governance, technology, political stability and effective payment system. Prasad et al. (2003) pointed out that, on balance, the argument for fi-nancial integration to support long-term growth is not well supported by quantita-tive evidence. Their findings also pointed out that for economies in their process of achieving the optimum level of financial integration, instabilities are likely to prevail. The financial integration also exposure the risks that even outlined developed country with good governance are receptive to global shocks as was evidenced by credit crunch in 2008.

Financial Integration in the Indian Context

In an attempt to become more connected into the global financial system, India started liberalising its domestic financial sector in the early 1990s, just like the rest of the globe. Improving domestic money, capital, and exchange markets while also making resource mobilisations more efficient was the major goal of these changes. Connecting with global markets, intended a qualitative diversification in external funding, risk spreading, and better investment opportunities.

The Indian economy could also be described as weak until the begining of the 1990s due to frail financial structures and embryonic support to growth in the real economy. Financial reforms have partially fulfilled these roles by ensuring the availability of credit services at low costs for sociolet and developing the financial framework. In the last twenty years, India had witnessed structural changes where interest and exchange rates follow market determined policy, monetary and phased opening of capital account and introduction of competitive government securities.

When the restrictions to foreign capital movements reduced, India got enormous foreign capital flows. For instance, the BSE was positioned among the premier, 10 major stock exchanges globally based on market capitalization (WFE, 2007). As per the World Exchange of the year 2008 the NSE of India is placed at the eighth and BSE of India at the ninth position with reference to performance during 2007-08. These indicators show that FII volume is significant in the Indian markets and India is one of the favourite destinations to undertake speculative investments.

While developed nations have seen more banking system exposure as a result of financial deregulation, India has seen less. Indian banks do not engage a lot in securities which exposes them to risk rather they engage a lot in what can be referred to as real business activities that includes banking operation. Despite India experiencing global admiration for the financial sectors it has put in place, its financial sectors struggle with liquidity crises during difficult times.

For example, in the case of the global credit crunch of 2008 – 2009, India’s Reserve Bank (RBI) was able to balance the management of requisite liquidity constraints and M3 money supply without a vast augmentation of the country’s balance sheet. Through monetary management tools, such as the Cash Reserve Ratio (CRR) and the Market Stabilisation Scheme (MSS), the Reserve Bank of India (RBI) observed and managed the short-term liquidity restriction. The developed world's economies required massive interventions to keep their economy stable, while India's stability proved the resilience of FR metal.

The paradigm of integrated growth of India’s financial system demonstrates the country’s global connectivity strategy as well as the efforts aimed at protecting domestic markets from potentially devastating systemic threats. That being said there still are numerous opportunities for deeper financial systems development, upgrade of the governance and transparency to secure more efficient financial growth and to protect from the outside impacts.

Concepts of Financial Stability in India

The future of the global financial system is a growing concern for central banks like the Reserve Bank of India (RBI). Financial stability is a relative term that differs among countries and central banks hence is commonly contextual. Despite this, what happens within these contexts is experienced and then simply categorised into transferable knowledge. Historically, objectives of central banks first were made to focus on monetary stability and later incorporated financial stability goal. In fact since mid 1990’s, almost simultaneously central banks too have been targeting both objectives. Financial stability regarding the concept emerged from the macroeconomic stability that suggested cooperation between the sovereign authorities and regulators for overall economic requirements.

Financial stability is analyzed from the regulators’ point of view, market point of view, and the government from the investors’ point of view. In democracies and especially in developing countries like India, reality of financial stability invites concerns with reference to multi- stakeholder viewpoints thus, the respective roles of the government and regulating bodies becomes critical in the deal with overlapping or conflicting interests. In such cases, the sovereignty authorities have to make priorities since it is usually impossible to tackle all the concerns at an equal level. India remains an ideal example because while the government and statutory regulators work hand in hand to ensure maintenance of financial stability, they have registered considerable success in the process so far.

With this definition, idea, and key features of financial stability in mind, we ask: what does it imply, how is it measured, what instrument is best, and how much help is required from central banks to keep the economy stable? Maintaining a steady financial system, public trust in the banking sector, and effective management of market volatility are all necessary for India's financial stability.

In other words, financial stability concerns the balance in the financing activities in order to meet the expectation of the public and requirements of the government. Stability, including that of financial markets and institutions, is a top goal. Banking institutions, non-banking financial enterprises, development finance institutions, insurance firms, provident funds, central and state governments, public sector units, and non-governmental organisations (NGOs) are all part of the financial dynamics of India. It is the responsibility of the Ministry of Finance, SEBI, IRDA, PFRDA, FMC, and RBI to ensure the stability of the financial industry. However, the general public views central banks, and the Reserve Bank of India in particular, as primarily responsible for ensuring financial stability. Despite the fact that the central bank does not have direct control over many other actions and organisations.

In its 2003–04 annual publication, "The Trend and Progress of Banking," the RBI first included a new chapter titled "Financial Stability," a clear indication that it was fully cognisant of this obligation.The current paper aims to look at this issue for the years 2004 onwards. There are always three important cornerstones for which financial stability is maintained, namely (a) institutional stability, (b) market stability and (c) price stability. Although, it is very difficult to achieve an ideal balance of stability across all three area at once nevertheless, governments strive for achieving an optimal balance through their public policies. Therefore, sustainability of financial systems is a function of global cooperation of policy makers, regulators and enforcement agencies in providing necessary safeguards against shocks erosive to financial stability of countries.

Concepts of Financial Stability in India

The Reserve Bank of India (RBI) wholeheartedly supports the global central bank's (Fed) objective of achieving financial stability. It is important to understand that the framework of FS is country/specific to the central bank contingent. Nevertheless, people take such specific experiences from context and use them to construct universalized lessons from them. Typically, central banking started with focusing merely on monetary price stability and subsequently added financial stability goals. Since the 1990s, central banking has involved them in both at the same time. Similarly, financial stability as a concept developed from the macroeconomic stability which could only be achieved through cooperation of sovereign authorities and regulators for balance.

Financial stability is a relative term and it means different things to the regulators, the markets, and the combating government authorities. In democratic and developing countries like India, financial stability is therefore complex with matters viewed from the perspective of several players which makes the government and its regulators very central in managing competing interests. In such cases goals have to be ranked because simply, where there are so many concerns, one cannot address them all at once no matter how much they may wish to do so as a sovereign power. India is a prime example where the government along with statutory regulators works for financial stability and has been quite successful up to this extent.

Of course all these discussions with reference to financial stability are carried out in a theoretical framework where features such as definition, measurement, selection of appropriate instruments and degree of intervention required from the central banks to support the concept form part of the deliberations. For India, financial stability means the effective clearing of finance deals, maintaining or having trust in the economy's operations, and ensuring that there is little or no high volatility that is detrimental to many operations within the economy.

Taken in literal sense, stability of financer suggests the ability to balance variations in the money related activities to satisfy the public impress and government standards. The stability and steadiness of the financial markets' and institutions' operations continue to be its top concerns. In India, financial stakeholders include many different types of organisations and groups, including federal and state governments, PSEs, banks, NBFIs, DFIS, insurance, provident funds, and NGOs. There are many regulatory organizations authorized to maintain and regulate the financial sector including RBI, SEBI, IRDA, PFRDA, FMC and the Ministry of Finance. However, the public at large regards central banks or especially the RBI as primarily responsible for financial stability even though a myriad activities and institutions that makes up the concept of FS falls outside of their purview.

Accepting this responsibility, the RBI has included a separate chapter on 'Financial Stability' in the recent publication 'The Trend and Progress of Banking in India 2003-2004'. Three core JSA of financial stability are instituted which include (a) institutional stability (b) market stability and (c) price stability. It is possible to maintain an optimal stability in one area only, therefore, the balance between economic, social and political stability is sought by governments through public policies. Therefore, financial stability implies cooperation involving policy makers, regulators and enforcers nationally and internationally about models of economic resilience against shocks and sustainable growth profiles.

Macroeconomic Frameworks for Financial Stability

One important aspect of the economy that central banks use to regulate regulation stability is the sources of financial stability measures. They have a direct access to markets which enable them to constantly assess market stability with other parties regulating. However, these frameworks must make it possible for supervisory bodies to operate independent of other entities, something that will make it easier for them to act fast and conclusively when responding to new risks. The 2008 global financial crisis provided a vivid example of many cross links between the macroeconomic and financial policies at the national and international levels. International economic policies which are generally referred to as macroeconomic polices if standard can hamper the growth of finance , whereas inadequate financial systems may also pose a barrier to the flow of monetary polices and thus the degree of stability. Moreover, when capital accounts integration intensifies, the issue of controlling and co-coaborating on liquidity and financial flow becomes almost impossible. Of course, there are many potential threats before the emerging markets including India these threats are the external monetary policies, bubbles in the asset price, and inflation resulting from global prices of the commodities. Policy makers cannot afford to wait for these risks to materialize, the following are some of the strategic policy measures that should be taken to deal with the risks. Of key concern therefore, it has become necessary for central banks, in particular, to come up with effective strategies on the prevention of asset price bubbles and to monitor inflation tendencies through strict monetary policies for the achievement of financial stability.

Indian Banking and Financial Sector Reforms

To improve its efficiency, competitiveness, and financial stability, India's banking and financial sector experienced structural changes. The specific aims included increasing operational flexibility of resources while building broader institutional capacity and improving financial sustainability. The major changes for the deregistration of interest rates were reduction of statutory pre-emptions and more stringent prudential regulations. The reforms in early 1990 ranged from increasing of competition in the banking systems, the government also embraced the international benchmark on how to regulate and supervise the banking system. At the same time, there upgrades in institutional and legal environments facilitated by technological developments. Some autonomy measures were initiated as part of measures to increase the capital base of banks such as injecting capital into public sector banks, risk based supervision, structured audit and monitoring. According to former RBI Governor Y.V. Reddy (2002), India’s financial reforms were guided by five principles: proceed cautiously, concurrent changes in monetary and fiscal policies, coordinated to ensure that financial institutions and markets are reinforced and problem banks receive corrective measures. They served to strengthen stability and order throughout the bank.

Implementation of Basel II in India

The Basel II norms were implemented in India on March 311, 2007 for bringing India’s banking system at par with International norms. The framework was centered on upgrading the risk management tools and increasing the protection against the financial risks. Credit risk was measured using the Standardised Approach, whereas operational risk was measured using the Basic Indicator Approach. Over time banks and regulators got experience, enforcement of some components of the IRB Approach became possible. To protect itself against risks Basel II also demanded more stringent prudential capital requirements. India’s banking system was in a comfortable position to meet these requirements because its CRAR was above 12% – as a matter of fact, it was already at 12.7%. Moreover, the RBI permitted banks to attract funds through such new age avenues as perpetual debt, preference share, and hybrid debt instruments so that there is more freedom in view of the capital adequacy requirement.

Objectives of the Study

The following precise goals are intended to be achieved by this study:

1. This study aims to investigate the effects of financial integration on the stability of India's financial system.

2. Comparing this country to others in SAARC in terms of financial integration, inflation, and GDP development is the primary objective of this article.

Data and Methodology

Databases maintained by organisations including the World Bank, the Asian Development Bank, the Reserve Bank of India (RBI), and the International Monetary Fund (IMF) are the sole sources of secondary data used in this analysis. This data includes both publicly available and privately held information. In order to evaluate India's economic performance, this study primarily aims to analyse secondary data to find out how GDP growth rate, inflation, and per capita income relate to one another.

This study aims to accomplish the aforementioned goals by utilizing a variety of statistical techniques and is set in the years 2011–2017. Conveniently, these techniques are used to preserve the accuracy of the findings and investigate the connection between financial integration, economic expansion, and sustainability.

Limitations of the Study

The study faced several limitations, including:

1. **Sample Size and Scope** - The study sample was relatively small, and included only South Asian countries, excluding data from other global economies.

2. **Time Frame** - The results rely only on the data up to 2017 while the long-term nature of economic change cannot be captured fully in such a limited time horizon at best.

3. **Secondary Data Sources** - Though occasionally the data from sources like the World Bank, IMF, RBI, and Asian Development Bank may not accurately reflect the local economic condition, the analysis was primarily based on secondary data.

4. **Regional Focus** - The studies presented include suggestions that are mainly relevant to South Asia and may not be generalized to other regions with different level of development.

Scope of the Study

The paper sheds the light on financial integration in South Asia and macroeconomic aspects related to the region. Additionally, they perceive the IMF, the World Bank, and the Reserve Bank of India (RBI) as vital in fostering economic development and steadiness. Subsequently, through comparing the GDP growth rates, the trends of inflation rates and analyzing the results of the financial integration standards, this study finds that India possesses with the robust performance in ensuring the financial stability. The authors also suggest that future research could cover longer horizons, more countries, and additional economies not in South Asia.

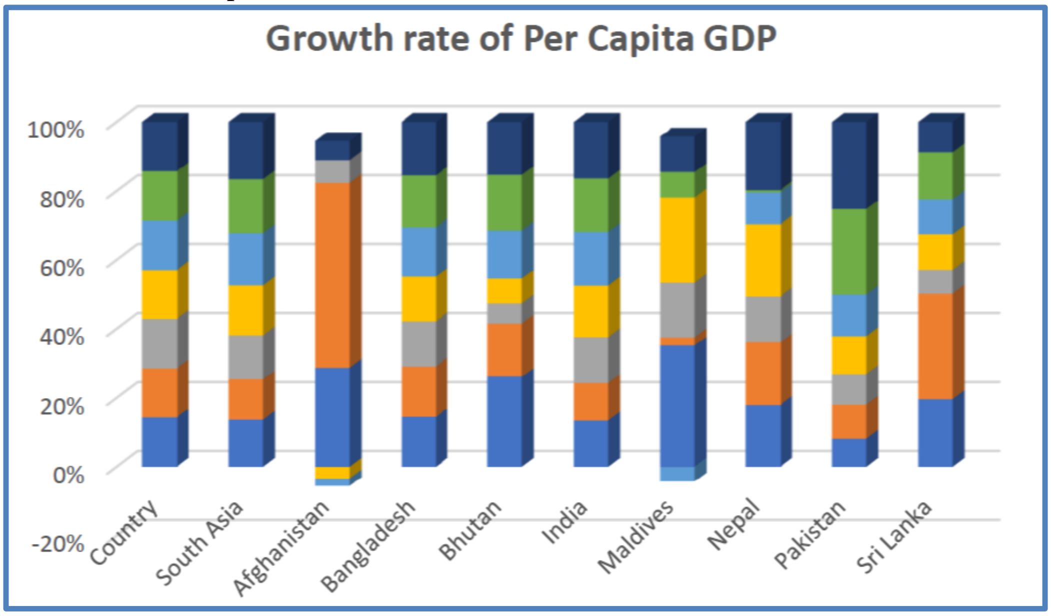
Table-01: Growth rate of Per Capita GDP

Table: Growth Rate of Per Capita GDP (% per year)

Country	2011	2012	2013	2014	2015	2016	2017
South Asia	5.0	4.3	4.7	5.3	5.6	5.7	6.1
Afghanistan	5.2	9.7	1.2	-0.6	-0.4	0.0	1.0
Bangladesh	5.1	5.2	4.6	4.6	5.1	5.3	5.5
Bhutan	7.8	4.6	1.8	2.1	4.2	4.8	4.6
India	5.3	4.3	5.3	5.9	6.2	6.1	6.5

Country	2011	2012	2013	2014	2015	2016	2017
Maldives	5.8	0.4	2.6	4.1	-0.7	1.2	1.7
Nepal	3.1	3.1	2.3	3.6	1.6	0.1	3.4
Pakistan	1.5	1.8	1.6	2.0	2.2	4.5	4.6
Sri Lanka	7.4	11.5	2.6	3.9	3.8	5.1	3.3

Source: Asian Development Outlook, 2016



The table below shows the growth rate of South Asian countries' per capita GDP from 2011 to 2017. It is possible to learn about these nations' economic health and financial stability from this data. India continues to show positive and progressive trend during the year under consideration the figure as 5.3% in 2011 and enhanced to 6.5% in 2017. This points for the stability of economic growth and financial integration processes in India.

On the other hand, Afghanistan presents the figures common for the countries with slow and intermittent growth rates. It however registered 5.2% in 2011, reached its maximum in 2012 at 9.7%, then went in the negative domains-(-0.6%) in 2014 and -0.4% in 2015. This has showed a very big financial insecurety and weakness in the Afghan economy which although slightly improved to 1percent in 2017.Maldives and Nepal also both also depict fluctuation in the GDP growth rate. While its economy shrank a little in 2015 by (-0. 7%) , the economic growth was again increased to (+1.7%) in 2017 in Maldives. The manufacturing sector's contribution to GDP in Bangladesh has been steadily climbing over the past several years, from 7.3% in 2014 and 8.2% in 2015 to a small dip to 7.8% in 2016 and an increase to 8.7% in 2017. Having grown at a pace of 0.1% in 2016 and then increasing to a further 0.2% in 2017, Nepal's trajectory has been anything but predictable. These trends show how difficult it is for many countries to maintain a steady rate of economic growth.

Sri Lanka depicting the largest fluctuations within the two time periods noted above. It rose as high as 11.5 percent in 2012, which was the highest among SAARC countries before coming down to 3.3 percent in the 2017 estimate. The variation of this trend may be indicative of cyclical movement of economic disequilibrium, which may be as a result of external shocks or internal financial restructuring.Overall, the consecursion made from the treatment above directs to the fact that India has the most stable and positive growth rates while Afghanista, Maldives, and Nepal are having certain problem owing to fluctuation in economic status. These swings imply continuing structural changes, joining financial markets and bettering governance to guarantee more prolonged and coherent economic development in South Asia.

Table-02: GDP growth rate and Inflation

Country	2011	2012	2013	2014	2015	2016	2017	Inflation (2011)	Inflation (2012)	Inflation (2013)	Inflation (2014)	Inflation (2015)	Inflation (2016)	Inflation (2017)
South Asia	6.3	5.6	6.2	6.7	7.0	6.9	7.3	9.4	9.3	9.3	6.8	5.0	5.2	5.7
Afghanistan	7.2	11.9	3.2	1.3	1.5	2.0	3.0	11.8	6.2	7.4	4.6	-1.5	3.0	3.5
Bangladesh	6.5	6.5	6.0	6.1	6.6	6.7	6.9	10.9	8.7	6.8	7.3	6.4	6.2	6.5
Bhutan	9.7	6.4	3.8	5.9	6.6	6.4	6.1	8.6	10.2	8.8	9.6	6.6	4.0	5.0
India	6.6	5.6	6.6	7.2	7.6	7.4	7.8	8.9	9.3	9.8	6.7	5.0	5.4	5.8
Maldives	8.7	2.5	4.7	6.5	1.5	3.5	3.9	11.3	10.9	2.3	2.1	1.0	1.2	1.4
Nepal	3.6	4.8	3.8	5.1	3.0	4.8	3.9	9.6	8.3	9.8	9.1	7.2	10.5	8.2
Pakistan	3.6	3.8	3.6	4.0	4.2	4.5	4.8	13.7	11.0	7.4	8.6	4.5	3.2	4.5
Sri Lanka	8.4	9.1	3.4	4.9	4.8	5.3	5.8	6.8	7.5	6.9	3.2	3.8	4.5	5.0

Source: Asian Development Outlook 2016

Summary of Findings and Conclusion

The inflation trends for the South Asian countries over the period under analysis (2011–2017) are represented in the above analysis. India has shown a decreasing tendency of inflation rate, which was at 8.9 percent in 2011 while it was 5.8 percent in 2017, which prove that country's economy is more stable and financially healthy. Pakistan, which had the highest Inflation of 13.7 percent of 2011 had reduced to 4.5 percent of 2017. Nonetheless, the result showed that the countries like Nepal and Afghanistan had higher instability compared with the other countries indicating that there was more volatility in their financial systems. Nepal again had the highest inflation rate of 8.2% in the South Asian region in 2017 while Maldives ranked at the bottom with 1.4%.

Specifically for GDP growth rates, the growth rates were high India rose from 6.6% in 2011 to 7.8% in 2017, making it amongst the highest growers in South East Asia. On the other hand, Afghanistan possessed a slow growth rate, mainly in the fiscal year 2014/15 due to fluctuation in financial conditions. Growth rates of Bhutan and Sri Lanka showed similar rise and fall of the graphs, While Bhutan's growth rate peaked in 2011 at 9.7 percent, Sri Lanka's growth rate dipped to 5.8 percent in 2017.

The study validates the assertions as India's steady GDP growth rate and falling inflation rates testifies to the country's financial strength than those of other South Asian countries hence achieving a better index in terms of need for better financial integration and improved economic performance. The study also reveals economic structure of India and shows that country has improved its position in terms of monetary integration hence noting it as a region of stability and improvement.

Consequently, the study provides evidence that South Asian financial integration and economic growth are affected by macroeconomic policy, GDP, and inflation. An economic stability in India was identified through consistent economic growth and reducing inflation rates. Nonetheless, Afghanistan, Nepal and Maldives were observed to be consistently higher, revealing weaker financial link. Through the analyzed data it has been concluded that regional integration, policy changes, and infrastructure investment are crucial to the development of sustainability and economic stability in South Asia. This study also recommends that future studies use more extensive data sets to learn more about the effects of financial integration on GDP growth over the long run.

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