Emerging Opportunities and Challenges in Global Financial Market

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Abstract

In this research article the area of study is the opportunities and risks that globalization of financial market lead to for developing nations. Global financial market generates gains, mainly to the growth of the financial system across the world. However, global financial market also creates financial crises and challenges. After nations liberalize themselves, initially they have to face the risk but in the longer duration of time, the consequence is advantageous. However, a few numbers of nations have taken benefit of global financial market but if they are able to integrate themselves with the financial globalization then they may reap the benefits in the long duration.

Keywords: - Global financial market, financial globalization, liberalization, crises

Introduction to Global Financial Market

In everyday life, we come across invariably with globally traded products and services. If I wish to drive a car, I may drive an Indian make car designed by a German auto designer with a French engine and a Japanese gearbox. While roaming around in a street of New York, US I may find a readymade garment made in Taiwan. We find California black Grapes, Thai Guava, Chile Apple, etc. in Indian fruit stores. If I wish to take an insurance policy, there are number of foreign players having a joint venture in Indian insurance sector and in same line, there are foreign banks operating in India.

As compared to visible products and invisibles like banking, insurance services, the global trade in financial assets is comparatively less evident; however, its money volume is much larger. This type of trade is done in the global financial markets. Global financial markets are exemplified by high capital mobility since global trade in financial assets becomes uncomplicated and consistent owing to small transactions costs in liquid markets.

Global financial market liquidity is vital to effective market performance. Liquidity in global financial markets assists the efficient allocation of financial funds through the productive distribution of capital and risk, the precise creation and spreading of information particular to issuer, and the effectiveness of monetary policy and financial stability.

In the 19th century, financial capital was extremely mobile. Then near the beginning of 20th century world has faced two world wars and the Great Depression. Governments of most of the nations executed limitations on global flows of capital, as a result capital mobility reduced and it also parted the worldwide financial markets. The General Agreement on Tariffs and Trade (GATT) was created after the world war to raise the strength, constancy and integration of goods and services markets.

The Eurocurrency market was another innovation in the line. Industrial and technical modernization resulted in reducing the international transactions costs. The objective was to develop the highly integrated global financial market. For this aspect such as, liberalizations of capital controls in the 1970s and 1980s was done.

The global financial market provides link to investors across the globe by offering investors an immense collection of investment products across an incredible range of financial markets. The financial market consists of the capital markets, commodities markets, and derivatives markets.

The Capital Market

It consists of the markets for stocks, bonds, mutual funds, and exchange-traded funds (ETFs).

A stock is fundamentally an ownership claim on the cash flows and assets of a company. According to the Bank for International Settlements, over 46,000 stocks were traded globally, and the global market consisted of more than $54 trillion worth of traded stocks at the end of 2012.

A bond is a debt security that represents a fixed-income claim on the cash flows and assets of a company. The global bond market was valued at about $80 trillion in 2012, in terms of the aggregate value of the bonds traded.

Mutual funds are collection of cash collected from investors and invested in diversified baskets of traded securities. The securities comprise stocks, bonds, and other money market instruments. Mutual funds make available a very convenient and low-cost approach for investors to diversify their portfolios across many industries and firm sizes. The Investment Company Institute estimates that in 2012 the mutual fund industry had assets of about $26.8 trillion globally.

Exchange-Traded Funds (ETF) offers the same benefits as mutual funds. An ETF follows a financial index, a commodity, or a basket of assets like an index (mutual) fund, however it is different from a mutual fund, as it trades on an exchange. By investing in ETF, an investor get hold of the diversification benefits of an index fund and can also sell short, buy on margin, and purchase small quantities (e.g., one share). ETFs have seen immense growth, with $2 trillion in assets as of year-end 2012.

Commodities Market

In this market, investors may invest in physical commodities. Approximately 50 main commodity markets exist worldwide, and investors may trade in about 100 principal commodities, including mined natural resources (gold, silver, oil, etc.) and agricultural products and livestock (soy, wheat, pork bellies, etc.). Commodity mutual funds had $47.7 billion in assets at the end of the year 2011. Global trading volume in commodity futures and options markets as of year-end 2011 was almost $11 trillion monthly, and the total annual global sales in the spot market stood at about $6.4 trillion.

Derivatives Market

In this market, the traders trade in derivative contracts. These are financial contracts whose value is driven by the value of underlying. Usually traded derivatives are forwards agreement, futures contract, options contract, and swap agreements. The total estimated amount of over-the-counter derivatives at the end of 2013 was about $710.2 trillion globally.

Means for Economic Growth in the Global Financial System

Following are the ways, which promotes economic growth:

1) It generates financial claims
2) It assists specialization and encourages trade
3) It helps in managing exposure and risk
4) It provides a platform to mobilize financial resources globally
5) It provides an international network for collecting the information for the assessment of business projects and organizations and accordingly investing the funds
6) It offers the pool of opportunities to organizations, entrepreneurs, and investors to participate in and contribute to global economic growth

Growth and Opportunities in World Trade

The global economy is substantial and emergent. As per the World Bank, global Gross Domestic Product (GDP) had grown from $71.83 trillion in 2012 to approximately $74.91 trillion in 2013. The global flow of goods, services, and finance was almost $26 trillion in 2012, or 36% of global GDP that year.

Global trade flows have improved noticeably over the last three decades. As per WTO trade statistics, the value of world merchandise exports increased from US$ 2.03 trillion in 1980 to US$ 18.26 trillion in 2011, which is corresponding to 7.3 per cent growth per year on average in current dollar terms. Commercial services trade accounted over the same period, increasing from US$ 367 billion in 1980 to US$ 4.17 trillion in 2011, which is 8.2 per cent per annum.

There are number of factors, which have contributed to this notable growth of global trade however, the significant reduction in trade barriers is one of the most vital factors. Global trade barriers include costs of transporting goods to the end customer, policy barriers (tariffs and non-tariff barriers) and internal trade and transaction costs (including domestic information costs, contract enforcement costs, legal and regulatory costs, local distribution, customs clearance procedures, administrative red tape, etc.).

Global trade opening is the outcome of agreements negotiated under the patronage of the World Trade Organization, or the result of preferential trade agreements (PTAs), has significantly decreases the average level of applied tariffs. To exhibit the same, the average tariff imposed by developed economies in 2010-11 on all imports was around 5.0 per cent, while the average rate on non-agricultural products was just 2.5 per cent, based on data from the WTO's Integrated Database.

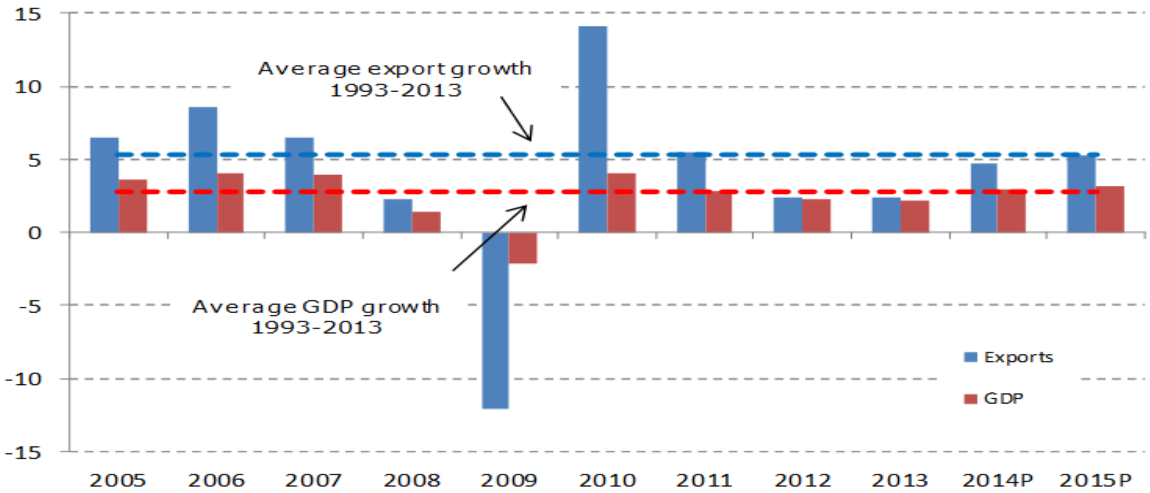

Figure 1.1: Growth in the volume of world merchandise trade and GDP, 2005-15[a] Annual % change

[a] Figures for 2013 and 2014 are projections.
Source: WTO Secretariat

The 2014 forecast of 4.7% is more than double the 2.1% increase of previous year; it remains below the 20-year average of 5.3%. For the past two years, growth has averaged only 2.2%.

The slow speed of global trade growth in 2013 was due to a combination of flat import demand in developed economies (0.2%) and moderate import growth in developing economies (4.4%). On the export side, both developed and developing economies only managed to record small, positive increases (1.5% for developed economies, 3.3% for developing economies).

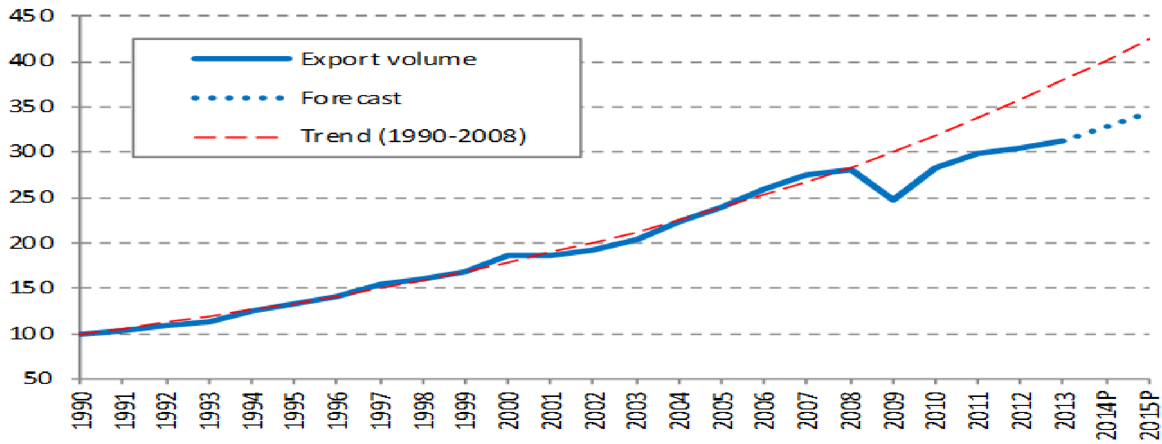

Figure 1.2: Volume of world merchandise exports, 1990-2015[a] Indices, 1990=100

[a] Figures for 2014 and 2015 are projections.
Source: WTO Secretaria

The WTO's forecast of 4.7% growth in world merchandise trade for 2014 is below the average rate of 5.3% for the last 20 years (1993–2013) and also below the pre-crisis average rate of 6.0% for 1990–2008 (Figure 1.2). In addition to creating a permanent shift downward in the level of trade, the global recession of 2008-09 may have reduced its average growth rate as well. The average rate of trade expansion in the three years since 2010 is 3.42%. Forecasts for 2014 and 2015, if correct, would raise the average to 4%, but this rate is insufficient to narrow the existing gap.

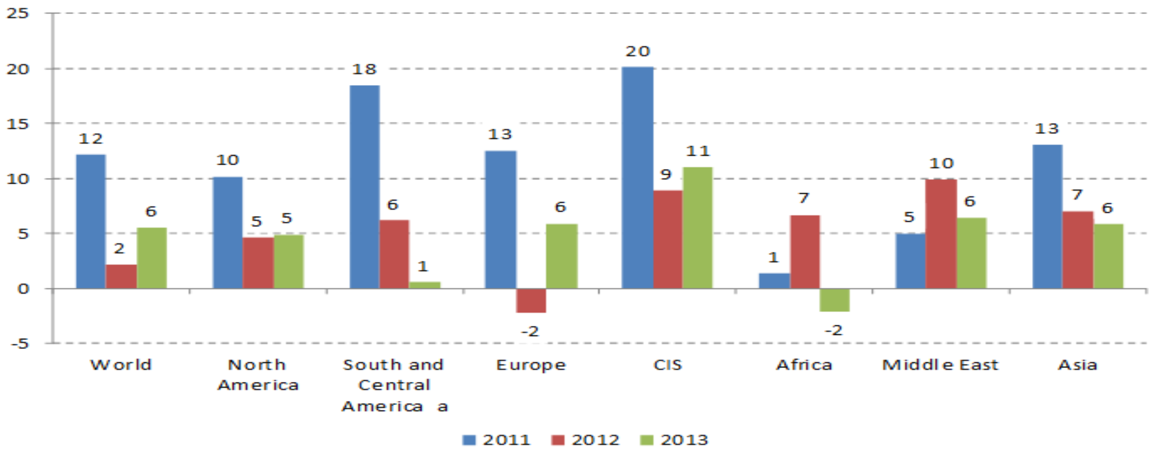

Figure 1.3: Growth in the value of commercial services exports by region, 2011 — 13 (Annual % change)

[a] Includes the Caribbean
Source: WTO Secretariat.

Year-on-year growth in commercial services exports by region for 2011-13 are shown in Figure 1.3. Imports are not shown in the chart, but their appearance is similar, with sharp declines between 2011 and 2012 for most regions, followed by smaller changes (some positive, some negative) between 2012 and 2013. On both the export and import sides, growth in European services trade turned sharply negative in 2012 before rebounding into positive territory in 2013.

The strongest decelerations were recorded by South and Central America, for both exports and imports, with Brazil responsible for much of the decline. On the export side, growth fell from 18% in 2011 to 6% in 2012, to 1% in 2013. On the import side it dropped from 23% in 2011 to 7% in 2012 to 6% in 2013.

Foreign Direct Investment (FDI) Opportunity

FDI is a vital driver of economic growth, is also a key source of non-debt financial resource for the economic development of developing country like India. Foreign companies invest in India to take advantage of relatively lower wages, special investment privileges such as tax exemptions, etc. For a country where foreign investments are being made, it also means achieving technical know-how and generating employment.

The Indian government's constructive policy establishment and healthy business environment have ensured that foreign capital keeps flowing into the country. The government has taken many initiatives in recent years such as relaxing FDI norms across sectors such as defence, Public Sector Unit (PSU) oil refineries, telecom, power exchanges, and stock exchanges, among others.

Market Size

According to Department of Industrial Policy and Promotion (DIPP), the total FDI inflows soared by 24.5 per cent to US$ 44.9 billion during FY2015, as compared to US$ 36.0 billion in FY2014. FDI into India through the Foreign Investment Promotion Board (FIPB) route shot up by 26 per cent to US$ 31.9 billion in the year FY2015 as against US$ 25.3 billion in the previous year, indicating that government's effort to improve ease of doing business and relaxation in FDI norms is yielding results.

Data for FY2015 indicates that the increase in the FDI inflows was primarily driven by investments in infrastructure and services sector. Within Infrastructure, Oil & Gas, Mining and Telecom witnessed higher FDI inflows, whereas IT services and trading (wholesale, cash & carry) drove the services inflows. Most recently, the total FDI inflows for the month of June 2015 touched US$ 2.05 billion as compared to US$ 1.9 billion in the same period last year.

During FY2015, India received the maximum FDI equity inflows from Mauritius at US$ 9.03 billion, followed by Singapore (US$ 6.74 billion), Netherlands (US$ 3.43 billion), Japan (US$ 2.08 billion) and the US (US$ 1.82 billion). Healthy inflow of foreign investments into the country helped India's balance of payments (BoP) situation and stabilized the value of rupee.

According to the data released by Grant Thornton India, the total merger and acquisitions (M&A) and private equity (PE) deals in the month of August 2015 were valued at US$ 2.6 billion (151 deals), which is 62 per cent higher in volume as compared to August 2014.

Investments/ Developments

Based on the recommendations of Foreign Investment Promotion Board (FIPB), the Government, in a meeting held on September 29, 2015, approved 18 proposals of FDI amounting to approximately Rs 5,000 crore (US$ 770 million).

Table 1.2: FDI Equity Inflows (Month wise) during the Calendar Year 2015

Calendar Year 2015 (Jan.-Dec.)		Amount of FDI Equity inflows	
		(In Rs. Crore)	(In US$ mn)
1.	January, 2015	27,880	4,481
2.	February, 2015	20,397	3,288
3.	March, 2015	13,221	2,117
4.	April, 2015	22,620	3,605
5.	May, 2015	24,564	3,850
6.	June, 2015	13,115	2,054
7.	July, 2015	12,769	2,007
8.	August, 2015	14,446	2,220
9.	September, 2015	19,181	2,897
Year 2015 (up to September, 2015) #		168,192	26,517
Year 2014 (up to September, 2014) #		135,978	22,431
%age growth over last year		(+)24 %	(+)18%

Source: Department of Industrial Policy and Promotion, Ministry of Commerce and Industry, Government of India

Emerging Challenges in Global Financial Market

1. Sustainable Development

The world is facing a tough sustainability challenge. These challenges to sustainable development are driven by wide underlying economic trends. Rigid trade, investment and financial relations have also raised interdependence between nations, which led to financialization, and it leads to larger risks of contamination in times of financial crisis. Simultaneously, economic growth has come with increasing income disparities in several nations. A future global agenda has to address this strong sustainability challenge and facilitate transformative change at all levels—local, national and global.

2. Strong Economic and Financial Ground Rules and Strong Institutions

A firm macroeconomic atmosphere with strong government finances, practical monetary policies and market-oriented structural policies are a requirement for sustainable economic expansion and a healthy financial sector. The global financial crisis in the past has shown, however, that there is not an apparent understanding among makers of the policy to understand the merits and demerits of various elements of a sound economic policy. Improving the contractual and regulatory environment is also important. Strong institutions make a rising nation more robust to link with the financial globalization process. Specifically, they boost the competence of the domestic financial system to transitional cautiously big global capital flows. Development of the regulatory framework should be done to improve the access of domestic organizations to financial services supplied overseas.

3. Volatility of Capital Flows

Global savings should be allocated to their optimum use, which in turn facilitates developing nations specifically with access to limited savings. The increased volatility of capital flows, global macroeconomic disparity, and manifold financial crises, which result in recessions. This signifies the financial risks and the extremely uncertain benefits of financial globalization for progress.

4. Vulnerability and Heterogeneity in the Global Economy

In general, globalization has offered opportunities for emerging economies and developing nations and their rate of expansion have been constantly superior to the rate of expansion in the developed nations. However, it has not prepared developing nations resistant to business cyclical shocks rather it has raised nations' vulnerabilities. A major part of the global population thus does not get much advantage from convergence.

5. Continual Disparities between the Nations

The heterogeneity among nations survives alongside with constant disparities. Income disparity is the most evident element. Global income disparity has reduced to some extent in recent years; however, disparities within many nations have been growing. These trends are multifaceted and determined by several structural and nation specific factors.

6. Global Financial System Risks and Responses

The global financial system bears considerable amount of upcoming challenges. Number of securitization markets successfully stopped up, assets are mounting up on balance sheets of bank. This is hurting capital situation and contributing to stringent credit situations simultaneously with valuation losses on mortgages and other assets. Accumulation of liquidity and counterparty apprehensions are primary factor, which is restricting the maturity of banks' disbursement outlines and affecting stern strain in interbank markets.

7. Integration with Global Financial System

The major challenge of financial globalization for the nations is to integrate with the global financial system. Not all nations, sectors, or firms have access to global financial markets and services neither can they take benefits generated by globalization. Out of all the developing nations, barely few nations are infused with foreign capital. In most of the developing nations they have put restrictions on the limit of foreign investment in some key sectors. Thus, only some chosen organizations can gain foreign funds. The reduced or no participation in the financial globalization process creates unfavorable situations for nations, sectors, and companies.

Conclusion

In previous years, nations around the globe have become more financially integrated, motivated by the probable advantages of global financial system. The chief advantage of global financial system is the growth of the global financial segment. Financial markets turn into stronger and further refined when they integrate with global markets. It raises the financial options for borrowers and lenders. Financial markets working in a global atmosphere facilitate international risk diversification and assist consumption smoothing. Even though globalization of financial markets has numerous prospective advantages, it also has new challenges. Due to global financial system, countries are exposed to external shocks and crises. Financial liberalization may in turn lead to increased risks.

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