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# Do we still have an impact of global crisis in Indian economy today?

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**ABSTRACT**

*The global financial crisis, brewing for a while, really started to show its effects in the middle of 2007 and into 2008. Around the world stock markets have fallen, large financial institutions have collapsed or been bought out, and governments in even the wealthiest nations have had to come up with rescue packages to bail out their financial systems. Indian economy began to slow down in 2007-08 (April-March) after reaching a GDP growth of 9.8 per cent in the last quarter of 2006-07. In fact, Indian economy grew at an annual average rate of 8.8 per cent during the five years ending 2007-08. In the first half of the financial year 2008-09, the growth rate dropped to 7.8 per cent. The global crisis has hit India through a "sudden stop" of capital inflows and a collapse of both external and domestic demand. The growth of the economy dropped to 6.7 per cent in 2008-09 from 9.0 per cent in the previous year and is slowly increased to 8% in 2009-10 and 8.5% for the financial year 2010-11. The present paper is an attempt to analyze the impact of global recession on Indian economy, how the Indian economy recovered and also analyze whether the global crisis still influencing the Indian economy*



## Introduction

The global financial crisis of 2008-09 emerged in September 2008 with the failure, merger of several large United States based financial firms and spread with the insolvency of additional companies, governments in Europe, recession and declining stock market prices around the globe. But the financial crisis really started to show its effects in the middle of 2007. Around the world, stock markets have fallen, large financial institutions have collapsed or been bought out and governments in even the wealthiest nations have had to come up with rescue packages to bail out their financial systems.

The crisis has become one of the most radical reshaping of the global banking sector, as governments and the private sector battle to share up the financial system following the disappearance of Lehman Brothers and Merrill as independent entities. Actually, the collapse of Lehman Brothers was a symbol of the global financial crisis. The real sector in many countries was already feeling the effects. Many industrialized nations were sliding into recession. The crisis became so severe that after the failure and buyouts of major institutions, the Bush administrations offered a $700 billion bailout plan for the US financial system.

Market liberalization and privatization in the commodity sector have also not resulted in greater stability of international commodity prices. There is wide spread dissatisfaction with the outcomes of unregulated financial and commodity markets, which fail to transmit reliable price signals for commodity producers. For the developing countries like India, the rises in food prices as well as the knock on effects from the financial instability and uncertainty in the industrialized nations are having compounding effect. High fuel costs, soaring commodity prices together with fears of global recession are warning many analysts.

## Objectives of the Study:

The objectives for the study are set as follows:

1. To study the grounds of global financial crisis and analyze its impact on Indian Economy
2. To highlight the growth prospects of Indian economy post global crisis
3. Grounds for Global Financial Crisis:

The reasons for the crisis are varied and complex. Some of them include boom in the housing market, speculation, high-risk mortgage loans and lending practices, securitization practices, inaccurate credit ratings and poor regulation.

**Boom in the Housing Market**:

Subprime borrowing was a major contributor to an increase in house ownership rates and the demand for housing. This demand helped fuel housing price increase and consumer spending. Some house owners used the increased property value experienced in housing bubble to re-finance their homes with lower interest rates and take second mortgages against the added value to use the funds for consumer spending. Increase in house purchases during the boom period eventually led to surplus inventory of houses, causing house prices to decline, beginning in the summer of 2006. Easy credit, combined with the assumption that housing prices would continue to appreciate, had encouraged many subprime borrowers to obtain adjustable-rate mortgages which they could not afford after the initial incentive period. Once housing prices started depreciating moderately in many parts of the U.S, re-financing became more difficult. Some house owners were unable to re-finance their loans reset to higher interest rates and payment amounts. Excess supply of houses placed significant downward pressure on prices. As prices declined, more house owners were at risk of defaultandforeclosure.

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**Speculation:**

Speculation in real estate was a contributing factor. During 2006, 22 per cent of houses purchased (1.65 million units) were for investment purposes with an additional 14 per cent (1.07 million units) purchased as vacation homes. In other words, nearly 40 per cent of house purchases were not primary residences. Speculators left the market in 2006, which caused investment sales to fall much faster than the primary market.

High- Risk Mortgage Loans and Lending Practices:

A variety of factors caused lenders to offer higher-risk loans to higher-risk borrowers. The risk premium required by lenders to offer a subprime loan declined. In addition to considering high-risk borrowers, lenders have offered increasingly high-risk loan options and incentives. These high-risk loans included "No Income, No Job and No Assets loans." It is criticized that mortgage underwriting practices including automated loan approvals were not subjected to appropriate review and documentation.

**Securitization Practices**:

Securitization of housing loans for people with poor credit-not the loans themselves-is also a reason behind the current global credit crisis. Securitization is a structured finance process in which assets, receivables or financial instruments are acquired, pooled together as collateral for the third party investments (Investment Banks). Due to securitization, investor appetite for mortgage backed securities (MBS), and the tendency of rating agencies to assign investment-grade ratings to MBS, loans with a high risk of default could be originated, packaged and the risk readily transferred to others.

**Inaccurate Credit Ratings:**

Credit rating process was faulty. High ratings given by credit rating agencies encouraged the flow of investor funds into mortgage-backed securities helping finance the housing boom. Risk rating agencies were unable to give proper ratings to complex instruments. Several products and financial institutions, including hedge funds, and rating agencies are largely if not completely unregulated.

**Poor Regulation**:

The problem has occurred during an extremely accelerated process of financial innovation in market segments that were poorly or ambiguously regulated – mainly in the U.S. The fall of the financial institutions is a reflection of the lax internal controls and the in effectiveness of regulatory oversight in the context of a large volume of non-transparent assets. It is indeed amazing that there were simply no checks and balances in the financial system to prevent such a crisis and "not one of the so called pundits" in the field has sounded a word of caution. There are doubts whether the operations of derivatives markets have been as transparent as they should have been or if they have been manipulated.

**Impact of Global Crisis on Indian Economy:**

The Indian economy has shown negative impact of the recent global financial meltdown. Though the public sector in India, including nationalized banks could some how insulate the injurious effects of globalization as we are also part of the globalization strategy of neo-liberalization, there is a limit of our ability to resist global recession, which may change into a great depression.

The impact of the crisis was significantly different for the Indian economy as opposed to the western developed nations.

**Impact on GDP:**

After a long spell of growth, the Indian economy is experiencing a down turn. Table (1) shows that in 2006-07 the GDP growth rate was 9.9% which became 9.0% in 2007- 08 and due to the impact of recent global financial crisis and global recession, the growth rate of Indian economy is now declining. In 2008-09, it reduced to 7.1%. The International Monetary Fund (IMF) has also projected the growth prospects for Indian economy to 5.1 % in next year. But the

RBI annual policy statement 2009 presented on July 28, 2009 projects GDP growth at 6 % in 2009-10. This declining trend has affected adversely the industrial activity, especially, in the manufacturing, infrastructure and in service sectors mainly in the construction, transport and communication, trade, hotels etc. Service export growth is also likely to slow as the recession deepens and financial services firms, traditionally large users of out-sourcing services are restructured. The financial crisis in the advanced economies and likely to slow down in developing economies could have adverse impact on the IT sector. About 15 to 18 percent of the business coming to Indian outsources includes projects from banking, insurance and the financial services sector which is now uncertain

A financial crisis can cause workers' earnings to fall as jobs are lost in formal sector, demand for services provided by the informal sector declines and working hours and real wages are cut. When formal sector workers who have lost their jobs enter the informal sector, they put additional pressure on informal labour markets.

**Impacts on Net Investment of FIIS**:

Industrial growth is faltering. India's industrial sector has suffered from the depressed demand conditions in its export markets, as well as from suppressed domestic demand due to the slow generation of employment. As per the Index of Industrial Production (IIP) data released by CSO, the overall growth in April-November 2008 was estimated at 3.9 percent compared to a growth of 9.2 percent in April-November 2007.

The recent crash in the Sensex is not simply an indicator of the impact of international contagion. There have been warning signals and signs of fragility in Indian finance for some time now and there are likely to be compounded by trends in real economy.

The most immediate effect of that crisis on India has been an outflow of foreign institutional investment from the equity market. Foreign Institutional Investment (FIIs), which need to retrench assets in order to cover losses in their home countries and are seeking havens of safety in an uncertain environment, have become major sellers in Indian markets. As FIIs pull out their money from the stock market, the large corporate will no doubt be affected, the worst affected are likely to be the exports and small and marginal enterprises that contribute significantly to employment generation.

In 2007-08, net Foreign Institutional Investments (FIIs) inflows into India amounted to $16040 million. But in April-November 2008 it was negative to $8857 million Table (2). Due to this, there was a collapse in stock prices. As a result, the Sensex fell from its closing peak of 20873 on January 2008 to nearly 8000 in October-November 2008.

**Impact on Foreign Exchange Rate:**

In addition this withdrawal by the FIIs and corporate were converting the funds raised locally into foreign currency to meet their external obligations led to sharp depreciation of the rupee. Between April 2008 and November 2008, the RBI reference rate for the rupee fell by nearly 25 percent, rupees per unit dollar gone up from Rs.40.02 in April 2008 to Rs.49.00 in November 2008 (Table-3).

The currency depreciation may also affect consumer prices and the higher cost of imported food hurt poor individuals and households that spend much of their income on food

**Impact on Foreign Exchange Reserves:**

The foreign exchange market came under pressure because of reversal of capital flows as part of the global decelerating process. Foreign exchange reserves are depleting. It was $ 309161 million in 2007-08 and came down to $247621 million

**Table 1: Trends In GDP At Factor Cost (Rs. In Crores)**

| Year | GDP(at1999-00 Price) | Growth in % |
|---|---|---|
| 1999-00 | 1792292 | - |
| 2000-01 | 1864773 | 4.4 |
| 2001-02 | 1972606 | 5.8 |
| 2002-03 | 2048287 | 3.8 |
| 2003-04 | 2222758 | 8.5 |
| 2004-05 | 2388384 | 7.5 |
| 2005-06 | 2612847 | 9.4 |
| 2006-07 | 2871120 | 9.9 |
| 2007-08 | 3129717 | 9.0 |
| 2008-09 | 3351653 | 7.1 |

Source: Central Statistical Organization, Government of India

**Table 2: Net investment of FIIS at monthly Exchange rate (in us $ million)**

| Year | Amount |
|---|---|
| 1999-00 | 2339 |
| 2000-01 | 2160 |
| 2001-02 | 1846 |
| 2002-03 | 562 |
| 2003-04 | 9949 |
| 2004-05 | 10272 |
| 2005-06 | 9332 |
| 2006-07 | 6707 |
| 2007-08 | 16040 |
| 2008-09* | -8857 |

*April-November, 2008-09

**Table 3: Foreign Exchange Rate**

| Month | Rupees per unit of Dollar | Appreciation/Depreciation |
|---|---|---|
| March2008 | 40.36 | - |
| April 2008 | 40.02 | +0.85 |
| May 2008 | 42.13 | -4.2 |
| June 2008 | 42.82 | -5.74 |
| July 2008 | 42.84 | -5.79 |
| Aug 2008 | 42.91 | -5.95 |
| Sep 2008 | 45.56 | -11.42 |
| Oct 2008 | 48.66 | -17.05 |
| Nov 2008 | 49.00 | -17.64 |
| Dec 2008 | 48.63 | -17.01 |

Source: Monthly Economic Report, Ministry of Finance, Government of India

**Table 4: Foreign Exchange Reserves (In Us $ Million)**

| Period | 2005-06 | 2006-07 | 2007-08 | 2008-09* |
|---|---|---|---|---|
| Foreign Exchange Reserves | 151622 | 199179 | 309161 | 247621 |

*As on 23rd January 2009

Source: RBI Weekly Statistical Supplement

**Table 5: India's Foreign Trade (In Us $ Million)**

| Period | 2005-06 | 2006-07 | 2007-08 | 2008-09* |
|---|---|---|---|---|
| Export | 103091 | 126414 | 155512 | 131990 |
| Import | 149166 | 185735 | 235911 | 225809 |
| Balance of Trade | -46075 | -59321 | -80398 | -93819 |

*April-December, 2008-09

Source: DGCI&S, Kolkata

in 2008-09, which shows the direct impact of the financial crisis on India's foreign exchange reserves (Table- 4).

**Impact on India’s Foreign Trade**:

The shrinking of aggregate in the world market as a consequence of the crisis has hurt the exporting manufacturing industries in the country. Table 5 shows that in 2007-08, India’s export and import were $155512 million and $235911 million respectively and balance of payment was $ -80398 million. And now in 2008-09, export and import were $131990 million and $225809 million respectively. The balance of payment was $ -93819 million. This shows that India’s exports are adversely affected by the slow down in global markets. This is already evident in certain industries like the garments industries where there have been significant job losses with the on set of the crisis. This along with a squeeze in the high-income service sectors like financial services, hospitality, tourism etc. will lead to a reduction in consumption spending and overall demand with the domestic economy. A direct consequence of this is a simultaneous loss of informal employment and lower generation of employment in the economy. The depreciation of rupee could not positively affect the new non-farm exports bill of India.

The other direct impact of the global financial crisis has occurred in the area of credit availability to the small-scale agriculture and other rural livelihoods. The impact of the crisis on the rural sector, originated from the slow down experienced by secondary and tertiary sectors. The fact that the present crisis adversely affected the manufacturing and service sectors imply that occupational diversification is more difficult to achieve. The financial crisis, therefore threatens to intensify the income deflation that is already a feature of the rural economy and simultaneously aggregate the alarming levels of hunger and malnutrition that currently exist in India.

**Growth Prospects**

India’s economic performance from 2009-10 to 2011-12 shows that the recovery from the slowdown during the global financial crisis is well underway. The overall growth of Gross Domestic Product (GDP) at factor cost at constant prices was 8.5 per cent in 2010-11 representing an increase from the revised growth of 8 per cent during 2009-10 and it is expected to reach 9 percent by the financial year ending 2011-12. This growth rates are achieved without a renewed build-up of inflationary pressure as long as agricultural growth returns to trend, infrastructure constraints are alleviated, and international prices remain stable.

In particular, agricultural sector growth was better than feared with a slightly positive growth rate despite the worst monsoon shortfall in three decades. The manufacturing and mining sectors were the main engines of growth, while services sector growth was lower than in FY2008/09, when it was buoyed by fiscal stimulus spending. In particular in the fourth quarter of FY2011-12, GDP growth reached 9 percent on the basis of a resurgent industrial sector. On the demand side, much higher investments replaced government stimulus. Wholesale price inflation has been around 10 percent between February and May 2011 after remaining in negative territory during much of 2009. Food inflation, however, declined from 18 percent to 12 percent over the same period.

Overall growth in the Index of Industrial Production (IIP) was 4.1 per cent during August 2011. The eight core Infrastructure industries grew by 3.5 per cent in August 2011 and during April-August 2011-12, these sectors increased by 5.3 per cent. In addition, exports and imports in terms of US dollar increased by 44.3 per cent 41.8 per cent respectively, during August 2011.

Over the next two years India could attract foreign direct investment (FDI) worth US$ 80 billion, according to a research report by Morgan Stanley. India has received US$ 48 billion FDI in the last two years. Considering the pace of FDI growth in India, KPMG (Klynveld Peat Marwick Goerdeler) officials believe that FDI in 2011-12 might cross US$ 35 billion mark. In addition, India has entered the club of top 20 exporters of goods and reclaimed its position among top 10 services exporters in 2010. India's goods exports rose by 31 per cent in 2010, helping it to improve its world ranking moving up two places to 20 from 22 in 2009

Wholesale price inflation is forecast to decline to around 6 percent by end-March 2011 as base effects recede and the impact of the FY2009-10 drought diminishes. Monetary aggregates, credit growth, and expectation surveys do not indicate emerging demand pressures and capacity constraints. The outlook faces substantial risks from the possibilities of higher international commodity prices, external shocks from the lingering effects of the global financial crisis, another deficient monsoon, and domestic supply and demand shocks which could lead to higher interest rates.

The sharp recovery in exports and imports has continued from 2009-10 to 2011-12, it is further noted that the deficit in current account, General Government Deficit and General Government debt decreased to 2.1, 6.6 and 69.2 percent of GDP respectively (Table 6).

**Conclusion and Suggestions**:

No doubt, India has been recovered from the global crisis from 2009-10 to till date. The growth in economic indicators shows that no more impact of global crisis on Indian economy. But to prevent from any further collapse would require an effective departure from the dominant economic philosophy of the neo-liberalism. The first such departure should be a return to Food-First doctrine, not only to ensure food security of the large population but also due to the fact that food production will be more profitable given the current signs of a shrinking market for export oriented commercial crops. The other important initiative that needs to be adopted is the building of institutions based on the principle of cooperation that will provide an alternative frame work of livelihood generation in the rural economy as opposed to the dominant logic of markets under capitalism. Institutions like cooperative markets and credit cooperatives can go a long way in addressing the lack of economically viable producer prices and loaning credit availability for economic activities in the primary sector.

The need of today is not just the pumping of liquidity in to the Indian economy but also in addition the injection of demand. This can occur only through direct fiscal action by government. In India, larger government expenditure has to be oriented towards agriculture, rural development, health, human resources and infrastructure to make inclusive and balanced growth. The new growth will have to come not from some new speculative bubble but from enlarged government expenditure that directly improves the livelihoods of the people and that is geared towards improving the production of food grains through a changing of peasant agriculture and not through corporate farming since that would reduce purchasing power in the hands of the peasantry and perpetuate its distress. In short, the new paradigm must entail infrastructure and food grain-led growth strategy on the basis of peasant agriculture sustained through larger government spending towards the agriculture and rural sector, which can simultaneously remove both recession and food crisis in India.

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