GLOBAL FINANCIAL CRISIS IMPACT ON INDIA

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ABSTRACT

The whole world is passing through a very difficult time .More so, the developed world while developing countries are also being adversely affected. Many of the industrially advanced nations are officially in recession, not knowing how long and how deep this recession will be?

Growth is slowing down in developing economies and Indian growth story which initially was thought to be decoupled is continuously being adversely affected by this gloomy scenario world over. India is now more connected to the rest of the world through both current and capital account **.**The negative impact of crises started with the outflow of foreign investments and decrease in exports of IT based services which changed value of rupee and also negatively affected the banking sector. Indian government and Reserve Bank of India both responded with fiscal and monetary policy respectively to combat the crises by increasing domestic demand. In the nutshell crises badly affected all spheres of the economy starting from trade to fiscal policy, monetary policy, growth rate, price stability, financial stability, industrial production, savings, investments, currency. The present paper attempts to analyse the brunt of this crises that India had to bear and come out with some concrete suggestions through which it can improve its situation.

KEYWORDS: global crises, export, import, fiscal policy, monetary policy, FII, WPI, IIP

Introduction

Financial crises and there spread are increasing with the increase in globalization .The origin may be different but the tremors are being felt in different parts of the world. The crises in Latin American nations in 1980s, the crisis in 1990s of Mexico, Asia ,Russia , American crises of 2008 and the recent one in the series is Euro-zone crises whose all layers are yet to be unfolded ,all affected the world with varying intensities. Earlier it was real estate bubble which burst in Thailand and now again the financial crises in America is related to real estate.

The recent crises have affected India also. After throwing some light on the global scenario we have discussed the effect on different sectors of Indian economy. Finally we have come out with some suggestions and policy prescriptions to minimize adverse effects of crises and grab the future opportunities.

I Global Scenario

International situation which originated in the sub-prime mortgage crises some 4-5 years ago in USA has now intensified with new dimensions from European nations. The whole thing started with rising interest rates and falling home prices resulting in defaults and foreclosures. This did not remain a mortgage crisis as these were scrutinized and packaged as investment products turning them illiquid. This resulted into failure of financial institutions dealing in those securities not just in USA but in Europe and to a lesser extent to East Asian countries also. This created environment of distrust and freezed many markets. This financial system crisis then spread to the real sector as well affecting it adversely.

The crux of the crisis originated in USA was the regulatory failure. Some part of the financial sector was not properly regulated and the role of rating agencies was also suspicious the surveillance system was not able to match innovations in financial sector. The Nobel Prize winner for economics Joseph Stiglitz argued that this bailout package was again based on" trickle-down economics" throw enough money at Wall Street and some of it will trickle down to the rest of the economy. It did not do anything about the basic source of the problem. It is seen as a bailout for the culprits while ordinary person would be left to pay for their folly. Some of bailouts had also been accompanied with charges of hypocrisy due to the appearance of socializing the costs while privatizing the profits.

The official explanation of the crisis divides it into two parts, in the first half food and commodity prices started rising sharply, a rise in inflation after long moderation. In the later stage sharp swings in growth started which lowered the GDP growth rate. The developments of the present crisis exposed that irrespective of the degree of globalization and soundness of domestic policies no nation can escape.

In Euro zone because of high fiscal deficits many nations are on the verge of default. Strong looking economies of Germany and France are also not performing up to expectation levels .The real economy crisis has penetrated Europe's core, pointing to further deepening of crisis. Japan is also experiencing long term stagnation and has been devastated by wholly unexpected shock.

II Impact on Indian Economy and Policy response

With financial markets downturn and slowing global growth the implications for India are a matter of concern. 2011 also did not come for the rescue of the world and deepening of crisis is not good news for India as it is more integrated to the world now through flow of goods services and finance. The global economy had contracted by 2.4% in 2009, got some of its bounce back in 2010, growing by 4% but in 2011 it is estimated to grow by another 2.8% only. The Euro zone crisis already had adversely effected India. It growth in the first half of the fiscal year 2011-

2012 fell to 7.3% from a projected 9%. India's industrial output contracted by 4.74% in the third quarter, but rebounded in the fourth, growing by 5.9%. The rupee had slid against the dollar in the wake of credit rating cuts by rating agencies, and has only recently shown signs of firming up.

Initially it seemed that India is not going to be affected in a big manner but now the signs of the adverse effect are more visible .It affected our gross domestic product(GDP), wholesale price index(WPI), index of industrial production(IIP), domestic savings and investments .The table 1 is highlighting the major changes. It is clear from the above table that average inflation and its standard deviation increased after the crisis. On the other hand growth rate of GDP decreased while fluctuations in it were more after 2006-07. Industrial growth shown by IIP also reflects the fact that industrial output reduced in a significant manner and fluctuations in it almost doubled. On an overseas acquisition spree over the past few years, Indian companies, have suddenly become wary of making investments in foreign companies as a result of the current global economic crisis .When we look at the domestic savings and investment, although they did not reduce significantly but their levels are definitely affected.

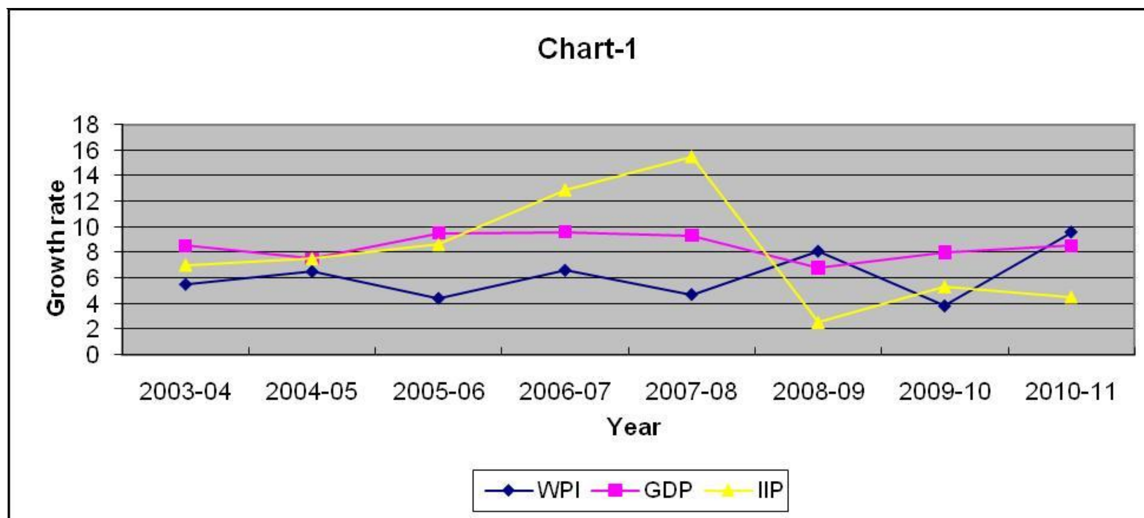
Table-1

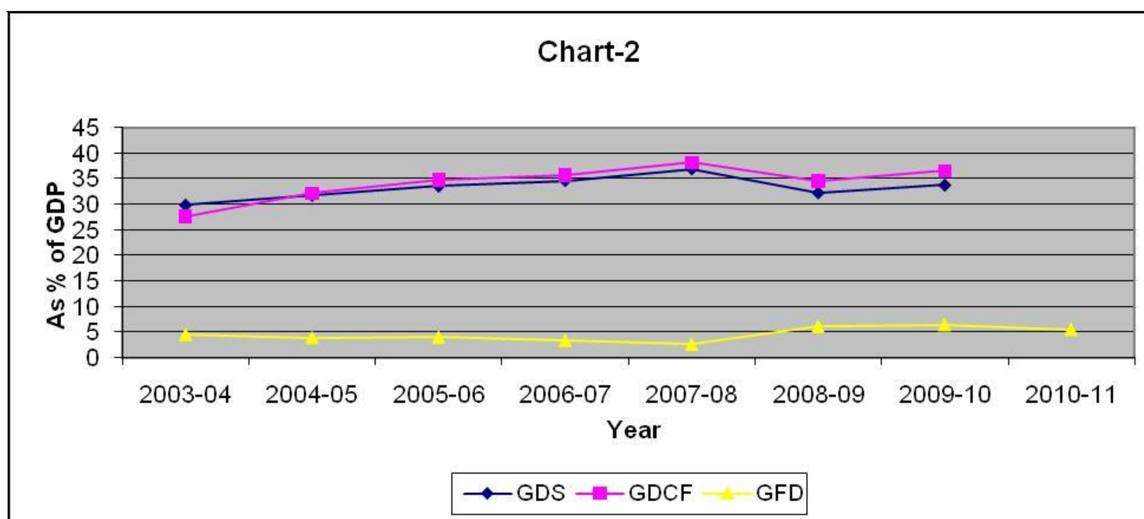
Macro-economic Indicators of India

Year	WPI Inflation Rate	GDP Growth	IIP Growth Rate	Rate of GDS as %GDP	Rate of GDCF as %GDP	GrossFiscal Deficit as %GDP
2003-04	5.5	8.5	7	29.8	27.6	4.48
2004-05	6.5	7.5	7.5	31.7	32.1	3.88
2005-06	4.4	9.5	8.6	33.5	34.7	3.97
2006-07	6.6	9.6	12.9	34.6	35.7	3.32
Average	5.75	8.775	9	32.4	32.525	3.9125
Standard deviation	1.0279429	0.98446263	2.68452355	2.10554823	3.61697387	0.47521048
2007-08	4.7	9.3	15.5	36.9	38.1	2.55
2008-09	8.1	6.8	2.5	32.2	34.5	6.04
2009-10	3.8	8	5.3	33.7	36.5	6.39
2010-11	9.6	8.5	4.5	-	-	5.5
Average	6.55	8.15	6.95	34.2666667	36.3666667	5.12
Standard Deviation	2.3684537	2.53559015	4.20152535	2.40069434	1.8036999	1.74289972

Source: RBI handbook of statistics on Indian economy 2011 and own calculations

To combat the adversities posed by the situation the government is taking actions on all fronts since the starting of the crisis. Government reduced level of taxes and gave lots of concessions on export as well as domestic front. It increased its expenditure. It did all to stimulate consumption and hence aggregate demand.. Because of loose fiscal policy the level of fiscal deficit is increased to unmanageable levels and the demands for its contraction are being raised from different quarters. The rising level of fiscal deficit is shown in table 1 and chart 2.





India is a rising country and for the future growth the requirement of infrastructure sector to grow at faster rate is a must but this sector is also languishing.The growth rate of the sector is coming down year after year as is visible from table 2.

Table 2

Index Numbers of Infrastructure Industries

Year	Composite Index	Electricity	Coal	Steel	Cement	Crude Oil	Refinery Products	Natural Gas	Fertilizers
(Base : 2004-05 = 100)									
Weight	**37.9**	**10.32**	**4.38**	**6.68**	**2.41**	**5.22**	**5.94**	**1.71**	**1.25**
2005-06	3.9	5.1	6.6	7	12.4	-5.2	2.1	1.4	0.6
2006-07	8.4	7.3	5.9	12.8	9.1	5.6	12.9	-1.4	3.1
2007-08	5.2	6.3	6.3	6.8	8.1	0.4	6.5	2.1	-7.9
2008-09	2.8	2.7	8	1.9	7.2	-1.8	3	1.3	-3.9
2009-10	6.6	6.2	8.1	6	10.5	0.5	-0.4	44.6	12.7
2010-11	5.8	5.5	-0.3	8.9	4.5	11.9	3	10	0
2011-12	5	8.3	0.2	7.8	-0.9	9.5	5.3	-10.2	1.1

Weights are in index of industrial production.

Source: RBI handbook of statistics on Indian economy

Impact on Indian foreign trade is very negative. The significant source of demand and revenue that is likely to be adversely impacted is services. According to Balance of Payments data, gross revenues from exports of software services amounted in 2010-11 to as much as 24 per cent of the gross revenues from merchandise exports. In 2009-10, the US alone accounted for 61 per cent of India's total software exports. European countries (including the

UK) followed with as much as 26.5 per cent. If these two regions are the first to be hit by the recession, it is unlikely that software export revenues will not be negatively affected. Over the period 2004-05 to 2009-10, services accounted for 66 per cent of the increment in India's GDP.

And revenues from software services amounted to 9.4 per cent of the GDP from services (excluding public administration and defense). The deceleration or decline in software export revenues is bound to affect GDP growth adversely. Exports and imports as a percentage of GDP are shown in table-3.

Table-3

	Trade			Invisibles	
Year	Exports/ GDP	Imports/ GDP	Net/ GDP	Payments / GDP	Receipts/ GDP
2001-02	9.4	11.8	3.1	4.6	7.7
2002-03	10.6	12.7	3.4	4.9	8.3
2003-04	11	13.3	4.6	4.3	8.9
2004-05	12.1	16.9	4.4	5.5	9.9
2005-06	13	19.4	5.2	5.9	11.1
2006-07	13.6	20.1	5.5	6.6	12.1
2007-08	13.4	20.8	6.1	5.9	12
2008-09	15.6	25.4	7.5	6.3	13.8
2009-10	13.2	21.8	5.8	6	11.8
2010-11	14.5	22	5	6.4	11.4

(Per cent)

Source: RBI handbook of statistics on Indian economy

As we know government responded on all fronts, RBI reduced all of its major rates i.e. repo rate, reverse repo rate, cash reserve ratio, statutory liquidity ratio to ease the liquidity conditions in the market and to maintain financial stability. But as the problem of inflation crept up and took devastating dimensions RBI again raised various rates but then rate hike adversely affected growth and RBI is signaling to reduce them in 2012 for growth impetus. The chronology of rate change after the crisis is in table 4.

Source: RBI handbook of statistics on Indian economy

India weathered the 2008 crisis well, but there are fears that this time round the country is not even ready for a crisis of much lesser magnitude, let alone a full-blown debt default in Europe or a possible US recession. Weak finances, persistently high inflation and policy inertia have considerably weakened the position of the government. A domestic meltdown is expected and our resilience won't be as much as last time .Fiscal and monetary cushions are also exhausted. India needs to be more prepared.

The shock waves produced by the financial crisis will have their own effect on the structure of capitalism. Acceptable capitalism would require more regulation. Future discussions must centre around the nature and scope of such regulation. Financial innovations that are dysfunctional do more harm than good. There are the lessons that we can draw from the current financial crisis.

III Conclusion and Policy Prescriptions

Concludingly we can say that the global crisis has negetively affected Indian economy although at lower scale initially but then to a more greater extent and it needs to make better strategies to take advantage of future challenges.

Developed nations should fix their financial and fiscal system so that real sector can also be protected.Issues of leverge and einterest rate regimes should be addressed on priority basis.Saving rates of household as well as government should be increased in USA and Euro zone.

Fiscal stimulus cannot be unlimited as its effectiveness depends on some preconditions and is questionable due to diminishing returns .It usually involves additions to the public debt of the government .We need to take it back as soon as possible as fiscal deficit is becoming out of control and need to be curbed.Operational aspects of managing public debt also need to be managed.

The link between monetary policy and financial stability need to be understood and more autonomy to the central bank should be given to maintain the enviable reputation earned by RBI.

Fiscal and monetary policy both should be co-ordinated for overall better performance of Indian economy.

India has huge domestic demand which need to be tapped.There should be quick and consistant policy making which can transmit positive signals to the private sector for boosting the investment levels in the economy.

Black money should be brought back and corruption should be controlled.Ethical and moral standards should be enhanced.A transparent and credible.

Export oriented sectors are more adversally affected.Policy responses should be sector specific.Trade relations also need to be more diversified with more number of nations and commodities.

Although to increase the private consumption is important India needs more amphasis on infrastructure investment. The fluctuations in currency need to be reduced and for that matter foreign investment will have to be promoted which is possible only when more reforms take place and there is consistency in policy actions.

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