THE GLOBAL FINANCIAL CRISIS AND ITS IMPACT ON INDIAN ECONOMY

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ABSTRACT

India is considered to be highly vulnerable to a crisis like this because of its greater integration with the rest of the world. The study shows that there are some reasons to believe that the financial crisis affected Indian economy adversely by slowing foreign remittances, foreign investment etc. The term financial crisis refers to the loss of confidence in a country's currency or other financial assets causing international investors to withdraw their funds from the country. The financial crisis and associated recession originated in the US in early 2008 and then spread to Europe has by now engulfed most of the economies in both developed and developing world. There is every possibility of direct as well as indirect implications of the crisis on all the economies of the world. The crisis has affected the entire global economies in one way or other. The present study makes an attempt to identify the immediate impact of the financial crisis on major world economies especially Indian economy in terms of selected economic indicators. The study examines the trends in GDP growth rates in the context of Indian economy against the background of global financial crisis and subsequent global recession. However, Indian economy shows the symptoms of rapid recovery from the sudden set back it had to undergo during 2008-09.

Keywords: *Indian Economy, Financial Crisis, Government Policies, Indian Exports, IT-BPO Sector.*

INTRODUCTION

The term financial crisis refers to the loss of confidence in a country's currency or other financial assets causing international investors to withdraw their funds from the country. The financial crisis and associated recession originated in the US in early 2008 and then spread to Europe has by now engulfed most of the economies in both developed and developing world. The crisis, of course, being an unavoidable phase in the path of market economy, injures almost all sectors of an affected economy. Various economic activities such as production, employment, saving, investment, consumption etc are being badly affected and thereby the economy of the country as well as an individual do undergo a downturn during the crisis. The speed and magnitude of the spread of the crisis from one corner of the world to the other is simply oiled by the globalization process. Historically the world economy has witnessed several financial crises in the past few decades. The most severe among them was the Great Depression of the 1930s which had very dangerous and protracted effect on the world economy compared to the current economic upheaval. Later on the world witnessed the OPEC oil crises of the 1970s, the United States Savings and Loan crisis of the 1980s, the prolonged economic downturn in the Japanese economy in the 1990s and the Asian financial crisis in the latter part of the 1990s. All these recessionary trends had been accompanied by shocks to the economies of one or more markets or regions and it took several years of concerted economic and regulatory policy adjustments for the affected markets to return to stability. It is quite natural for financial crises to occur frequently and the affected economies to recover subsequently; it nevertheless results in economic losses for the countries involved and for the people, businesses and institutions in those countries.

The global economic crisis also impacted trade credit. A number of banks, global buyers and firms surveyed independently by the World Bank, International Monetary Fund (IMF) and Bankers Association for Finance and Trade (BAFT), have felt that lack of trade credit and other forms of finance, such as working capital and pre-export financing, has affected growth in world trade. In addition, the costs of trade credit have substantially gone up, raising the challenge of affordability of credit for exporters. Small and Medium Enterprises (SME's) and exporters in emerging markets appear to have faced the greatest difficulties in accessing affordable credit. While there is strong anecdotal evidence that the financial crisis might have reduced the availability of trade credit leading to decline in the volume of trade and possibly deepening and prolonging the recession, data from the IMF indicates that the pace of decline in trade finance was just one-fourth that of the decline in trade volumes during the period October 2008 to January 2009. The Global Financial Crisis, which started in 2008, is considered to be the latest in the series of economic crises to adversely affect world economies. Unlike the past few crises, the current crisis has not spared any of the countries or market sectors, and has devastated economies that were traditionally strong. It is stated that an excessively loose monetary policy in the 1990sin major developed economies transformed into global imbalances and a full-blown financial and economic crisis for all the economies of the world The impact that followed was very deep throughout the world that was closely integrated during the globalization process in this context the present study focuses attention on the following objectives. The impact on the world economies in terms of indicators like GDP growth rate, volume of trade, unemployment rate etc have been analyzed using IMF data from 2005 to 2010. To identify and compare the immediate impact of financial crisis on the major Global economies in terms of selected economic indicators To examine the impact of financial crisis on India's external sector and growth Rate Financial crisis and the world economies The financial crisis of 2008 affected almost all economies of the world. However, the impact on the financial and real sectors was not uniform across the countries. While some economies that were structurally strong were able to better withstand the crisis, others had to be bailed out with extensive and multiple stimulus packages to overcome the adverse effects on the domestic economies3.

Indian economy during financial crisis

In the present global scenario, India has been considered as the most promising and fast growing economy in the world. Due to the liberalized rules for Foreign Direct Investment (FDI) in India, the real estate, telecommunication, services, construction activities, power etc have become very attractive investment avenues for both the domestic as well as foreign investors. Similarly, due to the increased activities of Foreign Institutional Investors (FIIs) like mutual funds, pension funds etc, the Foreign Portfolio Investment in the country has witnessed tremendous upswing during 2000s. The overall foreign investment in India met serious setback during the crisis. The impact of financial crisis is already felt in terms of reduced export earning, drastic decline in industrial growth and employment, depreciation of rupee, reduction in foreign exchange reserves, down turn in stock markets and many other indicators. The stock of foreign exchange declined from $330 billion some six months before to 245 billion by the first week of December 2008 and the BSE index declined from over 20000 during the early months of2008 to 9000 during the last week of November 2008. Indian economy could withstand the adverse effects of the financial crisis and thereby avoid the long term Consequences with the help of the strength it already achieved. However, it is wrong to say that it is free of adverse impacts. India's increasing dependence on bilateral trade with other countries and its financial relationship with the advanced economies somehow transferred the economic shocks to the national economy.

GDP growth rates in world economies

Economies	2005	2006	2007	2008	2009	2010
United states	3.05	2.67	2.14	0.44	-2.5	1.5
United Kingdom	2.17	2.85	2.56	0.74	-4.8	0.91
Advanced economies	2.63	2.99	2.72	0.56	-3.2	1.32
Emerging & dev. economies	7.09	7.94	8.31	5.99	2.1	5.08
Developing Asia	9.03	9.83	10.59	7.5	6.5	7.35
World average	**4.48**	**5.09**	**5.17**	**3.0**	**-0.8**	**3.1**

The table shows the GDP growth rates of major world economies during 2005 -2010. The deterioration in the economic conditions is well evident from the data. The average GDP growth rate of the world economy which was around 5 percent during 2005-2007, was seriously affected during the crisis period. In the year 2008, when the financial crisis started the world economies grew by 3 per cent. In 2009, when the crisis was in its peak, the world economic growth rate was negative i.e., -0.8 per cent. However, the economies started regaining Confidence showed positive growth of 3.1 per cent in the year 2010. The very similar trends are witnessed in all categories of economies as shown in the table. The advanced economies including the United States and United Kingdom were all growing steadily prior to the crisis, but deteriorated severely during 2008-09. These economies gradually started gaining momentum in 2010. Though the very similar trend was found in the emerging and developing economies and developing Asian economies, the severity and the magnitude of the deterioration was light.

India's GDP Trend

Year	Growth rate
2003-04	8.5
2004-05	7.5
2005-06	9.5
2006-07	9.6
2007-08	9.3
2008-09	6.8
2009-10	8.0
2010-11	8.6

In 2008-09, following the global meltdown, the growth rate of the Indian economy dropped to 6.7% from an average growth of 8.8% in the preceding five years. It is worth noting that India's GDP growth in 2008-09 was one of the highest in the world. This reflected, in part, the resilience of the country's growth impulses to a severe external shock and was also indicative of the fact that the Indian economy is still not open enough. The decrease in economic growth was the sharpest in the third quarter of 2008- 09. During the fourth quarter the down-turn was arrested mainly due to the good performance of India's agriculture sector, despite the continuing poor performance of industrial and services sectors. During the fourth quarter of 2008-09, real GDP growth was estimated at 5.8% as compared with 8.6% in the corresponding period of the previous fiscal.

The backbone of India's spectacular growth between 2003 and 2008 was robust domestic demand. The high growth trajectory came to a halt in the third quarter of 2008- 09. In real terms, during 2008- 09 the growth in private consumption demand decreased to 2.9% from 8.5% in 2007-08. Coupled with a decrease in the investment demand this was a major blow for the economy, as private consumption accounted for almost 55% of GDP in 2008-09. This offset the sharp increase in government consumption expenditure, which expanded by 20.2% in 2008-09, resulting in the contribution of government consumption expenditure to the real GDP growth (at market pieces) in 2008-09 at 32.5% as against of only 8.0% in 2007-08.

The last quarter of 2008-09 and the first quarter of 2009-10 witnessed slight recovery from the downturn, though at an extreme sluggish rate. Private consumption and investment demand continued to decelerate during the first quarter of 2009-10. Government consumption expenditure growth, which had increased sharply in the third and fourth quarters of 2008-09, also dropped marginally during the first quarter of 2009-10. The real GDP growth measured from the demand side was slightly higher at 6.1 % during the first quarter of 2009-10, than the preceding two quarters (GDP growth rate was 5.8% for both last two quarters of 2008-089). During the second quarter of 2009-10, real GDP growth picked up to 7.9% hinting at recovery of the growth of Indian economy-according to the advance estimates released by the CSO, the Indian economy is expected to grow by 7.2% in 2009-10. Thus, the Indian economy performed remarkably well, despite the global economic crisis.

Impact of US Financial Crisis on Indian Economy

Central bank policies:

The Federal Reserve's primarily concern was to manage the monetary policy and was least bothered about the housing bubble and dot-com bubble. Once the bubble burst, the Central Bank tried to control the spread of the crisis on other sectors.

Government Policies:

To provide house at affordable price to all the people was the priority of both the Clinton and Bush administration. In 1974, President Carter passed the Community Reinvestment Act. This Act made mandatory for all the banks and saving institution to provide home loans to the lower income people in broad outlying areas where they had branch.

Impact on India's export:

Among the export oriented sectors, labor intensive sectors like textile, leather, handicrafts etc were the worst hit. These sectors have shorter gestation periods, and labor is more easily laid off. These sectors also depend on informal and home based workers, who are largely bereft of social security and sometimes even appropriate labor standards. The corresponding employment loss and marginalization of the informal labor sector take a long time to take a reverse turn. Though in terms of value textile and gems & jewelry are important sectors in India's export basket, they have shown a rising trend since the end of 2009. The benefit of depreciated currency has provided some respite to these two sectors. However, the scenario has remained quite grim in sectors such as leather, handicrafts and marine products. The volatility in exports of machine & tools sector is also worth noting. Exports in these sectors have still not recovered. The negative impact on the income and employment for those who are directly and indirectly engaged in these sectors is a matter of record.

Impact on India's handloom sector, jewelry export and tourism:

Around 50,000 artisans employed in jewellery industry have lost their jobs as a result of the global economic meltdown. Further, the crisis had affected the Rs. 3000/- crores handloom industry and volume of handloom exports dropped by 4.6 per cent in 2007-08, creating widespread unemployment in this sector.

IT-BPO sector:

The overall Indian IT-BPO revenue aggregate is expected to grow by over 33per cent and reach $64 billion by the end of current fiscal year. Over the same period, direct employment to reach nearly 2 million, an increase of about 375000 professionals over the previous year. IT sectors derives about 75percent of their revenues from US and IT-ITES (Information Technology Enabled Services) contributes about 5.5 percent towards India's total export. So the meltdown in the US will definitely impact IT sector. Further, if Fortune 500companies slashes their IT budgets, Indian firms could adversely be affected.

CONCLUSION

The GDP growth rate of Indian economy was also met a slow down during the period of financial crisis. In order to counter the negative fallout of the global slowdown on the Indian economy, the federal Government responded by providing certain fiscal stimulus packages in the form of tax relief to boost demand and increased expenditure on public projects to create employment and public assets. India's central Bank – the Reserve Bank of India (RBI) took a number of monetary easing and liquidity enhancing measures to facilitate flow of funds from the financial system to meet the needs of productive sectors. A number of steps like cutting down the Cash Reserve All these timely and strong steps taken by the monetary authorities helped Indian economy show a rapid recovery from the financial crisis. The world economy is also exhibiting signs of recovery, driven largely by the robust growth in emerging economies. Advanced countries however, continue to face uncertainty with large fiscal deficit, high public debt and large scale unemployment. Indian economy also shows the symptoms of rapid recovery from the sudden set back it had to undergo during 2008-09. This is significantly due to the strong and focused steps taken by country's central bank and the government. The economy remained on the path of rapid resurgence which began in 2009-10 and has virtually returned to the high growth path that it had achieved during 2005-08, before the global financial crisis and economic meltdown. The Indian economy has been relatively less affected by the global crisis. In fact, India, along with China, is one of the growth engines in facilitating a faster turnaround of the global economy. In these circumstances, of a relatively impressive performance, India needs to continue to remain watchful. Firstly, despite recovery, advanced countries continue to face risk of double-dip recession with high unemployment rate, growing fiscal deficit and high public debt - GDP ratios. Such risks can have direct implications for the Indian economy, which is increasingly integrated with the rest of the world. Secondly, with interest rates at historic low in most advanced economies, capital flows from these countries are finding their way into the fast growing Asian economies including India. Finally, a simultaneous exit by all countries would be disastrous – until recovery has firmly taken hold, it is vital that some stimulus remains in play.

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