Global Economic Crisis: Impacts, Challenges and Opportunities for India

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Abstract

Today India is more integrated with the world economy through both the current and capital accounts. The unfolded global financial crisis has come in various forms and represented many challenges as well as opportunities in India. The Indian economy has shown considerable resilience to the global economic crisis by maintaining one of the highest growth rates in the world. Economic growth stood at 8.6 percent during fiscal year 2010-11. GDP growth for 2009-10 was placed at 8 percent. When compared to countries across the world, India stands out as one of the best performing economies. Although there was a clear moderation in growth from 9 percent levels to 7 percent soon after the crisis hit, in 2010-11, at 8.6 percent, GDP growth in nearing the pre-crisis levels and this pace makes India the fastest growing major economy after China. The downturns started in USA in September, 2008 have some negative impact on Indian economy. Despite having low exposure of toxic assets involved in the sub-prime crisis and a gradualist approach towards liberalisation of the financial sector, certain parts of financial sector were significantly affected like outflow of Foreign Institutional Investments (FII) from equity market that also led to rupee depreciation. It had adversely impacted country exports and software business. To fight with this crisis the government has also responded with some of monetary and fiscal stimulus. The present paper is an attempt to analyze the impact of recent global financial crisis on Indian economy and challenges that our economy faced and opportunities arisen from this financial global crisis.

Keywords:

Global Financial Crisis, GDP, Liberalisation, Foreign Institutional

Introduction

The term 'financial crisis' covers the series of events started with the crashes in housing market banking sector and overall recession. It is not merely a financial crisis. The crisis involves the real economy as well, not just the financial sector.

In the world history many a times the world economy has faced the financial and economic crisis. One of them was the great depression world wide of 1930s. After a few decades the 1970's OPEC oil crisis. The US saving and loan crisis occurred in 1980s and in late 1990s Japan economic downturn and Asian financial crisis. These all economic recessionary crises had given shocks to the several economies altogether and took a several years to get the stability back in affected markets as well policy rules regime.

The global economic crisis is rooted in the subprime crisis which surfaced in

2007 in United States of America and European countries followed by financial meltdown i.e. bankruptcies of banks and insurance companies in these developed countries and soon the crisis also spread to other markets and countries cutting across geographical boundaries to the extent of the global integration through various channels. As the crisis already mentioned not merely financial crisis of banking, insurance and stock market but of the real economy had impacted the industrial output and unemployment ratio in the advanced developed capitalist countries.

When the global economies were taking fiscal measures to mitigate the impact 2007 crisis had led to a large amount of unsustainable sovereign debt and resulted in Euro Zone sovereign debt crisis. Followed by the US subprime recently the euro zone has also grown with their home ground crisis; 'Euro Zone Crisis'. Starting from the euro countries Greece, Ireland, Portugal, Spain and lastly Italy, all these European countries have felt the sovereign debt problem resulted in fear of country defaults and rise in the borrowing costs. This crisis is not the currency crisis but it is about the managing the economies in the single currency zone with different fiscal capabilities and debt contour. It is not sovereign debt only but rooted in the real economy with various structural problems in which the euro zone will have to manage monetary, fiscal and financial system. The economies with large fiscal deficits started giving bail out packages to the failed banks and financial institutes and turned the economies on the verge of bankruptcy and unable those to honour the obligation and the “sovereign debt” come to an end the images of riskless assets.

Impact of recent crisis on Global Economies

The 2008 sub-prime crisis was the outcome of globalization and the neoliberal policies pursued by the government across the world. With the globalization there led to concentration of wealth and assets in selected financial and business organization with increase in speculative activities and with the liberalisation intervention has been withdrawn by the regulatory authorities. The growth process became dependent on speculative bubbles in financial, property market and credit driven consumption growth in developed economies. The crisis which erupted in most of the developed nations in 2008 affected all the economies all over the world and resulted in job losses, enterprise bankruptcies and down warded the income of millions of the people. Followed by Lehman Brother Crisis in September 2008, the global economy and all the global inter bank financial markets froze in view of large losses suffered by the financial institutes and uncertainty created by the counterparty balance sheets and led to a reconsideration of earlier policy approaches of self regulated markets. All the disorder in various segments of the financial markets resulted in slower economic growth in developed nations. The real GDP in developed countries went down to (-3.7 percent) in 2009 and turned into negative figures from the 2.4 percent in previous years and overall global GDP growth decreased to 0.6 percent in 2009 from the robust growth of 5 percent during 2004-07. The rate of unemployment in US economy also came down from 4 percent in 2006 to around 10 percent in 2009. The net capital flow also turned negative in Emerging Developed Economies (EDEs) in 2008 and slower down the growth.

Table. 1 GDP growth rates in major 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 & developing 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**	**-0.8**	**3.1**

(Source: International Monetary Fund – World Economic Outlook Database)

With the decrease in growth the trade volumes were also affected by the crisis. The trade came down from the average 8% to 3% in 2008. This resulted in complete weakening of confidence in the global trade.

Table.2 Change in trade volume

Year	% change in volume of trade
2005	7.8
2006	9.1
2007	7.33
2008	2.95
2009	-12.3
2010	2.47

(Source: International Monetary Fund – World Economic Outlook Database)

The deleveraging created by the European countries in the globe has induced the euro crisis all over the world. Apart from the policy actions taken from the European Unions during the 2011, the global financial markets continuously coming down to in lieu of the rating downgrade of European Financial Stability Fund (EFSF) and other Euro countries downgraded by S&P.

Impact and challenges on various sectors for India

Due to globalization, the Indian economy cannot be insulated from the present financial crisis. The connectivity of all the global financial markets impacted not only US markets but European, UK and Asian financial markets also. The Indian economy too had felt the impact of the crisis but not to that extent. Although India, like other Asian countries, suffered indirect impact of financial crisis than other economies like China and other East Asian countries which heavily relied on external demand, exports for their growth prospectus. Mainly two reasons were there for India of the indirect impact one was no direct exposure to the toxic subprime mortgage assets or unsuccessful financial institutes and second is India's growth attributed to a rise in domestic demand for capital formation. External demands and exports of all goods and services amounted to only 20% of the country's total Gross Domestic Product (GDP). After this the euro zone appeared to head the recession and the global growth again slowed down after a short recovery from sub-prime, growth in India too has moderated more than was expected. With increased uncertainty across the globe and sovereign debt crisis that led to weak industrial growth, slow investment activities, deceleration in capital flow in country for commercial sector resulted decline in output growth. With these food and commodity inflation, energy prices, depreciation in domestic currency also fueled to impact of crisis and resulted in downturn in growth percentage of year 2011-12 from 7.6 percent to 6.9 percent.

The impact of global economic crisis on Indian Economy was immediate but it can broadly be divided into two parts: (i) direct impact on financial sector and (ii) indirect impact on economic activities.

Subprime impact on finance markets

- Global crisis intensified not only developed countries but also spread to emerging countries through capital and current account and balance of payments. In the initial period of sub-prime crisis the impact was relatively small or impervious as Indian financial institutes were well capitalized and had limited exposure to the US sub-prime assets and other derivatives. Only some number of banks had exposure in collateralized debt obligations or bonds which suffered mark to market losses with credit spreads.
- At the same point of time the crisis had impacted some of the financial segments like capital, money markets, foreign exchange, credits because of the overseas financing constraints. Overseas crisis made difficult for Indian corporate and financial institutes. The Foreign Financial Institution inflows turned in negative figures with selling of portfolio in Indian capital markets in order to cover losses in their home country. This outflow had led to stock market from 20873 in January, 2008 to nearly 8000 in October, 2008 and also decline in domestic FOREX liquidity and resulted in tightening of Rupee liquidity. The prices of the stock came down by 70 percent from their high in January, 2008. It was no safe haven for the investor both in primary market as well in secondary market.

Table. 3 FII Movements in India

Year	FII flows (US mn $)
2000-01	1,847
2001-02	1,505
2002-03	377
2003-04	10,918
2004-05	8,686
2005-06	9,926
2006-07	3,225
2007-08	20,328
2008-09	-15,017

(Source: CMIE)

- The inter-bank call money (overnight) rates also increased during the period from second half of September' 08 to end October' 08 (high of 19.70 per cent on October 10). After the fall of Lehman Brothers there was a downward pressure on the rupee. The exchange rate depreciated from Rs. 39.37 per dollar in January 2008 to Rs. 51.23 per dollar in March 2009. The fund redemption put pressure on mutual funds (MFs) and ultimately further on non-banking financial corporations (NBFCs) as MFs was important source of funds.

Falling growth and Inflation:

- After the long spell of growth, the Indian economy had experienced slowdown in growth rate. The Gross Domestic Product (GDP) in 2006-07 was 9.6% which became 9.3% in 2007-08 due to global recession and crisis. That drastically came down to 6.8% in 2008-09. This decline was due to slower industrial activity, mainly production, infrastructure and in service sector like communication, transport, tourism. Currency depreciation also affected the consumer prices in the country, the inflation rose to peak of 12.9% in first week of August. Inflation and higher cost of imported food impacted individuals and households to spend more of their income on food.

Table. 4 Trends in GDP at factor cost (Rs. in crores)

Year	GDP (in rupees)	GDP
1999-2000	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
2008-09	3351653	7.1

(Source: Central Statistic Organisation, Government of India)

Table. 5 Inflation data

Year	Inflation rate
2008	8.35
2009	10.88
2010	11.99
2011	9
2012	6.5

(Source: Morgan Stanley)

Unemployment

- The impact from the global economic crisis is resulting in unemployment in various sectors and areas of the Indian Economy and simultaneously loss of non farm employment in the economy. In one of the survey of Government's Labour Bureau from eight sectors like mining, textiles, metals and metal products, automobile, gems and jewellery, construction, transport, IT etc. analysed there were a large numbers of people had lost a job and decline in employment in year 2008-09. The decline impacted the recruitments from the elite education institutions. The weakening demand for Indian exporter in United States and European countries has declined employment from the software and outsourcing firms.

Impact on Industrial and service sector

- During the recession the industrial growth was also hampered. The main reason behind that was depressed demand from export markets as well from domestic markets resulted from unemployment due to crisis. The liquidity squeeze created in global markets had hampered the Indian companies' credit facilities from the foreign financial institutes and compelled to shift to Indian banks resulting that in credit crunch in domestic markets. With the increased risk in overseas markets, Indian banks also curtailed the credit expansion for the domestic money demand and this led to the drastic fall in Industrial production (IIP) data also. In the phase of uncertainty and to manage their balance sheets the banks and other financial institutes curtailed credit available in automobile, housing and consumer durables. In manufacturing sector, the growth has come down to 4.0 per cent in April-November, 2008 as compared to 9.8 per cent in the corresponding period last year. As per the Reserve Bank of India (RBI) reported it was drastic fall in credits and resulted into lower demands from the consumer side. The service sector which contributes more than 50% share in total GDP of the nation and main growth indicator also slowed down specifically banking, financial services, transport, communication, hotels, and restaurant services.

Impact on agrarian situation

- After the years of exposure of liberalisation and privatisation policies the agricultural sector was not being given as much importance in Indian economy but with all over recession also impacted the commodity prices and led to down turn in the country. Theses falling prices of the commodity severely damaged the earnings of the farmers and laboures working in agriculture sector and livelihood of the mass population of India.

Impact on International business

- The impact of this financial crisis had created the serious credit crunch of trades in India. The impact was mainly on account of India's growing two way trade (merchandize exports and imports). India's two way trade (merchandize exports plus imports), as a proportion of GDP, was 40.7 per cent in 2008-09, the crisis year, up from 19.6 per cent in 1998-99. Indian Exporters were finding difficulty in securing credits from banks and instances of delaying and not honoring guarantee were increased. Exports which accounted for 22 % of the GDP are expected to fall by 12 %. The direct impact of global slowdown on export industry in India were gems, jewellery, textiles, leather and hand craft was huge. The sharp drop in export growth not only led to economic slowdown and widening of trade deficit but also caused debt defaults and resulted in cutbacks in pipeline investments.

Opportunities arisen from Global Crisis

The unfolding global economic crisis came in various forms and presented many challenges but these also brought opportunities. The extent to which the challenges engendered by the crisis can be converted into opportunities by the country so this has given chance to developing countries to mature in various dimensions. The international system and concept of power also undergone a shift and had serious repercussion on developing countries and develop more responsibilities for global economic and financial stability.

Competitive global markets

- Against the impact on international business and declining in the exports has demanded a change from the Indian policymakers to maintain the domestic demand work towards gaining investor's confidence. The Indian government has option to explore other ASEAN countries rather solely depending on the developed countries Europe and US with keeping incentive for exporters to be competitive globally. For this strong governance reforms are required from government to improve overall competitiveness of the Indian economy.

Food grain led growth

- The government put more emphasis on enlarging government expenditure for the developments and growth rather on new speculative bubbles that caused global financial crisis. This put focus on agricultural sector and production of food that directly improves the livelihoods of the people engaged in particular sector. The new paradigm requires 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.

Stand in global economic agenda

- With the global financial turmoil the emerging markets have got the prominent stand in global economic agenda. The policy choices made by the emerging countries India and China has made their role active internationally on key policy issues and strengthening global economic governance for their long-term interest to take the lead on global challenges.

Strategic Industrial advantage

- At the time of crisis when the automobile companies in US were facing recession and received public funds from government to overcome their shortcomings. In the same phase emerging country like India has got the competitive advantage over the industries' of developed country in terms of operating condition, novel market segments, dynamic market shifts, valuable learning opportunities and enhanced indigenous competition. In structural terms the growth of business capabilities available through market transactions provides international businesses with an increasing range of options in terms of where value is added and whether this is managed under common ownership or contracted externally. These increased strategic and structural options are likely to play an increasingly important role in future competitive adaptation.

Retail sector development

Countries throughout Asia and specially India were well positioned for an early recovery from the economic crisis as domestic demand is holding up well, GDP growth continued and trillions of dollars of sovereign reserves were providing governments and state banks with tools for action. The global recession has made prime real estate locations increasingly available and affordable in many developing markets. It also has made acquisition valuations of many local-market retailers very attractive. Unlike most developed markets, GDP in emerging markets is expected to continue to grow, albeit at a slower rate, and populations in many countries are younger, increasingly urban and showing a growing interest in modern retail formats. Asian countries continued to transform their economies with domestic consumption as a primary focus – a trend that should favor continued growth in retail business also over the long term.

Conclusion

Although Indian policymakers reacted in proactive manner and introduced the host of measures to reduce the impact of the crisis but it was apparent India has been affected by the global crisis with the reason being integration of the country with the other world economies. With large and expanded leverages, liquidity and complexities had led to the crisis, the economies with large finances even failed to adjust with the growth so to deal with this crisis. The deceleration in growth in developed countries has major impact on EDE like India like the GDP has fallen to 5.5 percent and Index of Industrial production (IIP) fell by minus 3.3 percent. This further had distressing impact on employment, capital formation, export-import and poverty. In this context this paper attempts to demystify the growth of India in the face of falling of external demands. To prevent the crisis strong policy regime and changes in neo-liberalisation approach are required. The moderation approach is the important outcome of this crisis to all the economies in the world. The impacts and challenges faced by our economies have also given the opportunities to the EDEs. The first valuable reform that requires the development of the agricultural sector and make India as food- grain country to face the economic and fiscal crises and reduce dependence on other sectors. Apart from the agrarian development the focus should also be put on the Government spending for rural and urban infrastructure and reducing the dependence on the private spending for economic and social developments in the country. The changes in the global markets also led the growing pool of business capabilities in emerging markets and created new strategic options for the multinational enterprises. As every crisis has been turned as opportunity for India so the Indian policymaker also need to maintain the domestic demand and work against gaining investor's confidence. Some of the governance reforms are required in retail and other sectors to maintain growth and to create India economy competitive.

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