

## Recent Global Meltdown and its Impact on Indian Economy

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**Abstract**—Today, India is much more integrated with the world economy through both the current and capital accounts. The down turn that appears to have begun in the USA in September, 2008 have negative impact on Indian economy. The most immediate effect of this global financial crisis on India is an out flow of foreign institutional investment (FII) from the equity market. This withdrawal by the FIIs led to a steep depreciation of the rupee. The banking and non-banking financial institutions have been suffering losses. The recession generated the financial crisis in USA and other developed economies have adversely affected India's exports of software and IT services.

For fighting this crisis, government responded through its monetary policy by pumping the liquidity into the system rather than using effective fiscal policy i.e. public expenditure and investment to face the recession. No doubt, government has introduced three fiscal stimulus packages for stimulating demand in the economy but it is not sufficient, the larger government expenditure should be oriented towards agriculture and infrastructure.

The present paper is an attempt to analyze the impact of recent global financial meltdown on Indian economy. The paper is divided into three sections. In the first introductory section, we have discussed the features of recent global financial meltdown. The section two, deals with the impact of this crisis on Indian economy. Conclusion and suggestions have been given in the third section.

**Keywords-** Depreciation, Foreign Institutional Investment (FII), Global Financial meltdown, India, Recession.

### I. INTRODUCTION

In the era of globalization financial crisis seems to have been occurring with greater frequency. The crises of Latin America in the early 1980s and Mexico, Asia and Russia in the 1990s were the four major crises. The fifth one is the recent global financial crisis. Ten year ago, financial crisis of the East Asia was due to a real estate bubble in the Thailand burst, triggering the flight of international speculative capital, today, it is fallout of the real estate crisis in the USA which threatens the financial markets.

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.

The Nobel Prize winner for economics Joseph Stiglitz argued that this bailout package is again based on "trickle down economics" you throw enough money at Wall Street and some of it will trickle down to the rest of the economy. It does 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 have also been accompanied with charges of hypocrisy due to the appearance of socializing the costs while privatizing the profits.

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 rise 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.

### II. SECTION: II

#### **Impact of the Global Meltdown on the 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.

TABLE I. TRENDS IN GDP AT FACTOR COST IN RS. CRORE

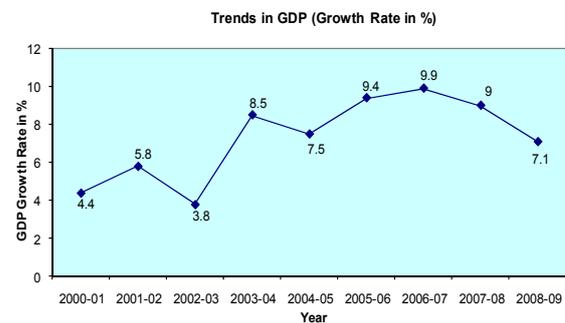
Year	GDP (at 1999-00 Price)	Growth in %
1999-2000	1792292	-
2000-01	1864773	4.4
2001-02	1972606	5.8
2002-03	2048287	3.8
2003-04	2222758	8.5
2004-05	2388384	7.5
2005-06	2612847	9.4
2006-07	2871120	9.9
2007-08	3129717	9.0
2008-09	3351653	7.1

Source: Central Statistical Organization, Government of India

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 out-sources 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.

Figure 1.



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.

TABLE II. NET INVESTMENT OF FIIS AT MONTHLY EXCHANGE RATE (IN US \$ MILLION)

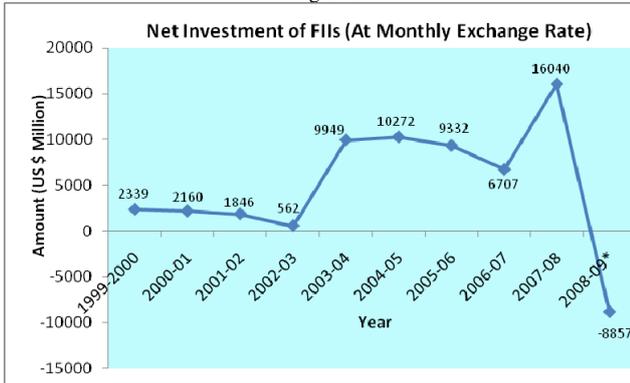
Year	Amount
1999-2000	2339
2000-01	2160
2001-02	1846
2002-03	562
2003-04	9949
2004-05	10272
2005-06	9332
2006-07	6707
2007-08	16040
2008-09*	-8857

\*April-November, 2008-09

Source: Security and Exchange Board of India (SEBI)

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)

Figure 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. Fig. (3)

Figure 3. Daily movements of BSE Sensex in 2008-09



Source: Bombay Stock Exchange, India

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.

TABLE III. FOREIGN EXCHANGE RATE

Month	Rupees per unit of Dollar	Appreciation/Depreciation
March 2008	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

Figure 4.

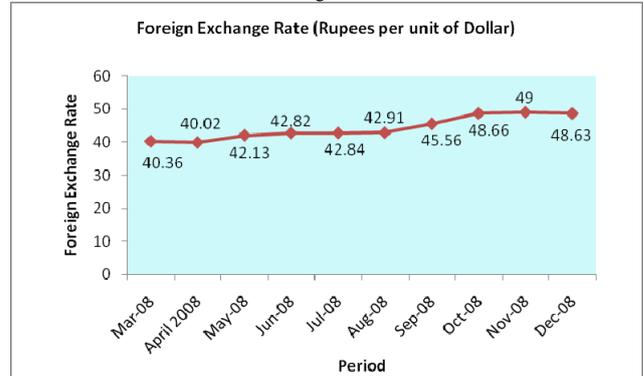
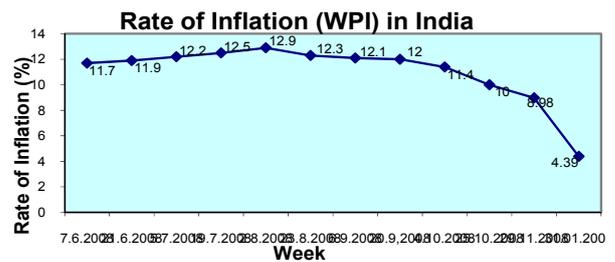


Figure-5 shows that the rate of inflation has gone down to 8.98% in the last week of November 2008 from the peak of 12.9 % in first week of August and further sharply declined during recent few weeks. The recent trends suggest a faster than expected reduction in inflation. The decline inflation should support consumption demand and reduce input costs for corporate. From the external sector perspective, it is projected that imports will shrink more than exports keeping the current account deficit modest. But the current account deficit is widening.

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

Figure 5.



down to \$247621 million in 2008-09, which shows the direct impact of the financial crisis on India's foreign exchange reserves. (Table- 4 and Fig.-6)

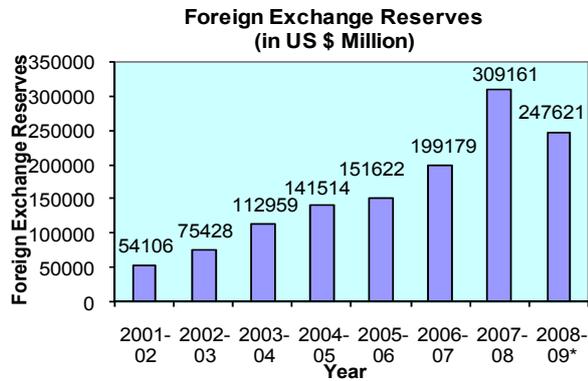
TABLE IV. FOREIGN EXCHANGE RESERVES (IN US \$ MILLION)

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

As on 23<sup>rd</sup> January 2009

Source: RBI Weekly Statistical Supplement

Figure 6.



\*As on 23<sup>rd</sup> January 2009

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 new non-farm employment in the economy. The depreciation of rupee could not positively affect the exports bill of India.

TABLE V. INDIA'S FOREIGN TRADE IN US \$ MILLION

	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

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.

#### How the Government and RBI responded:

The government of India and RBI responded to the challenge strongly through its fiscal and monetary policies.

The government has introduced three fiscal stimulus packages. These are expanded safety-net programmes for the rural poor, the farm loan waiver package and payout following the Sixth Pay Commission report for stimulating demand in the economy.

On the other hand in aftermath of the turmoil caused by bankruptcy, the Reserve Bank has announced a series of measures to facilitate orderly operation of financial markets and to ensure financial stability, which predominantly includes extension of additional liquidity support to banks. The RBI has been effectively able to manage domestic liquidity and monetary conditions consistent with its monetary policy.

This has been enabled by the appropriate use of a range of instruments available for liquidity management with the Reserve Bank such as the Cash Reserve Ratio (CRR), which was reduced to 5% in July 2009 from 9% in August 2008 and Statutory Liquidity Ratio (SLR) stipulation and Open Market Operations (OMO) including the Market Stabilization Scheme (MSS) and Liquidity Adjustment Facility (LAF). Reduction in the repo rate (the rate at which RBI lends to the banks) from 9% as on October 2008 to 4.75% in July 2009 and the reverse repo-rate (RBI's borrowing rate) reduced to 3.25% in July 2009 from 6% as on October 2008 in order to improve the flow of credit to productive sectors at viable costs so as to sustain the growth. Further more, money market liquidity is also impacted by our operation in the foreign exchange market, which in turn, reflects the evolving capital flows. The existing set of monetary instruments has thus, provided adequate flexibility to manage the evolving situation.

So the financial sector has emerged without much damage thanks in part of our strong regulatory framework and in part on account of most of the nationalized banking sector.

### III. SECTION: III

#### Conclusion and Suggestions:

No doubt, India has been hit by the global meltdown, it is clearly due to India's rapid and growing integration into the global economy. The strategy to counter these effects of the global crisis on the Indian economy and prevent the latter 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. Such an alternative policy to tackle the consequences of the financial crisis will require effective Keynesian policies in the form of increased public expenditure at the rural and urban infrastructure. We see that government's engagement generally arrives very later to solve the financial crisis by which time many financial firms are near insolvency. This generates larger cost for the economy and exchequer. Our key goal today should be to avoid these costs through rapid action.

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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