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R. B. NARAYANRAO BORAWAKE COLLEGE

SHRIRAMPUR, DIST. AHMEDNAGAR (M.S.)

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"IMPACT OF THE GLOBAL ECONOMIC CRISIS ON INDIAECONOMY"

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INTRODUCTION: In the last three decades liberalization, globalization and privatization (LPG) has largely proceeded based on the belief in the self regulatory capacity of markets without adequate structures and systems in place to govern the process. By mid-2007 this has led to the appearance of large cracks threating the stability of the world economy on two fonts : the sharp like of primary commodity prices and the global financial crises, which evolved since the financial crises in the 1990s that severely disrupted in the large number of emerging economies in Asia, Latin America and traditional economies. By the end of 2008 the world economy had rapidly entered a phase of globally synchronized slowdown and in the first quarter of 2009 headed towards a global recession.

The financial sector of India is not deeply integrated with the global system. Which spared in the first round adverse effects of the global financial crisis and left Indian banks mostly unaffected. however, as a financial crisis morphed in a full-blow global economic downturn. India could not escape the second round effects. The global crisis has effected India through the three ways like financial market, exchange rate and trade flows. India has shown considerable resilience to the global economic crisis by maintain one of the highest growth rate of 6.7 percent in 2008-09 which was 2.1 percent lower than its average growth during the last five years.

During the global economic crisis, the service sector has been a one of the main drivers of India's growth which accounted for about 88 percent of the growth rate in the real GPD. In this way the Indian economy looked to be relatively insulated from the global economic crisis that started in August 2007, when the sub-prime mortgage crisis first surfaced in the United States (US). In fact, the Reserve Bank of India (RBI) was raising interest rates until August 2008.

OBJECTIVES OF THE STUDY: The following are the objectives of the study:
1)To study the events leaving to the great economic crisis of the twenty first century. 2)To understand the causes of the economic crisis. 3)To analyse the impact on Indian economy. 4)To know the future of the Indian economy.

RESEARCH METHODOLOGY : The study is based on secondary data. The information and data required for the study has been collected from various sources like reference books, journals, magazines, newspapers and we sites.

Events Leading to the Great Financial Crisis of the twenty First Century :

Over the past decades, the world economy has been going through more or less continuously, a series and stresses in the current wave of globalization. As well as before 1990s most middle income countries, together with newly formed transitional economics were re-integrated into the international capital market as emerging market economies, through the market based debt restructuring process under the Brady Plan. Therefore, emerging market economies have been exposed repeatedly to financial crisis at the mercy of investors. In particular, they have suffered bitter experiences with currency attacks and collapse, adversely affecting the balance sheets of their financial institutions, corporations and households due to a high degree of liability dollarization; so, deepening and prolonging the crisis further.

In the process, potential default risks of original sub-prime mortgage products were overloaded, as they were reshuffled many times over and hidden from their balance sheets. Although the financial market become irrational with systemic risks building up individual market participants, driven by instant pay off and profit taking believed that their decisions were based on rationality backed up by sophisticated financial modeling.

Despite immediate interventions through a series of large-scale liquidity injections by the federal reserve and the main central banks in Europe, inter-bank money markets have been largely frozen since then, leading to liquidity crunch in in many financial markets and credit crunch in many financial institutions. So several over leveraged banks and financial institutions in the United states and Europe were the first to go bankrupt and some of them were nationalized after the governments were forced to become a major equity holder.

Despite the anxieties and tensions reflecting huge uncertainty and a crisis of confidence that gripped global financial markets and sectors during the intervening period between the summers of 2007 and 2008; the continuing buoyant economic growth of several emerging market economic such as Brazil, Russia, India and China sustained an optimistic growth prospect for the world economy for some time.

The global financial crisis has rapidly become a reality with the real economy side effects being felt imminently worldwide. No country has been immune to the cascading effects of the crisis.

Causes of Economic Crisis :

Poor Regulations: The problem has occurred during an extremely accelerated process of financial innovation in market segment that were poorly or ambiguously regulated mainly in the US. In short there are doubts, whether the operations of derivatives markets have been as transparent as they should have been or if they have been manipulated.

Fair Value Accounting Rules: Fair value accounting rules require banks and others to value their assets at current market prices. The board aim of fair value accounting is to enable investors, financial system participants and regulators to better understand the risk profit of securities in order to better assess their position.

Boom in the Housing Market: Sub-prime borrowing was a major contribution to an increase in house ownership rate and the demand for housing. Increase in house purchases during the boom period eventually led to surplus inventory of houses. Once housing prices started depreciating moderately in many parts of US re-financing became more difficult. In this way excess supply of houses placed significant downward pressure on prices.

Mismatch Between Financial Innovation and Regulation: Everywhere the government seeks to regulate the financial institutions to avoid crisis and to make sure country's financial system efficiently promotes economic growth and opportunity. But according to Conway (2009) report that the financial innovation inevitably exacerbates ricks, while a tightly regulated financial system hampers growth.

Faulty Credit Rating : Risk rating agencies were unable to give proper rating to complex instruments. So credit rating process was faulty.

Excessive Leverage: According to Global economic outlook (2008) report that, the final problem came from excessive leverage. Investors bought mortgage banked securities by borrowing e.g. wall street banks had borrowed 40 times more they were worth.

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

Securitization and Repackaging of Loans: The mortgage market crisis that originated in the US was a complex matter involving a whole range of instruments of the financial market that transcended the boundaries of sub-prime mortgage. In short they originated and sold poorly underwritten loans without demanding appropriate documentation or performing adequate due diligence and passed the ricks along to investors and securities without accepting responsibility for subsequent one faults.

High Risk Mortgage Loans and Ceding Practices: 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.

Typical Characteristics of US Financial System Failure of Global Corporate Governance:

The main reasons for current crisis in the advanced industrial countries related to the failures in corporate governance that led to non-transparent incentives schemes the encouraged bad accounting process.

Impact on Indian Economy: Due to the globalization, the Indian economy cannot be insulated from the present financial crisis in the developed economies. The development in the US financial sector has affected not only America but also European Union, U.K. and Asia. Until the emergence of global crisis the Indian economy was going through a phase of high growth driven by domestic demand -growing domestic investment, financial mostly by domestic savings and sustained consumption demand. In fact, consumption and saving were well-balanced. Service sector, led by domestic demand, contributed to the stability in growth. Concomitantly, inflation was also generally low and stable. In this way overall improvement in macroeconomic performance in India was attributed to calibrated financial sector reforms that resulted in an efficient system of financial intermediation, albeit bank-based; the rule based fiscal policy that reduced the drag on private savings and forward - looking monetary policy that balanced the short term tradeoff between growth and inflation on continuous basis. Therefore the impact will be multi-fold.

1.Exchange Rate : Exchange rate volatility in India has increased in the year 2008-09 compared to previous year i.e between January 1 and October 16, 2008, the Reserve Bank of India (RBI) reference rate for the rupee fell by nearly 25 percent from Rs. 39.20 per dollar to rs. 48.86. This depreciation may be good for India's export that arte adversely affected by the slow down in global market but it is not so good for those who have accumulated foreign exchange payment commitments.

2.FDI Inflows : Foreign Direct Investment (FDI) inflow into the core sectors plays a significant role as a source of capital, management and technology in transitional economics. It implies that FDI can have positive effects on the host economy's developmental efforts. India has opened its economy and has opened its economy and has allowed the entry of multinational corporations as a part of the reform process started in the beginning of 1990s. India has offered greater incentives to encourage FDI inflows into economy.

3.Information Technology : The US banks have huge running relations with Indian Software Companies. A rough estimate suggests that at least a minimum of 30000 Indian jobs could be impacted immediately in the wake of happenings in the US financial system. Approximately 61 percent of the Indian IT sector revenues are from US Financial corporation like Washington Mutual, Bank of America, Morgan Stanley, Goldman Sachs, Citigroup and Lehman Brothers. In short the top five Indian players account for 46 percent of the IT industry revenues.

4.Banks : The ongoing crisis will have an adverse impact on some of the Indian banks. Some Indian banks and financial institutions have not experienced the kind of losses and write downs the banks and financial institutions in the western world have very few branches abroad. Our Indian banks are slightly better protected form the financial meltdown largely because of the greater role of the nationalized banks even today and other controls on domestic finance.

5.Export and Import : The Indian export - import market also affected the global crisis. In 2008-09 export - import both had been reduced due to crisis of 2007. In fact in 2009-10 export and import of India reached in negative. therefore, demand for Indian product has reduced in international market as a result export gone under negative in 2009-10.

6.Stock Market: The financial turmoil affected the stock market even in India. The movement of Sensex shows a positive and significant relation with foreign institutional investment firms into the market. This also affected on the primary market.

7.Inflation Rate : By January 2010 the domestic growth signals were pointing towards a consolidation of the recovery process. However, sustained increase in food prices was beginning to spin over manufactured products. Inflation rate in primary commodities moved up 8.32

percent in August 2009 to 22.2 percent by March 2010. The decomposition of food inflation indicates that during the recent period the key drives of food inflation are no cereals. All together inflation rates is increasing at higher rate.

8.Indian Agriculture : India has opened its market since July 1991 by lowering tariff and nontariff barriers as well as liberalizing investment policies. Still Indian agriculture is far less vulnerable to the external economics stocks than agriculture in many developing countries. The impact of economic crisis is transmitted through three ways i./e financial sector, export and exchange rate and the impact manifests itself in several direct and indirect ways.

9.Increase in Unemployment : The global financial crisis could increase unemployment. Layoffs and wage cuts are certain to take place in many companies where young employees are working in Business Process Outsourcing (BPO) and Information Technology(IT) sector. The international labour organization (ICO) predicted that millions of jobs will be lost by the end of 2009 due to the crisis.

10.Real Estate: The crisis will hit the Indian real estate sector hard. The realty sector is witnessing a sudden slump in demand because of the global economic slowdown.

11.Investment : it is expected that the capital inflows into the country will dry up. Investments in mega projects which are under implementation and in the pipeline are bound to buy more time before injecting funds into infrastructure and other ventures. The investment in tourism, hospitality and healthcare has slowed down fresh investment flows into India in doubt.

India @ 2050 : The future of the Indian Economy : The global economic recession and crisis has quite expectedly impacted India, too. But it is a moot point whether the Indian economy is affected more by the global economic ups and downs or by India's structural and political problems and economic management or mismanagement.

There is very significant global interest in the Indian economy. Along with China, Brazil, Indonesia and a few other countries, India promises great potential of growth in the next few years and decades. The future of the Indian economy is thus a significant concern among the global financial and business community, economic policy - makers and managers, multilateral financial institutions, economists and other academics as well as investors and consumers in India.

The significant global interest in India is not surprising. It is well known that on a purchasing power parity basis. India is already the fourth largest economy in the world; very close to the size of the Japanese economy, the third largest in the next 15 to 18 years this size s expected to grow. As a result many forgein investors and a majority of global companies and business are making a beeline for the Indian market, which promises a booming middle class of a few hundred million consumers, expanding steadily in the next few decades.

CONCLUSION:- Considering the above mentioned facts in the context of global financial crisis and its impact on Indian economy, the researcher has conclude that the ongoing financial crisis has shown how in prepared the international monetary and financial system under the current regime is to take on task of financial intermediation for productive investment and economic development. The Indian economy is being affected by the effects of the global financial crisis. great savings habit among people have saved Indian economy from going out of gear. In this way it is expected that growth of Indian economy will be moderate in future.

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