ANALYSIS OF GLOBAL FINANCIAL CRISIS AND ITS IMPACT ON INDIAN ECONOMY

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ABSTRACT:

Global Financial Crisis is among the greatest financial challenges to the world economy which is originated in United States of America. The global economic slowdown is unprecedented in scale and has severe implications on policy formulation among emerging market. Currently India has one of the largest Developing countries in the world. Strong economic growth in the last decade combined with a population of over a billion makes it one of the potentially largest markets in the future. This paper provides an overview of global financial crisis (GFC) and its impact on the Indian Economy. The present study makes an attempt to identify the immediate impact of the financial crisis on Indian economy in terms of selected economic indicators. The study examines the trends in export, import, gdp growth rates etc in the context of Indian economy against the background of global financial crisis and subsequent global recession. India is considered to be highly vulnerable to a crisis like this because of its greater integration with the rest of the world. There are some reasons to believe that the financial crisis affected Indian economy adversely by slowing foreign remittances, foreign investment, adverse bop position etc. However, Indian economy shows the symptoms of rapid recovery from the sudden set back it had to undergo during 2008-09 and future trends also.

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INTRODUCTION:

The macro effects have so far been muted due to the overall strength of domestic demand, the healthy balance sheets of the Indian corporate sector, and the predominant domestic financing of investment. What stands out glaringly in the current regulatory failure? The regulatory failure was twofold. First, some parts of the financial system were either loosely regulated or were not regulated at all, a factor which led to "regulatory arbitrage" with funds moving more towards the unregulated segment. The Indian economy looked to be relatively insulated from the global financial crisis that started in August 2007 when the 'sub-prime mortgage' crisis first surfaced in the US. But as the financial meltdown, morphed in to a global economic downturn with the collapse of Lehman Brothers on 23 September 2008, the impact on the Indian economy was almost immediate. Credit flows suddenly dried-up and, overnight, money market interest rate spiked to above 20 percent and remained high for the next month. It is, perhaps, judicious to assume that the impacts of the global economic downturn, the first in the centre of global capitalism since the Great Depression, on the Indian economy are still unfolding.

Indian Economy During Financial 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 base index declined from over 20000 during the early months of 2008 to 9000 during the last week of November 2008. The impact of the global crisis on India can broadly be divided into three different aspects:

(1) The immediate direct impact on its financial sector;
(2) An indirect impact on economic activities; and
(3) Potential long-term geopolitical implications.

Fortunately, India, like most of the emerging economies, was lucky to avoid the first round of adverse affects because its banks were not overly exposed to subprime lending. Only one of the larger private sector banks, the icecap, was partly exposed but it managed to counter the crisis through a strong balance sheet and timely government action. The banking sector as whole maintained a healthy balance sheet and, over the third quarter of 2008, a nightmare for many big financial institutions around the world, India's banks reported encouraging results and witnessed an impressive jump in their profitability.

However, the indirect –or second-round– impact of the crisis has affected India quite badly. The liquidity squeeze in the global market following Lehman brothers' collapse had serious implications for India, as it not only led to massive outflows of foreign institutional investment (fii) but also compelled Indian banks and companies to shift their credit demand from external sources to the domestic banking sector. It thereby exerted pressure on domestic market liquidity, thereby giving rise to a credit crunch. Coupled with the ensuing loss of confidence, this increased the risk aversion of Indian banks, hurting credit expansion in the domestic market.

Additionally, given the recession in the developed world, the demand for Indian exports in their major markets has almost collapsed. Merchandise exports shrank by more than 17% from October 2008 to may 2009. The decline in exports has accelerated; with a drop in may 2009 of 29.2% compared with may 2008. Likewise, exports of services are also facing a steep downturn. In the third quarter of 2008-09, growth in services exports declined to a mere 5.9%, compared with 34% in the same period a year back. Earnings from travel, transport, insurance and banking services have contracted, while the growth of software exports declined by more than 21 percentage points. The real shock came in the fourth quarter of 2008-09 when services exports contracted by 6.6% over the same period a year back.

India is not completely insulated against financial crisis. To some extent it is protected but still there is blow on our economy due to this crisis. The reasons why it was protected to some extent can be mentioned as below:

1. Our growth has been largely domestic demand driven with a comfortable level of foreign exchange reserves.

2. In our economy derivatives market is much regulated where it won't allow for immediate profit recognition.

3. The strength in balance sheets displayed by India Inc due to domestic financing.

Lastly another reason for this is the proactive steps taken by government of India, of whom Dr. Rangarajan has always been in forefront to take steps to keep us on safer side.

METHODS AND MATERIALS:-

The present study focuses on the global financial crisis and its impact on Indian economy. The data for this study has been collected from secondary sources of information are mainly from the web sites and News dailies (news papers) besides from the research publications which are mentioned in the reference section.

Analysis the impact of economic crisis in India:-

A) Impact on the Indian banking system

One of the key features of the current financial turmoil has been the lack of perceived contagion being felt by banking systems in emerging economies, particularly in Asia. The Indian banking system also has not experienced any contagion, similar to its peers in the rest of Asia. The Indian banking system is not directly exposed to the sub-prime mortgage assets. It has very limited indirect exposure to the US mortgage market, or to the failed institutions or stressed assets. Indian banks, both in the public sector and in the private sector, are financially sound, well capitalized and well regulated. The average capital to risk-weighted assets ratio (CRAR) for the Indian banking system, as at end-March 2008, was 12.6 per cent, as against the regulatory minimum of nine per cent and the Basel norm of eight per cent.

A detailed study undertaken by the RBI in September 2007 on the impact of the sub-prime episode on the Indian banks had revealed that none of the Indian banks or the foreign banks, with whom the discussions had been held, had any direct exposure to the sub-prime markets in the USA or other markets. However, a few Indian banks had invested in the collateralized debt obligations (CDOs)/ bonds which had a few underlying entities with sub-prime exposures.

Thus, no direct impact on account of direct exposure to the sub-prime market was in evidence. Consequent upon filling of bankruptcy by Lehman Brothers, all banks were advised to report the details of their exposures to Lehman Brothers and related entities both in India and abroad. Out of 77 reporting banks, 14 reported exposures to Lehman Brothers and its related entities either in India or abroad. An analysis of the information reported by these banks revealed that majority of the exposures reported by the banks pertained to subsidiaries of Lehman Brothers Holdings Inc., which are not covered by the bankruptcy proceedings. Overall, these banks' exposure especially to Lehman Brothers Holdings Inc. which has filed for bankruptcy is not significant and banks are reported to have made adequate provisions. In the 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.

(B) Impact on stock and forex market.

With the volatility in portfolio flows having been large during 2007 and 2008, the impact of global financial turmoil has been felt particularly in the equity market. Indian stock prices have been severely affected by foreign institutional investors' (FIIs') withdrawals. FIIs had invested over Rs 10, 00,000 Crore between January 2006 and January 2008, driving the Sensex 20,000 over the period. But from January, 2008 to January, 2009 this year, FIIs pulled out from the equity market partly as a flight to safety and partly to meet their redemption obligations at home. These withdrawals drove the Sensex down from over 20,000 to less than 9,000 in a year. It has seriously crippled the liquidity in the stock market. The stock prices have tanked to more than 70 per cent from their peaks in January 2008 and some have even lost to around 90 per cent of their value. This has left with no safe haven for the investors both retail and institutional.

The primary market got derailed and secondary market is in the deep abyss. Equity values are now at very low levels and many established companies are unable to complete their rights issues even after fixing offer prices below related market quotations at the time of announcement. Subsequently, market rates went down below issue prices and shareholders are considering purchases from the cheaper open market or deferring fresh investments. This situation naturally has upset the plans of corporate to raise resources in various forms for their ambitious projects involving heavy outlays In India, there is serious concern about the likely impact on the economy of the heavy foreign exchange outflows in the wake of sustained selling by FIIs on the bourses and withdrawal of funds will put additional pressure on dollar demand. The availability of dollars is affected by the difficulties faced by Indian firms in raising funds abroad. This, in turn, will put pressure on the domestic financial system for additional credit. Though the initial impact of the financial crisis has been limited to the stock market and the foreign exchange market, it is spreading to the rest of the financial system, and all of these are bound to affect the real sector. Some slowdown in real growth is inevitable. Dollar purchases by FIIs and Indian corporations, to meet their obligations abroad, have also driven the rupee down to its lowest value in many years. Within the country also there has been a flight to safety. Investors have shifted from stocks and mutual funds to bank deposits and from private to public sector banks. Highly leveraged mutual funds and non-banking finance companies (NBFCs) have been the worst affected.

(C) Impact on industrial sector and export prospect.

The financial crisis has clearly spilled over to the real world. It has slowed down industrial sector, with from 8.1 per cent from last year to 4.82 per cent this year. The service sector, which contributes more than 50 per cent share in the GDP and is the prime growth engine, is slowing down, besides the transport, communication, trade and hotels & restaurants sub-sectors. 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. Sluggish export markets have also very adversely affected export-driven sectors like gems and jewellery, fabrics and leather, to name a few. For the first time in seven years, exports have declined in absolute terms for five months in a row during October 2008-February 2009. In a globalised economy, recession in the developed countries would invariably impact the export sector of the emerging economies.

Export growth is critical to the growth of Indian economy. Export as a percentage of GDP in India is closer to 20 per cent. Therefore, the adverse impact of the global crisis on our export sector should have been marginal. But, the reality is that export is being and will continue to be adversely affected by the recession in the developed world. Indian merchandise exporters are under extraordinary pressure as global demand is set to slump alarmingly. Export growth has been negative in recent months and the government has scaled down the export target for the current year to $175 billion from $200 billion. For 2009-10, the target has been set at $200 billion.

(D) Impact on employment

Industry is a large employment intensive sector. Once, industrial sector is adversely affected, it has cascading effect on employment scenario. The services sector has been affected because hotel and tourism have significant dependency on high-value foreign tourists. Real estate, construction and transport are also adversely affected. Apart from GDP, the bigger concern is the employment implications a survey conducted by the Ministry of Labour and Employment states that in the last quarter of 2008, five lakh workers lost jobs. The survey was based on a fairly large sample size across sectors such as Textiles, Automobiles, Gems & Jewelers, Metals, Mining, Construction, Transport and BPO/ IT sectors. Employment in these sectors went down from 16.2 million during September 2008 to 15.7 million during December 2008 Further, in the manual contract category of workers, the employment has declined in all the sectors/ industries covered in the survey. The most prominent decrease in the manual contract category has been in the Automobiles and Transport sectors where employment has declined by 12.45 per cent and 10.18 per cent respectively. The overall decline in the manual contract category works out to be 5.83 per cent. In the direct category of manual workers, the major employment loss, ie., 9.97 per cent is reported in the Gems & Jewellery, followed by 1.33 per cent in Metals Continuing job losses in exports and manufacturing, particularly the engineering sector and even the services sector are increasingly worrying. Protecting jobs and ensuring minimum addition to the employment backlog is central for social cohesiveness.

Conclusion:

While there are growth-related challenges in the short to-medium term, there seem to be some opportunities for managing the bottom line for the rest of the year. The macroeconomic environment is depressing and has impacted the overall confidence in the sector from a market perspective. A US recession, in all probability, will last through 2009 and more, in making this period a challenging one for growth. Despite the foreboding financial crisis, the opportunities are massive. Making the growth vs. profitability trade-off early on during the slowdown is just one of them. Profitability levers are still available if growth is sacrificed where required, and managed well. All in all, the environment looks weakest in a long while, and yet there remain pockets of opportunity. These areas, if tapped intelligently, would enable the Indian industries firms to ease the blow of this financial crisis and help them tide through the tough times. The crisis has now spread globally, and further reduces room to maneuver. To conclude, we are tempted to use a popular aphorism; the Chinese character for “Crisis” represents two symbols “Danger” and “Opportunity“ but the choice is ours.

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