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IMPACT OF GLOBAL ECONOMIC CRISIS ON INDIAN ECONOMY

Dr. Prakash Gangadharrao Kadrekar

Associate Professor , H.O.D & Vice Principal , Degloor College , Degloor ,
Dist - Nanded (MS)

ABSTRACT:-

Recession or crisis is a form of the normal business cycle. The crisis may be a traumatic or stressful change in, political, social, economic, military affairs and large-scale environmental event. The recent economic crisis is widely viewed as a glaring example of limitless pursuit of greed overindulgence at the expense of caution, prudence, due diligence and regulation. The origin of current economic crisis back to mid 2007, when three things became clear - Low income or sub prime US households that had borrowed heavily from banks and financial companies to buy homes, the size of this sub prime housing loan market was huge at about $ 1.4 trillion and Wall Street financial engineers had packaged these loans to really complicated financial instruments.

KEYWORDS : Global Economic Crisis , Indian Economy , political, social, economic.

INTRODUCTION:

Since 2001 to 2006 U.S.A. economy was economically sound and the interest rate prevailing in various sectors were low, prices of houses were continuously increasing because of lower rate of interest and banking sector was incurring lower profit. Therefore the banks and financial institutions in USA had thought a new idea regarding the lending, in which high rates of interests were charged and loans were given to the sub-prime lenders for purchasing the houses. These were fully aware about the risk involved in sub prime lending for housing but they have taken such risk on the belief that housing prices would never fall.

Investment in housing sector was found to be profitable to the speculators as well as banks, due to the continuously rising prices of houses. Americans have made huge speculative investment in housing sector. It caused a rise in demand for houses and housing loansin US. In order to fulfill the demand for huge loans for housing, the funds available with banks and financial institutions were found insufficient. Therefore, American banks and financial institutions introduced a new credit weapon called Mortgage Bonds. The basis of these mortgage bonds was the houses already mortgaged by the people for borrowing housing loans were again mortgaged by artificially increasing the price of houses more than their actual prices.These mortgage bonds were sold in international market. Large amounts of funds were collected by American banks by selling these mortgage bonds. These funds were utilized for financing the housing loans in US.

This housing bubble based on sub-prime loans burst in 2006-07. In the same year housing

prices had declined after 15-16 years. It adversely affected the speculative investment made in housing sector. Those who had invested in houses to earn more profit, have to face losses. Therefore, they started to sell the houses but due to lack of demand, houses could not be sold. Huge over dues of housing loans were not repaid by the borrowers. Banks and financial institutions did not succeed in the recovery of these loans. The price of mortgage bonds started a steep fall resulting in loss for those who invested in mortgage bonds. Hence, the liquidity problem in America became very serious. Meltdown set in the third quarter of the year 2007. The large banks like Lehman Brothers, Merrill Synch had declared bankrupt. In USA, 19 large banks and 100 private financial institutions were declared bankrupt. Thus, the default in mortgage loans for housing is the primary reason for the financial crisis sweeping the world.

CAPITAL OUTFLOW:

The main impact of the global financial turmoil in India has emanated from the significant change experienced in the capital account in 2008-09, relative to the previous year. Total net capital flows fell from US$17.3 billion in April-June 2007 to US$13.2 billion in April-June 2008. Nonetheless, capital flows are expected to be more than sufficient to cover the current account deficit this year as well. While Foreign Direct Investment (FDI) inflows have continued to exhibit accelerated growth (US$ 16.7 billion during April-August 2008 as compared with US$ 8.5 billion in the corresponding period of 2007), portfolio investments by foreign institutional investors (FIIs) witnessed a net outflow of about US$ 6.4 billion in April-September 2008 as compared with a net inflow of US$ 15.5 billion in the corresponding period last year. Similarly, external commercial borrowings of the corporate sector declined from US$ 7.0 billion in April-June 2007 to US$ 1.6 billion in April-June 2008, partially in response to policy measures in the face of excess flows in 2007- 08, but also due to the current turmoil in advanced economies.

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 or institutional. The primary market got derailed and secondary market is in the deep abyss.

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.

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 industrial growth projected to decline 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.

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.80 A survey conducted by the Ministry of Labor 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 & Jeweler, 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 2008.81 Further, in the manual contract category of workers, the employment has declined in all the sectors/ industries covered in the survey.

CONCLUSION:

In the concluding words we can say, India cannot escape unscathed present crisis because its economy has become more integrated with rest of the world over the past two decades. In order to overcome the global economic crisis, monetary and fiscal stimulus package are essential. More transparency is required in the process of setting bank rate, repo rate, reverse repo rate, CRR, SLR etc. The RBI must lower the policy rates further to bring down the costs of funds and boost the growth momentum. The link between monetary policy and financial stability need to be understood and more autonomy to the central bank should be given to maintain the enviable reputation earned by RBI. Monetary & fiscal policy both should be co-ordinated for overall better performance of Indian economy.

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