Effect of financial crisis on indian economy

Introduction

Financial Crisis – a very common word heard in the recent few years. Year 2008, the beginning of the credit crunch. It was like Tsunami waves which took away almost everything from the economies. Recession can be defined as " significant decline in the economic activity lasting more than a few months, which is normally visible in real GDP, real income, employment, industrial production, imports-exports, and wholesale-retail sales". Powerful developed economies like US and the Euro area were not able to control or reduce the effect of recession. The emerging economies like China, India and Brazil even though affected by recession but kept a good control over it. Through this research dissertation, I want to discuss the effect of financial crisis on a developing country. So, I have chosen India to discuss this topic.

India is one of the powerful emerging economies in the world. In the recent years, India has shown a significant growth in GDP and overall. With recession and its effect overall the world, India with its good policies was able to prevent recession from entering into the deep roots of the country. Even though we can say financial crisis didn't affect India but still there are some sectors badly affected by the crisis. So I basically I would be discussing about the effect of financial crisis on India and the transmission of crisis from developed countries to India.

Literature Review

The literature review for this research includes the effect of financial crisis on the GDP growth rate of the country. The GDP growth rate of India was increasing at a rapid rate but showed a down-turn due to the after effect of recession. The GDP growth rate of the country was above 8. 5% in 2010 and it was reduced to 8. 2% at the start of 2011. The GDP was affected because of the country's globalisation. In the last decade the country's integration into the world economy was really fast. Due to this rapid growth, the percentage of imports-exports, as a proportion of GDP grew from 21. 2% in 1997-98 to 34. 7% in 2007-08. This growth shows the immense growth of economy. During the period of 2003-08, the investments share in GDP increased by 11%. Domestic funds was available in bulk but still it was expensive than foreign funding. The growth potential of India was strong in the global market, so the foreign investors were ready to provide funds at lower cost and thereby take risk. Because of this globalisation the financial crisis on the global economy affected the Indian economy.

Country's banking sector is relatively one of the healthy sectors in the economy and when the recession effect came to India both the Government of India and RBI (Reserve Bank of India) responded to the challenge in coordination and consultation. The actions of RBI comprised of monetary accommodation and counter cyclical regulatory forbearance. RBI measures helped the financial sector of the country to increase the initial primary liquidity which amounts up to 7% of country's GDP. This shows how the banking sector of India controlled the effect of financial crisis.

On the other hand, the economic activities of the country were slowing down. As the real GDP rate was diminished, the service sector, in which India is one of the best due to the powerful human resource, was affected. The service sector includes construction, transport & communication, trade, hotels and restaurants sub-sectors. Business outsourcing is another major services provided by India. Most of the business outsourcing was done for US companies but due the financial crisis, this section affected badly. This in turn has affected the employment sector of the country. India is a country with high population, so a slight increase in the unemployment means so many of them has lost jobs. This must be the first time in seven years, exports have declined terribly. The industrial production index has also showed a negative growth. The uncertainty around the recession has decreased the business confidence.

And the country has a decelerated investment demand. Before recession, Foreign Institutional Investors (FII) was the bulk buyers in the Indian stock market. They bought huge number of shares by investing millions of dollars, as Indian economy was a developing at a rapid rate. But the subprime crisis affected them very badly. Some of the companies were short of cash, whereas others were trapped with bad debts. Even there are companies which had to declare bankruptcy. These after effects had a great impact on the Indian stock markets.

The adverse effect of financial crisis on the economic growth of the country can affect the poor and the food security of the country. The increase in food price in India was comparatively lower than that of global food prices. When the price of food globally increased by 150%, in India it was just 23%. This happened between 2005 and second quarter of 2008. After that, there was a decline in the food prices but it is still much higher than that at the beginning of the decade. If compared, the inflation of food articles was 10% and that of general inflation was 6%.

India is one of the top receivers of foreign remittance. India secure the first position with 17. 4 billion US $ in 2003. Middle-east is one of the main destinations for migrants from India. But after financial crisis, the Gulf countries, mainly UAE got affected badly. UAE is one of the countries, where we can find a lot of Indians in the construction sector which went down after the crisis. This has affected the flow of remittance from UAE to India. According to World Bank the remittance flow to developing countries can go down by 7%-10%. This will affect the foreign exchange reserve and investment sector of the country.

While concluding the literature part, it is clear that Indian economy was affected badly. But due to strong policies and high liquidity, the government was able to reduce the after effect to an extent.

Methodology

Through this topic I would like to find answers for some questions. They are:

What are the effects of global financial crisis on Indian economy?

How did crisis affect Indian economy?

What are the precautions and measures taken by the responsible authorities against crisis?

In order to discuss these questions, I would like to research online as well as books & newspapers, so that I get a clear-cut idea on financial crisis and Indian economy. Financial crisis is a familiar topic, so the details about it are available online. To do this research dissertation, online details are not enough, but interview with concerned persons will be useful for the project.

When the research is done about the effect on Indian economy, the economy is divided into different sectors. Banking sector is one sector which was successful in preventing the recession effect. Giving more importance to Banking sector will be good enough to explain the effect on Indian economy.