Vol. 2 No. 3 June 2014 ISSN : 2319-961X

GLOBAL FINANCIAL CRISIS AND INDIAN ECONOMY

R. Ullamudaiyar
Ph.D scholar, Department of Economics,
Saraswathi Narayanan College (Autonomous), Madurai-625022.

Dr. P. Bala Subramanian
Associate professor, Department of Economics,
Saraswathi Narayanan College (Autonomous), Madurai-625022.

Abstract

All over the world banks are closing down, industries are shutting down, millions are losing jobs. An allpevading anxiety, frustration is enveloping. It all exploded one day like this. 'Lehmann Brothers files for bankruptcy' – these headlines splashed across the front pages have 'shocked and awed' the people all over the globe, no doubt. But the unprecedented ferocity and impact of this financial turmoil is only being felt now. Lehmann Brothers-4th Largest investment bank in the US With an enviable history of 158 years had survived the Great Depression of 1930s. It had even declared a profit of Rs.2400 crores for the first quarter of 2007. Despite the terrible prospect of bankruptcy starting in the eye, Lehmann had handed out plush jobs with annual package ranging from Rs.70 lakhs to Rs.1 crore to some of the pass-outs from IIM, Bangalore. Now, while these graduates are left high and dry, their senior alumni with 'prestigious' jobs at Lehmann have started packing to fly towards safer pastures-backhome!

The meltdown in the US financial markets, beginning with the sub-prime crisis and rapidly accelerating to affect an ever-wider circle of major institutions, began with the bankruptcy of Lehman Brothers, the below-par sale of Merrill Lynch and a US government bailout of American International Group (AIG), the world's biggest insurer. Two other giant investment bankers Morgan Stanley and Goldman Sachs-had to be allowed to change their status to bank holding companies so as to bring them under supervision of the banking regulatory bodies.

***Keywords**: American International Group, financial turmoil, Great Depression, Global Financial Crisis, Credit default swaps, sensex*

Introduction

All over the world banks are closing down, industries are shutting down, millions are losing jobs. An allpevading anxiety, frustration is enveloping. It all exploded one day like this. 'Lehmann Brothers files for bankruptcy' – these headlines splashed across the front pages have 'shocked and awed' the people all over the globe, no doubt. But the unprecedented ferocity and impact of this financial turmoil is only being felt now. Lehmann Brothers-4th Largest investment bank in the US With an enviable history of 158 years had survived the Great Depression of 1930s. It had even declared a profit of Rs.2400 crores for the first quarter of 2007. Despite the terrible prospect of bankruptcy starting in the eye, Lehmann had handed out plush jobs with annual package ranging from Rs.70 lakhs to Rs.1 crore to some of the pass-outs from IIM, Bangalore. Now, while these graduates are left high and dry, their senior alumni with 'prestigious' jobs at Lehmann have started packing to fly towards safer pastures-backhome!

The meltdown in the US financial markets, beginning with the sub-prime crisis and rapidly accelerating to affect an ever-wider circle of major institutions, began with the bankruptcy of Lehman Brothers, the below-par sale of Merrill Lynch and a US government bailout of American International Group (AIG), the world's biggest insurer. Two other giant investment bankers Morgan Stanley and Goldman Sachs-had to be allowed to change their status to bank holding companies so as to bring them under supervision of the banking regulatory bodies.

Nature and causes of Global Financial Crisis

The origin of current crisis traced back to mid 2007 when three things became clear. One, low income or sub prime US households had borrowed heavily from banks and finance companies to buy houses were defaulting heavily on their debt obligations. Two, the size of this sub prime housing loan market was huge at about $ 1.4 trillion. Three, wall streets financial engineers had packaged threes loans to really complicated financial instruments called collateralized Debt Obligation-CDO. The main reasons for the present financial crisis are,

- Boom and burst in the housing market
- Speculation
- High risk mortgage loans lending / borrowing practices.
- Inaccurate credit ratings.
- Government policies.
- Polices of central bank.
- Financial institution dept level and incentives.
- Credit default swaps.

Global Financial Crisis and India

Even as the first signs of Economic collapse started showing in America, Our Prime Minister Dr.Manmohan Singh, previous minister Chidambaram, Planning Commission Chariman Montek Singh Ahluwaliah have consistently assured Indians that 'The fundamentals of Indian Economy are quiet strong and there is absolutely no reason for panic'! it is unlikely they did not know the simple truth that in the globalised world most national economies will collapse with America's down fall. True to the proverb 'when it thunders the their becomes honest', they have finally accepted that 'India is in recession and the situation will become grave in the coming days'.

Indian economy has been hurt by the global financial crisis like;

i. Reduction in capital flow
ii. Slowdown in the sectoral growth
iii. Drying up of liquidity
iv. Adverse effect on our export of goods and services
v. Decline in the internal accruals of the corporate.

The intensity of recession of India is felt every passing hour with ever increasing incidents of job losses, closing down of industries, salary cuts etc. The share market has collapsed by 30 lakh crores since November 2007. Share market 'sensex' that once rose to 21,000 points has today nose-dived to 8,500 points. First 10 top giant industries incurred a loss of Rs.30,000 crores in a week's span between November 17-23, 2008. Around Rs.45,000 crores has been withdrawn in 2008 alone by the Foreign Institutional Investors causing scarcity of dollars, which the turn has devalued Rupee, the result Indian Rupee has an exchange value of Rs.50/- or more against a dollar!

Exposure of Banks

So far the RBI has claimed that the exposure of Indian Banks to assets impaired by the financial crisis is small. According to reports, the RBI had estimated that as a result of exposure to collateralized debt obligations and credit default swaps, the combines mark-to-market losses of Indian banks at the end of July was around $450 million .

Given the aggressive strategies adopted by the private sector banks, the MTM losses incurred by public sector banks were estimated at $90 million, while that for private banks was around $360 million. As yet these losses are on paper, but the RBI believes that even if they are to be provided for, these banks are well capitalized and can easily take the hit.

Such assurances have neither reduced fears of those exposed to these banks or to investors holding shares in these banks.

These fears are compounded by those of the minority in metropolitan areas dealing with foreign banks that have expanded their presence in India, whose global exposure to toxic assets must be substantial. What is disconcerting is the limited information available on the risks to which depositors and investors are subject. Only time will tell how significant this factor will be in making India vulnerable to the global crisis.

A Third indirect fallout of the global crisis and its ripples in India is in the form of the losses. A third indirect fallout of the global crisis and its ripples in India is in the form of the losses sustained by non-bank financial institutions (especially mutual funds) and corporates, as a result of their exposure to domestic stock and currency markets.

Such losses are expected to be large, as signaled by the decision of the RBI to allow banks to provide loans to mutual funds against certificates of deposit (CDs) or buyback their own CDs before maturity. These losses are bound to render some institutions fragile, with implications that would become clear only in the coming months.

Exposure of Industries

The commodity market in stagnant, and production is on a downfall in spite of these measures industry after industry is laying off workers. ASSOCHAM – All India Association of Industry and Commerce has estimated that job losses will be 25% to 30% in Iron, Cement, Construction, Real Estate, aviation, IT, BPO and Finance sectors across India. Export based industries are paralysed. 60% of the IT, BPO sector dependent on America is in danger. Wipro, Satyam and other IT companies are sending home thousand of employees. Abound 35% jobs area likely to be cut in BPO companies. The Garment Industry has terminated 7 lakh employees. Sale of truck has gone down by 35%. 10 lakh jobs and 3,500 units have vanished in textile sector. One of the biggest non-banking finance corporations Bajaj Capital is at its wits end because there are no customers to take loans since tow weeks. The Mining Industry particularly that of Bellary is rusting. Around 20 mines have stalled work. The rest of them are working at half their capacities. While China that was importing 88% of the county's iron ore has fallen by 54% in India.

Harbours have become of tons of iron ore in Haldia and Mamagao, sea food in Cochin, industrial goods in Kandla and Mundra, and vehicle spare parts in Chennai are rotting. The manufacturing Units of Ludhiana (Ready made Garments) and Tirpur (manufacture of hosieries) are gathering dust. In the next three months 10 lakh people in construction, 10 lakh in mining industry, 5 lakh more in textile industry, and 4.5 lakh in hotel industry are likely to lose jobs. 83% of the job aspirants who will enter the job market next year will not find placements. Job cuts by 51% are likely in electricity sector. The statistics of percentage of youngsters who are appointed and who will not be employed in various sectors are as follows – 78% in retail market, 78% in transport sector, 66% in drugs and chemicals, 51% in machine manufacture sector. Tourism industry is already preparing for a 10% slump. 'Unpaid Holiday' (No job and No Pay for some period of time) is becoming a popular jargon for implementation in may important industries. 11 Public Banks and 14 commercial banks do not have the adequate Capital Adequacy Ratio-CAR (The average amount stipulated by RBI to be kept with the banks to pa back the depositors amount)!

Economic Impact due to Global Financial Crisis

Peenya industrial Estate (Asia's biggest industrial area) in Bangalore, with around 5000 small scale industries units are closing down one after another due to lack of work orders since 3 months. The dark clouds of unemployment are hovering over 5 lakh workers depending on these industries. Credit card applications of Aviation, Finance and real estate employees are ruthlessly rejected by the Banks. The Banks now claim that these employees do not have loan repayment capacity. Karnataka State Government's exchequer also affected by recession. Collection of taxes (Commercial tax, stamp duty, transport tax) this year has fallen by 7%. It amounts to a loss of Rs.5000 crores to the exchequer. The already scanty social welfare measures will be further affected.

Mr.K.V.Kamath, Chief of Confederation of Indian Industries-CII-the chief representative of Indian Industries has accepted that 6.3 lakh crores of mutual fund and non-banking finances are in peril. When the government owned UTI mutual fund was in crisis during 2001, the government pumped thousands of crores of Rupees to save it. Now, it transactions of such huge dimensions involving 80 mutual funds are in danger, one can surely guess the gravity of the scary situation.

A whopping 1 lakh crore is invested into real estate in India by banks and mutual funds. But, lakhs of flats, apartments and houses in various cities including Bangalore have no takers. The result-Banks are worried about the impending danger of default by the developers. Meanwhile, a big developer has already defaulted on a loan of Rs.200 crores! Hence, banks have taken initiative in impressing the builders to reduce the costs of houses. Still the flats have no takers because of pauperized pocket of the people. Every other sector is pauperized be it agriculture, cement, steel, petroleum, power and coal.

Wisdom lately dawned on the Prime Minister Manmohan Singh, previous Finance Minister Chidambaram and Commerce Minister Kamal Noth who are crying hoarse' reduce the prices, create the demand'. These cries are unfortunately falling on the deaf ears of the capitalists. Answer is simple. As is reflected in the main article, the capitalist system stands on the foundation of maximum profit. The capitalists will never produce to meet the needs of the society. Is it not a rather futile expectation that the capitalists should reduce costs, because they survive on the principle of maximization of profits. They will willingly destroy the produce but they will never part with it for the deserving, poor and needy. If 10 crore tons of coffee was destroyed in Brazil, a mountain load of wheat was thrown into the sea in America.

Inflation and Financial Crisis

People are at loss in understanding the government's language on inflation. Government is declaring that inflation has fallen. But, the price of sona masuri that was Rs.18 a few months ago in now Rs.30 a kilo. The prices of all basic commodities have gone up. Even as the pries of crude oil have fallen from 140 dollars to 50-60 dollars, none of the government owned oil companies have reduced the price of petrol, diesel and LPG substantially. Silence is the answer to the just question on why prices cannot be reduced commensurately.

A few pro-capitalist economists say that 'Inflation is an outcome of the accumulated riches with people' because by definition inflation is a condition when there is more money in circulation in comparison to the goods available in the market. This is the height of 'logic'. The reasons for inflation are different. Firstly, a huge accumulation black money. (The estimated amount of black money that is in the direct knowledge of government.) The estimated amount of black money in India is about 20% of the total national wealth (Rs.43 lakh crores). Second, since there was huge inflow of foreign currency into share market, RBI has proportionately printed and circulated Indian Currency., Third, Indian Rupees has been released into the share market for purchasing dollars. This has in turn increased its percentage in foreign exchange reserves. Fourth, government has on many occasions printed more notes to meet the deficit budget. Fifth, even with the government having proof that basic commodities are stock piled by the black marketers to artificially increase their price; it has turned a blind eye to the problem.

Conclusion

Thus economic recession due to fall in production and inflation due to price rise have thoroughly drained people. The capitalist system at present is tottering on its lat legs. The reasons for the present crisis are substantiated by the above facts. According to a report in time of India, not even 25% of the total agricultural produce reaches the common man because of administrative corruption.

In states like Maharashtra and West Bengal the direct links between black market and government is thoroughly exposed. Today it is impossible for any political party serving either the oppressive national or international capitalists to remain pro-people. As a correct alternative a strong united people’s movement should grow.

References

1. Mohan, Rakesh. "Global financial crisis and key risks: impact on India and Asia." RBI Bulletin (2008): 2003-2022.
2. Bajpai, Nirupam. "Global financial crisis, its impact on India and the policy response." (2011).
3. Reddy, Y. Venugopal. Global crisis, recession and uneven recovery. New Delhi: Orient Blackswan, 2011.
4. Kumar, Rajiv, and Pankaj Vashisht. "The global economic crisis: Impact on India and policy responses." (2009).
5. Ghosh, Jayati, and C. P. Chandrasekhar. "The costs of ‘coupling’: the global crisis and the Indian economy." Cambridge journal of economics 33.4 (2009): 725-739.