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GLOBAL RECESSION AND INDIAN ECONOMY

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I.INTRODUCTION

According to National Bureau of Economic Research (NEBR) the recession in United States begins from December, 2007 and much greater intensity since September 2008. The industrialized world has been undergoing a recession, a pronounced deceleration of economic activity. This global recession has been taking place in an economic environment characterized by various imbalances and was sparked by the outbreak of the financial crisis of 2007–2009. Although the late-2000s recession has at times been referred to as "the Great Recession," this same phrase has been used to refer to every recession of the several preceding decades.

A global recession has resulted in a sharp drop in international trade, rising unemployment and slumping commodity prices. In December 2008, the National Bureau of Economic Research (NBER) declared that the United States had been in recession since December 2007Several economists have predicted that recovery may not appear until 2011 and that the recession will be the worst since the Great Depression of the 1930s. The conditions leading up to the crisis, characterised by an exorbitant rise in asset prices and associated boom in economic demand, are considered a result of the extended period of easily available credit, inadequate regulation and oversight, or increasing inequality.

II.CONCEPTULIZATION

In a 1975, the economic statistician Julius Shiskin suggested several rules of thumb for identifying recession, one of which was 'two down quarters of Gross Domestic Product' (GDP). In time the other rules of thumb were forgotten and a recession is now often defined simply as a period when GDP falls (negative real economic growth) for at least two quarters. Some economist prefers a definition of a 1.5% rise in unemployment within 12 months. In the United States the Business cycle Dating Committee of the National Bureau of Economic Research (NBER) is generally seen as the authority for dating US recessions. The NBER defines as economic recession as, 'a significant decline in the economy activity spread across the country, listing more than a few months, normally visible in real GDP growth, real personal income, employment, industrial production and wholesale-retail sales'. Almost universally, academics, economists, policy makers and businesses defer to the determination by the NBER for the precise dating of a recession's onset and end.

A global recession is a period of global economic slowdown. The International Monetory Fund (IMF) takes many factors into account when defining a global recession, but it states that global economic growth of 3% or less is equivalent to global recession. By this measure, three periods since 1985 qualify: 1990-1993, 1998 and 2001-2002. informally, a national recession is a period of declining productivity. In a 1974 New York Times article, Julius Shiskin suggested several rules of thumb to identify a recession, which included two successive quarterly declines in Gross Domestic Product (GDP), a measure of the nation's output. This two-quarter metric is now a commonly held definition of a recession. In the United States the NBER is regarded as the authority which identifies a recession and which takes into account several measures in addition to GDP growth before making an assessment. In many developed nations other than USA, the two-quarter rule is also used for identifying a recession.

III.PRE-RECESSION ECONOMIC IMBALANCE

The onset of the economic crisis took most people by surprise. Many of the economists and commentators predicted a recession based on the collapse of the then booming housing market in the U.S. in between 2000 and 2006.Among the various imbalances in which the US monetary policy contributed by excessive money creation, leading to negative household savings and a huge US trade deficit, dollar volatility and public deficits, a focus can be made on Commodity boom, Housing bubble and inflation.

I. Commodity boom:

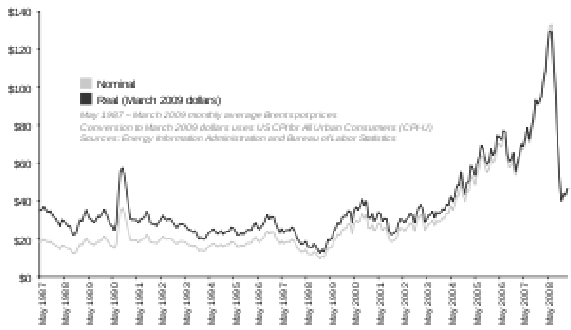

Fig.1.Brent barrel petroleum spot prices, May 1987 – March 2009.

The decade of the 2000s saw a global explosion in prices, focused especially in commodities and housing, marking an end to the commodities recession of 1980-2000. In 2008, the prices of many commodities, notably oil and food, rose so high as to cause genuine economic damage, threatening stagflation and a reversal of globalization.

In January 2008, oil prices surpassed $100 a barrel for the first time, the first of many price milestones to be passed in the course of the year. In July 2008, oil peaked at $147.30 a barrel and a gallon of gasoline was more than $4 across most of the U.S.A. These high prices caused a dramatic drop in demand and prices fell below $35 a barrel at the end of 2008. Some believe that this oil price spike was the product of Peak Oil. There is concern that if the economy was to improve, oil prices might return to pre-recession levels. The food and fuel crises were both discussed at the 34th G8 summit in July 2008.

In the second half of 2008, the prices of most commodities fell dramatically on expectations of diminished demand in a world recession.

ii. Housing b

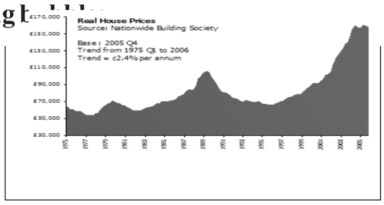

Fig.2.UK house prices between 1975 and 2006.

By 2007, real estate bubbles were still under way in many parts of the world, especially in the United States, United Kingdom, United Arab Emirates, Italy, Australia, New Zealand, Ireland, Spain, France, Poland, South Africa, Israel, Greece, Bulgaria, Croatia, Canada, Norway, Singapore, South Korea, Sweden, Finland, Argentina, Baltic states, India, Romania, Russia, Ukraine and China. U.S. Federal Reserve Chairman Alan Greenspan said in mid-2005 that "at a minimum, there's a little 'froth' (in the U.S. housing market) … it's hard not to see that there are a lot of local bubbles" The Economist magazine, writing at the same time, went further, saying "the worldwide rise in house prices is the biggest bubble in history". Real estate bubbles are (by definition of the word "bubble") followed by a price decrease (also known as a housing price crash) that can result in many owners holding negative equity (a mortgage debt higher than the current value of the property).

iii. Inflation

In February 2008, Reuters reported that global inflation was at historic levels, and that domestic inflation was at 10-20 year highs for many nations."Excess money supply around the globe, monetary easing by the Fed to tame financial crisis, growth surge supported by easy monetary policy in Asia, speculation in commodities, agricultural failure, rising cost of imports from China and rising demand of food and commodities in the fast growing emerging markets," have been named as possible reasons for the inflation.

In mid-2007, IMF data indicated that inflation was highest in the oil-exporting countries, largely due to the unsterilized growth of foreign exchange reserves, the term "unsterilized" referring to a lack of monetary policy operations that could offset such a foreign exchange intervention in order to maintain a country's monetary policy target. However, inflation was also growing in countries classified by the IMF as "non-oil-exporting LDCs" (Least Developed Countries) and "Developing Asia", on account of the rise in oil and food prices. Inflation was also increasing in the developed countries, but remained low compared to the developing world.

I.CAUSES OF DEPRESSION

i. Subprime lending as a cause

Based on the assumption that subprime lending precipitated the crisis, some have argued that the Clinton Administration may be partially to blame, while others have pointed to the passage of the Gramm-Leach-Bliley Act by the 106th Congress, and over-leveraging by banks and investors eager to achieve high returns on capital.

Some believe the roots of the crisis can be traced directly to subprime lending by Fannie Mae and Freddie Mac, which are government sponsored entities. The New York Times published an article that reported the Clinton Administration pushed for subprime lending: "Fannie Mae, the nation's biggest underwriter of home mortgages, has been under increasing pressure from the Clinton Administration to expand mortgage loans among low and moderate income people" (NYT, 30 September 1999).

ii. Government activities as a cause

In 1992, the 102nd Congress under the George H. W. Bush administration weakened regulation of Fannie Mae and Freddie Mac with the goal of making available more money for the issuance of home loans. The Washington Post wrote: "Congress also wanted to free up money for Fannie Mae and Freddie Mac to buy mortgage loans and specified that the pair would be required to keep a much smaller share of their funds on hand than other financial institutions. Whereas banks that held \$100 could spend \$90 buying mortgage loans, Fannie Mae and Freddie Mac could spend \$97.50 buying loans. Finally, Congress ordered that the companies be required to keep more capital as a cushion against losses if they invested in riskier securities. But the rule was never set during the Clinton administration, which came to office that winter, and was only put in place nine years later."

Others have pointed to deregulation efforts as contributing to the collapse. In 1999, the 106th Congress passed the Gramm-Leach-Bliley Act, which repealed part of the Glass-Steagall Act of 1933. This repeal has been criticized by some for having contributed to the proliferation of the complex and opaque financial instruments which are at the heart of the crisis. However, some economists object to singling out the repeal of Glass-Steagall for criticism. Brad DeLong, a former advisor to President Clinton and economist at the University of California, Berkeley and Tyler Cowen of George Mason University have both argued that the Gramm-Leach-Bliley Act softened the impact of the crisis by allowing for mergers and acquisitions of collapsing banks as the crisis unfolded in late 2008.

iii. Credit creation as a cause

The Austrian School of Economics proposes that the crisis is an excellent example of the Austrian Business Cycle Theory, in which credit created through the policies of central banking gives rise to an artificial boom, which is inevitably followed by a bust. This perspective argues that the monetary policy of central banks creates excessive quantities of cheap credit by setting interest rates below where they would be set by a free market. This easy availability of credit inspires a bundle of malinvestments, particularly on long term projects such as housing and capital assets, and also spurs a consumption boom as incentives to save are diminished. Thus an unsustainable boom arises, characterized by malinvestments and overconsumption.

But the created credit is not backed by any real savings nor is in response to any change in the real economy, hence, there are physically not enough resources to finance either the malinvestments or the consumption rate indefinitely. The bust occurs when investors collectively realize their mistake. This happens usually some time after interest rates rise again. The liquidation of the malinvestments and the consequent reduction in consumption throw the economy into a recession, whose severity mirrors the scale of the boom's excesses.

The Austrian School argues that the conditions previous to the crisis of the late 2000s correspond exactly to the scenario described above. The central bank of the United States, led by Federal Reserve Chairman Alan Greenspan, kept interest rates very low for a long period of time to blunt the recession of the early 2000s. The resulting malinvestment and overconsumption of investors and consumers prompted the development of a housing bubble that ultimately burst, precipitating the financial crisis. This crisis, together with sudden and necessary deleveraging and cutbacks by consumers, businesses and banks, led to the recession. Austrian Economists argue further that while they probably affected the nature and severity of the crisis, factors such as a lack of regulation, the Community Reinvestment Act, and entities such as Fannie Mae and Freddie Mac are insufficient by themselves to explain it.

Austrian economists argue that the history of the yield curve from 2000 through 2007 illustrates the role that credit creation by the Federal Reserve may have played in the on-set of the financial crisis in 2007 and 2008. The yield curve (also known as the term structure of interest rates) is the shape formed by a graph showing US Treasury Bill or Bond interest rates on the vertical axis and time to maturity on the horizontal axis. When short-term interest rates are lower than long-term interest rates the yield curve is said to be "positively sloped". When short-term interest rates are higher than long-term interest rates the yield curve is said to be "inverted". When long term and short term interest rates are equal the yield curve is said to be "flat". The yield curve is believed by some to be a strong predictor of recession (when inverted) and inflation (when positively sloped). However, the yield curve is believed to act on the real economy with a lag of 1 to 3 years.

A positively sloped yield curve allows Primary Dealers (such as large investment banks) in the Federal Reserve system to fund themselves with cheap short term money while lending out at higher long-term rates. This strategy is profitable so long as the yield curve remains positively sloped. However, it creates a liquidity risk if the yield curve were to become inverted and banks would have to refund themselves at expensive short term rates while losing money on longer term loans.

The narrowing of the yield curve from 2004 and the inversion of the yield curve during 2007 resulted (with the expected 1 to 3 year delay) in a bursting of the housing bubble and a wild gyration of commodities prices as moneys flowed out of assets like housing or stocks and sought safe haven in commodities. The price of oil rose to over $140 dollars per barrel in 2008 before plunging as the financial crisis began to take hold in late 2008.

iv. Oil prices

Economist James D. Hamilton has argued that the increase in oil prices in the period of 2007 through 2008 was a significant cause of the recession. He evaluated several different approaches to estimating the impact of oil price shocks on the economy, including some methods that had previously shown a decline in the relationship between oil price shocks and the overall economy. All of these methods "support a common conclusion; had there been no increase in oil prices between 2007:Q3 and 2008:Q2, the US economy would not have been in a recession over the period 2007:Q4 through 2008:Q3." Hamilton's own model, a time-series econometric forecast based on data up to 2003, showed that the decline in GDP could have been successfully predicted to almost its full extent given knowledge of the price of oil. The results imply that oil prices were entirely responsible for the recession; however, Hamilton himself acknowledged that this was probably not the case but maintained that it showed that oil price increases made a significant contribution to the downturn in economic growth.

I.EFFECTS

The late-2000s recession is shaping up to be the worst post-war contraction on record :

Real gross domestic product (GDP) began contracting in the third quarter of 2008, and by early 2009 was falling at an annualized pace not seen since the 1950s. Capital investment, which was in decline

·year-on-year since the final quarter of 2006, matched the 1957-58 post war record in the first quarter of 2009. The pace of collapse in residential investment picked up speed in the first quarter of 2009, dropping 23.2% year-on-year, nearly four percentage points faster than in the previous quarter.

·Domestic demand, in decline for five straight quarters, is still three months shy of the 1974-75 record, but the pace – down 2.6% per quarter vs. 1.9% in the earlier period – is a record-breaker already.

i. Trade and industrial production

In middle-October 2008, the Baltic Dry Index, a measure of shipping volume, fell by 50% in one week, as the credit crunch made it difficult for exporters to obtain letters of credit. In February 2009, The Economist claimed that the financial crisis had produced a "manufacturing crisis", with the strongest declines in industrial production occurring in export-based economies. In March 2009, Britain's Daily Telegraph reported the following declines in industrial output, from January 2008 to January 2009: Japan -31%, Korea -26%, Russia -16%, Brazil -15%, Italy -14%, Germany -12%.

Sovereign funds and private buyers from the Middle East and Asia, including China, are increasingly buying in on stakes of European and U.S. businesses, including industrial enterprises. Due to the global recession they are available at a low price. The Chinese government has concentrated on natural-resource deals across the world, securing supplies of oil and minerals.

ii. Pollution

According to the International Energy Agency man-made greenhouse gas emissions will decrease by 3% in 2009, mainly as a result of the financial crisis. Previously emissions had been rising by around 3% per year. The drop in emissions is only the 4th to occur in 50 years.

iii. Unemployment

The International Labour Organization (ILO) predicted that at least 20 million jobs will have been lost by the end of 2009 due to the crisis — mostly in "construction, real estate, financial services, and the auto sector" — bringing world unemployment above 200 million for the first time. The number of unemployed people worldwide could increase by more than 50 million in 2009 as the global recession intensifies, the ILO has forecast.

In December 2007, the U.S. unemployment rate was 4.9%. By October 2009, the unemployment rate had risen to 10.2%.A broader measure of unemployment (taking into account marginally attached workers, those employed part time for economic reasons, and discouraged workers) was 16.3%.Spain's unemployment rate reached 18.7% (37% for youths) in May 2009 — the highest in the eurozone. In July 2009, fewer jobs were lost than expected, dipping the unemployment rate from 9.5% to 9.4%. Even fewer jobs were lost in August, 216,000, recorded as the lowest number of jobs since September 2008, but the unemployment rate rose to 9.7%. In October 2009, news reports announced that some employers who cut jobs due to the recession are beginning to hire them back.

The rise of advanced economies in Brazil, India, and China increased the total global labor pool dramatically. Recent improvements in communication and education in these countries has allowed workers in these countries to compete more closely with workers in traditionally strong economies, such as the United States. This huge surge in labor supply has provided downward pressure on wages and contributed to unemployment.

v. Recession Entrepreneurs

The term Recession Entrepreneurs was coined by JJ Ink in 2009, after they found that most of their marketing consulting clients were recession made entrepreneurs, those that had been laid off due to the economic downturn and had thus decided to use their savings and unemployment benefits to start their own business. The recession has allowed many Recession Entrepreneurs to completely change course in their careers and pursue their dream jobs. Recessions are historically ripe with opportunity for innovation, allowing a unique opportunity for entrepreneurs. "The recession has also injected life into a slew of small businesses that are thriving either in spite of or because of the economic downturn, giving new relevance to the old adage that one man's misfortune is another's opportunity."

vi. Financial markets

For a time, major economies of the 21st century were believed to have begun a period of decreased volatility, which was sometimes dubbed The Great Moderation, because many economic variables appeared to have achieved relative stability. The return of commodity, stock market, and currency value volatility are regarded as indications that the concepts behind the Great Moderation were guided by false beliefs.

The effects of these events were also felt on the Shanghai Composite Index in China which lost 5.14 percent, most of this on financial stocks such as Ping An Insurance and China Life which lost 10 and 8.76 percent respectively. Investors worried about the effect of a recession in the US economy would have on the Chinese economy. Citigroup estimates due to the number of exports from China to America a one percent drop in US economic growth would lead to a 1.3 percent drop in China's growth rate.

vii. Travel

According to Zagat's 2009 U.S. Hotels, Resorts & Spas survey, business travel has decreased in the past year as a result of the recession. 30% of travelers surveyed stated they travel less for business today while only 21% of travelers stated that they travel more. Reasons for the decline in business travel include company travel policy changes, personal economics, economic uncertainty and high airline prices. Hotels are responding to the downturn by dropping rates, ramping up promotions and negotiating deals for both business travelers and tourists.

viii. Insurance

A February 2009 study on the main British insurers showed that most of them do not plan to raise their insurance premiums for the year 2009, in spite of the prediction of a 20% raise made by The Daily Telegraph and The Daily Mirror. However, it is expected that the capital liquidity will become an issue and determine increases, having their capital tied up in investments yielding smaller dividends, corroborated with the £644 million underwriting losses suffered in 2007.

I.POLICY RESPONSES

The financial phase of the crisis led to emergency interventions in many national financial systems. As the crisis developed into genuine recession in many major economies, economic stimulus meant to revive economic growth became the most common policy tool. After having implemented rescue plans for the banking system, major developed and emerging countries announced plans to relieve their economies. In particular, economic stimulus plans were announced in China, the United States, and the European Union. Bailouts of failing or threatened businesses were carried out or discussed in the USA, the EU, and India. In the final quarter of 2008, the financial crisis saw the G-20 group of major economies assume a new significance as a focus of economic and financial crisis management.

i. United States policy responses

The Federal Reserve, Treasury, and Securities and Exchange Commission took several steps on September 19 to intervene in the crisis. To stop the potential run on money market mutual funds, the Treasury also announced on September 19 a new $50 billion program to insure the investments, similar to the Federal Deposit Insurance Corporation (FDIC) program. Part of the announcements included temporary exceptions to section 23A and 23B (Regulation W), allowing financial groups to more easily share funds within their group. The exceptions would expire on January 30, 2009, unless extended by the Federal Reserve Board. The Securities and Exchange Commission announced termination of short-selling of 799 financial stocks, as well as action against naked short selling, as part of its reaction to the mortgage crisis.

ii. Asia-Pacific policy responses

On September 15, 2008 China cut its interest rate for the first time since 2002. Indonesia reduced its overnight repo rate, at which commercial banks can borrow overnight funds from the central bank, by two percentage points to 10.25 percent. The Reserve Bank of Australia injected nearly $1.5 billion into the banking system, nearly three times as much as the market's estimated requirement. The Reserve Bank of India added almost $1.32 billion, through a refinance operation, its biggest in at least a month.

China's export driven economy is starting to feel the impact of the economic slowdown in the United States and Europe, and the government has already cut key interest rates three times in less than two months in a bid to spur economic expansion. On November 28, 2008, the Ministry of Finance of the People's Republic of China and the State Administration of Taxation jointly announced a rise in export tax rebate rates on some labor-intensive goods. These additional tax rebates will take place on December 1, 2008.

The stimulus package was welcomed by world leaders and analysts as larger than expected and a sign that by boosting its own economy, China is helping to stabilize the global economy. News of the announcement of the stimulus package sent markets up across the world. However, Marc Faber January 16 said that China according to him was in recession.

In developing and emerging economies, responses to the global crisis mainly consisted in low-rates monetary policy (Asia and the Middle East mainly) coupled with the depreciation of the currency against the dollar. There were also stimulus plans in some Asian countries, in the Middle East and in Argentina. In Asia, plans generally amounted to 1 to 3% of GDP, with the notable exception of China, which announced a plan accounting for 16% of GDP (6% of GDP per year).

iii. European policy responses

Until September 2008, European policy measures were limited to a small number of countries (Spain and Italy). In both countries, the measures were dedicated to households (tax rebates) reform of the taxation system to support specific sectors such as housing. From September, as the financial crisis began to seriously affect the economy, many countries announced specific measures: Germany, Spain, Italy, Netherlands, United Kingdom, Sweden. The European Central Bank injected $99.8 billion in a one-day money-market auction. The Bank of England pumped in $36 billion. Altogether, central banks throughout the world added more than $200 billion from the beginning of the week to September 17.

On 8 October 2008 the British Government announced a bank rescue package of around £500 billion ($850 billion at the time). The plan comprises three parts. First, £200 billion will be made available to the banks in the Bank of England's Special Liquidity scheme. Second, the Government will increase the banks' market capitalization, through the Bank Recapitalization Fund, with an initial £25 billion and another £25 billion to be provided if needed. Third, the Government will temporarily underwrite any eligible lending between British banks up to around £250 billion. In February 2009 Sir David Walker was appointed to lead a government inquiry into the corporate governance of banks.

In early December German Finance Minister Peer Steinbrück indicated that he does not believe in a "Great Rescue Plan" and indicated reluctance to spend more money addressing the crisis. In March 2009, The European Union Presidency confirms that the EU is strongly resisting the US pressure to increase European budget deficits.

iv. Global responses

Most political responses to the economic and financial crisis has been taken, as seen above, by individual nations. Some coordination took place at the European level, but the need to cooperate at the global level has led leaders to activate the G-20 major economies entity. A first summit dedicated to the crisis took place, at the Heads of state level in November 2008.

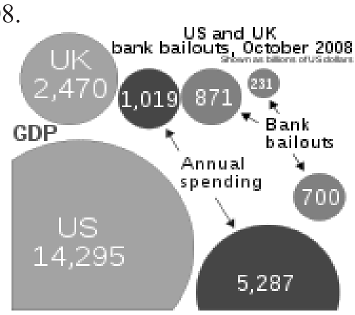

Fig.3. Responses by the UK and US in proportion to their GDPs

The G-20 countries met in a summit held on November 2008 in Washington to address the economic crisis. Apart from proposals on international financial regulation, they pledged to take measures to support their economy and to coordinate them, and refused any resort to protectionism.

Another G-20 summit was held in London on April 2009. Finance ministers and central banks leaders of the G-20 met in Horsham on March to prepare the summit, and pledged to restore global growth as soon as possible. They decided to coordinate their actions and to stimulate demand and employment. They also pledged to fight against all forms of protectionism and to maintain trade and foreign investments. They also committed to maintain the supply of credit by providing more liquidity and recapitalizing the banking system, and to implement rapidly the stimulus plans. As for central bankers, they pledged to maintain low-rates policies as long as necessary. Finally, the leaders decided to help emerging and developing countries, through a strengthening of the IMF.

I.CONCLUSION

There are four distinct characteristics of the Indian economy that soften the impact of today's conditions as demographics, regulation, exports, and the informal economy.

India's demographics are favorable to growth. It's a young country with low dependency ratios. Millions of Indians under the age of 30 are slowly receiving better access to healthcare and education, which enables younger Indians to drive the economy by virtue of middle class growth. They will become consumers, spend discretionary income, and enjoy the associated status. This growing middle class will continue to create large levels of domestic customer demand for goods and services.

The fall of Satyam may turn out to be a blessing in disguise for India. The scandal has intensified calls in the country for greater financial transparency, corporate governance, and shareholder activism. Furthermore, the swift and strong response by the country's regulatory agencies has provided global investors with a positive signal that the Indian government, while not perfect, is dead serious about smart financial regulations and accountability.

The Indian parliament is on the verge of passing a bill that would create hundreds of special economic zones around the coastal perimeter of the country. These zones provide the Indian government a vehicle with which to attract significant foreign direct investment from overseas and indigenous multinational corporations . The SEZs, while not without controversy, are attractive to global investors for their favorable land policies and generous tax incentives. In the global race for FDI, India's SEZs could afford it an unmatched competitive advantage among other emerging economies.

The country's vibrant informal economy, in which goods and services have been traded in the absence of official markets for hundreds of years, affords India's overall economy an invaluable -- and unique -- layer of protection. While traditional development and financial statistics estimate Indian market segments for the global business community, these analyses rarely capture the true weight of this economic activity, which by nature is difficult to approximate.

As the global recession affects its foreign direct investment inflows and exports, India's informal economy acts as a piece of elastic, connective tissue that picks up slack in the system and provides markets for goods and services that may not have been otherwise traded given the circumstances. The existence of this informal economy combined with an emerging middle class, a growing financial regulatory environment, and the creation of more SEZs makes India uniquely situated to survive the current economic storm, no matter if it is a roaring tiger or a slowly moving elephant.

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