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R. B. NARAYANRAO BORAWAKE COLLEGE

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ON

" ECONOMIC CRISIS AND INDIA'S MONETARY POLICY "

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Global Economic crisis and India

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I. INTRODUCTION : Economic crises and there spread are increasing with the increase in globalization. The origin may be different but the tremors are being felt in different parts of the world. The new economic policy of 1991 which is based on Liberalization, Privatization and Globalization (LPG), increased the rate of economic development in India. During post economic reforms Indian economy grew at the rate of 8 to 9 per cent. As a result, all macro economic indicators such as saving, investment export and import, foreign exchange reserve and level of employment increased in a considerable manner. The waves of global economic crisis are giving some trouble to India also but we do not see intensive atmosphere of recession in internal India.

Though it is true in some way but till Indian economy has received a great blow of economic crisis, and it restricted our fast run of development completely. The economic crisis that developed around 2006-07 in United States of America (USA) due to which economies all over the world are considered to be entering into prolonged slowdown in economic activities. The intensity of present economic crisis is so high that is being compared with global economic recession in 1873, great depression of 1930s and East Asian crisis of 1990s. The present economic slowdown is considered to be sub-prime mortgage crisis in the financial sector of the US. As a result, the sub prime lending crisis led to the collapse of booming US housing sector.

II. GLOBAL ECONOMIC CRISIS

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.

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 loans in 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.

III. IMPACT OF GLOBAL ECONOMIC CRISIS ON INDIAN ECONOMY

The Indian economy had performed well during the last two decades, resulting in high growth rate of real Gross Domestic Product (GDP), besides increase in domestic savings and increase in investment and productivity. Though the epicenter of the economic crisis was the US sub prime mortgage market, its agitations are being felt in financial markets all over the world. Though in the beginning Indian officials denied the impact of global economic crisis affecting the Indian economy but later the government had to acknowledge the fact that global crisis will have some impact on the Indian economy.

The US meltdown which shook the world had little impact on India, because of India's strong fundamental of the economy, well regulated banking system and less exposure of Indian financial sector with the global financial market. Perhaps this has saved Indian economy from being swayed over instantly. Unlike in US where capitalism rules exist, in India, market is closely controlled by the government. The meltdown in the U.S. has not created any credit crunch in Indian economy but the credit crunch in U.S. led to panic in India. After a long spell of growth Indian economy experiencing a downturn, faltering of industrial growth, double digit inflation, widening of current account deficit etc.

The global crisis affected the health of several sectors of Indian economy through distinct channels: financial markets, trade flows, export & inport and exchange rates.

Conclusions:

- India cannot escape unscathed present crisis because its economy has become mo integrated with rest of the world over the past two decades.
- More transparency is required in the process of setting bank rate, repo rate, reverse repo rate, CRR, SLR etc.
- To speed up the pace of economic development and to attract foreign direct investment in Indian economy, there is an urgent need to ensure the protection of investors, their lives and money through maintaining the proper law and order.

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