International Journal of Research (IJR) Vol-1, Issue-4, May 2014 **ISSN 2348-6848**

Impact of Global Meltdown on GDP, Growth and Foreign Trade of Indian Economy

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Abstract:

In the era of globalization financial crisis seems to have been occurring with greater frequency. The global financial crisis of 2008-2009 emerged in September 2008 with failure of several large United States based financial firms and stock market prices around the globe. But the financial crisis really started to show its effects in the middle of 2007 and into 2008. Around the world the stock markets have fallen. Large financial institutions have collapsed and also wealthiest nations have come under this wave of recession. Indian economy is also one of the victims of this great meltdown. With which our GDP and exports showing decreasing trend and many industries are bankrupted. An attempt was made to study the impact of meltdown on GDP growth and trade of India. *Simple regression was used to find out the dependence of GDP on exports in India. The result shows India's GDP and balance of trade showed decreasing trend during the period of global meltdown in 2007-08. Some analysts say that this is the first crisis in the modern financial markets where new products created by debt and asset securitization are traded globally.*

Key words: *Global meltdown, GDP, Exports.*

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Introduction:

The term financial meltdown is applied broadly to a variety of situations in which some financial institutions or assets suddenly lose a large part of their value other situations that are often called financial meltdown include stock market clashes, currency crisis and sovereign defaults. The initial clue of the problem came from the crumple of two Bear Stearns hedge means early 2007. Consequently a number of other banks and financial institutions also began to show signs of suffering. Matters actually came to the forefront with bankruptcy of Lehman Brothers, a big investment bank, in September 2008. When a bank suffers a sudden rush of withdrawals by depositors, it is known as bank-run which a common form of meltdown. Banking runs generally occur after periods of risky lending and heightened loan defaults. When a country that maintains fixed exchange rate system is suddenly forced to devalue its currency because of speculation it is known as currency crisis and when a country fails to pay back its debt, it is known as sovereign default. While devaluation and default could both be voluntary decisions of the government, they are often perceived to be involuntary results of a change in investor sentiment that leads to a certain stop in capital inflows or a sudden increase in capital flight.

Objectives:

- To study the impact of meltdown on GDP growth and trade of India.
- To investigate causes of global meltdown in India.

Hypothesis:

H_o : there is no significant relationship between GDP and exports.

H_a : there is significant relationship between GDP and exports.

Methodology:

The present research paper is based on secondary data. The main source of data and literature are books, articles, papers, government reports and journals. The descriptive and analytical methods of research have been used while doing this research paper. Various database sources from internet and many recognized newspapers have also been used. Also simple regression is employed for showing

the relationship between GDP and balance of foreign trade.

$$Y = \alpha + \beta x + \upsilon_i \quad \ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots \quad (1)$$

Main idea:

The effects of global meltdown crisis speeded all over the world. As noble prize winner for economics Joseph Stieglitz argued that this bailout package is again based on "trickle down economics". The Indian economy has shown also the effects of the meltdown. Though public sector in India, including national banks could somehow insulate the injurious effects of globalization we are also part of globalization strategy of neo-liberalization, there is limit of our ability to resist global recession, which may change into great depression.

Table 1.1

Trends in GDP at factor cost in Rs. Crore

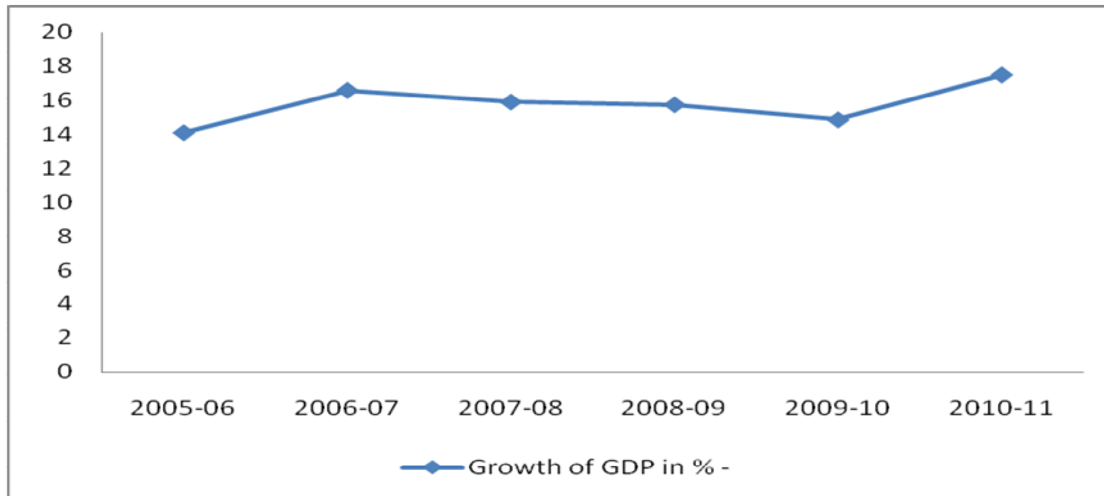
Year	GDP(in Crores of Rupees)	Growth of GDP in %	Exports in crores	Imports in crores	Balance of trade	Growth of exports in %	Growth of imports in%	Growth of balance of trade
2004-05	2971464	-	3753.40	5010.65	-1257.25	-	-	-
2005-06	3390503	14.10	4564.18	6604.09	-2039.91	21.60	31.80	62.25
2006-07	3953276	16.59	5717.79	8405.06	-2687.27	25.28	27.27	31.73
2007-08	4582086	15.90	6558.64	10123.12	-3564.48	14.71	20.44	32.64
2008-09	5303567	15.74	8407.55	13744.36	-5336.81	28.19	35.77	49.72
2009-10	6091485	14.85	8455.34	13637.36	-5182.02	0.57	-0.78	-2.90
2010-11	7157412	17.49	11429.22	16834.67	-5405.45	35.17	23.45	4.31

Source: CSO, India

After a long spell of growth, the Indian economy experience a down term. (**Table 1.1)** shows that in 2006-07 the GDP growth rate was 16.59% which became 15.90% in 2007-08, due to the impact of global financial crisis and global recession, the growth rate of Indian economy declined further 15.74% in 2008-09 which reaches 14.84% in 2009-10, but then it once again

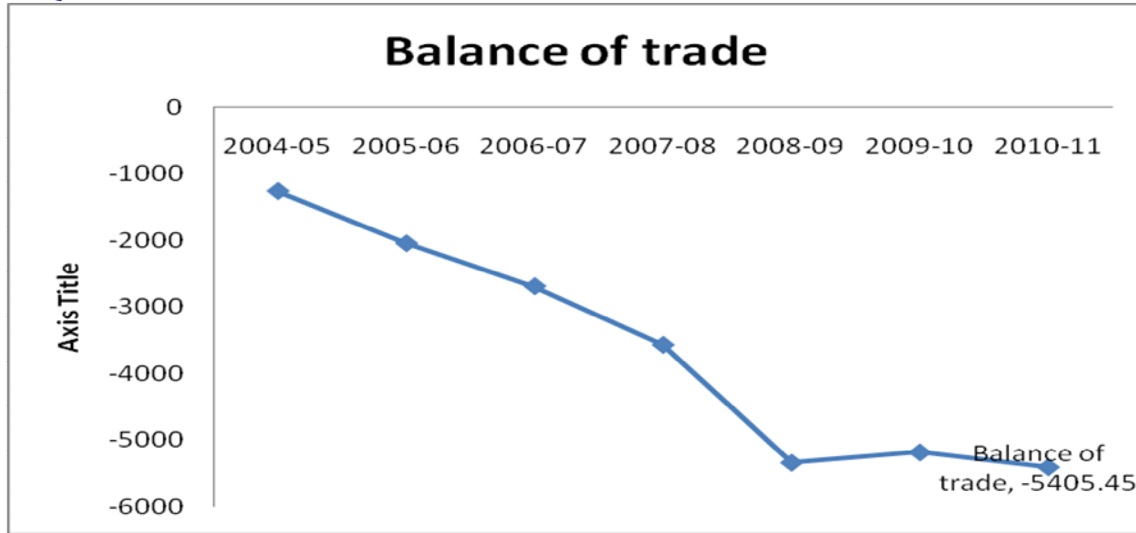
regained its pace, which shows graphically in **(fig 1.1)**.

Fig 1.1: GDP Growth Rate in India



On the other hand the exports and imports showing continuous fluctuation in the above **(table 1.1).** But in 2007-08 due to global meltdown it affects both exports and imports. As a result balance of trade continuously decreasing due to increasing growth of imports in 2006-07, exports was 25.28 and in 2007-08 it decline 14.71. It means that world global meltdown badly affects our balance of payment which declines from -273.03 to -5336.81 in 2000-01 to 2008-09 as shown in **(fig 1.2)**

Fig 1.2: Balance of Trade in India



OLS Model:

To find out the relationship between the dependent variable (GDP) and independent variable (Export), OLS regression model was employed.

OLS model is:

GDP = f (X)

$$Y = \alpha + \beta x + \upsilon_i \quad \ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots \text{(1)}$$

Y = GDP (gross domestic production)

X = exports

υ_i = error times

α, β = parameters

Table 1.2

Model Summary

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.987[a]	.975	.970	2.61409E5

a. Predictors: (Constant), VAR00003

Table 1.3

Coefficients[a]

Model		Unstandardized Coefficients		Standardized Coefficients	t	Sig.
		B	Std. Error	Beta		
1	(Constant)	860428.873	298434.365		2.883	.034
	VAR00003	561.034	40.323	.987	13.914	.000

a. Dependent Variable: VAR00001

It has been concluded from the above tables (**1.2 & 1.3**) that there is direct relation between GDP and exports in India. As the calculated ***"T"*** is greater than table value, so we reject the H_O null hypothesis, as the calculated ***"T"*** is statistically significant, so we accept H_1 alternative hypothesis and conclude that independent variable have direct impact on GDP in India. The variation in dependent variable is explained by independent variable (exports) about 98%. Therefore change in one unit in exports brings about 98% changes in GDP in India.

The main cause by which Indian economy is become the victim of melt down is, due to globalization. The origin of the meltdown is USA and India has much export market in USA that is one of the big reason of why India is come under the meltdown 2008. India's industrial sector had suffered from the depressed demand conditions in its export markets, as well as from suppressed domestic demand due to the slow generation of employment as per the index of industrial production (IIP) data released by central statically organization (CSO), the overall growth in April-Nov. 2008 was estimated at 3.9% compared to a growth of 9.2% in April-Nov 2007. The crash in the Sensex is not simply an indicator of the impact of the international contagion. There had been warning signals and signs of fragility in Indian finance for some time now and there are likely to be compounded by in real economy. The most important effect of that crisis on India had been an out flow of foreign institutional investment from the equity market. Foreign institutional investment (FIIs), which need to retrench assets in order to cover losses in there home

countries and we seeking havens of safety in an uncertain environment, had become major sellers in Indian markets. As FIIs pulled out there money from the stock markets, the large corporate was bound to be affected, the worst affected were to be the exports and small and marginal enterprises significantly to employment generation. We therefore come to conclusion that the saving factors for India were the strong macro-economic policies, including the fiscal and the external positions, which made it less vulnerable to global crisis, thereby preventing the financial contagion from seriously from disrupting banking and non-banking financial structure to avoid credit crunches. The most essential message that we must gain knowledge from the crisis is that we must be self-sufficient. All the way through World Trade Organization (WTO) propagates free trade; we must adopt protectionist procedures in certain sectors of the economy so that recession in any part of the globe does not influence our country.

Remedial Measures:

The backwash effects of the crisis spread to the all developing nations including India. Both the RBI and government responded to challenge in close coordination and consultation. The main plank of the government response was fiscal stimulus while RBI's action comprised monetary accommodation and cyclical regulatory measures. In the context of Present Crisis, the Policy of government was enunciated by the Finance Minister in his speech while presenting the interim Budget to Parliament on Feb.16 2009 for the year 2010. He stated,"The country is facing difficult economic situation, the cause of which is not emanating from within its boundaries. However, left unattended, the impact of this crisis is going to affect us in medium to long term. The government had two policy options. In view of falling buoyancy in tax receipts, the government could have taken a decision to cut expenditure and thereby live within the estimated deficit for the year. The second option was to increase public expenditure and government adopted second one. To get rid from this meltdown, Indian government announced two packages on Dec.07 2008 and Jan.02 2009, provided tax relief to boost demand and aimed at increasing rate of public expenditure on Public Projects to create employment and Public assets. In the context, the government renewed its efforts to increase infrastructure investments. In the period from Aug. 2008

to Jan. 2009, the government accorded approval for 37 Infrastructure Projects.

Conclusion:

As we know the meltdown of 2008 was a severe jolt to the world economy particularly financial institutions. From all the reasons that caused it, the present economic order which is capitalistic in nature is the main reason responsible for it. The world is not still stable. World economy has not revived from the Meltdown fully and even seeds of recession have not been removed. The world is still in danger of heavy recessions and unemployment is increased day by day. According to sources (Treading Economics.com), unemployment rate in USA is still chronic in nature and is 8.1%. The present system of exchange rate system has threatened the world stability and every country is viewing capital flight with suspicion. The order needs to be changed and measures need to be taken to enhance stability in modern world. Interest rate has always triggered the instability and many modern economists favor interest free banking. If steps are not taken, time will come when we will have to face yet another recession. The worlds most countries now follow managed float system to keep a vigil on financial institutions. Sound financial system means sound economy. That is why some economists argue that it is financial crisis that leads to recession. Growth with stability has been prime objective and we need an order that will ensure there things.

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