Global Economic Turbulence and India

The ongoing global economic turbulence, which, in a sense, is a continuation of the financial crisis that began in 2007, is threatening to become another major global recession. The grim situation has created panic in the developed world, so much so that London's *The Economist* has already predicted a double-dip global recession led by America. The turbulence, mainly triggered by the sovereign debt crises in many European countries followed by the unprecedented downgrading of the US sovereign long term credit rating by Standard & Poor, saw the world stock exchanges going into a tailspin. The sovereign credit crisis in the Eurozone has led to virtual insolvency of Greece, Ireland and Portugal. The crisis is now threatening Spain and Italy and is unlikely to stop there. Adding fuel to the fire, the turbulence has laid the seeds of a more fundamental crisis. As the burden of sovereign debt is passed on to the common people, their purchasing power correspondingly declines and combined with the growth of unemployment, leads to a sharp contraction in domestic demand. India's Finance Minister Pranab Mukherjee recently rightly warned the world community that if not managed with an iron hand, the crisis will have a contagion effect and indeed lead to a double-dip global recession.

This crisis has already drastically reduced global trade and slowed down the world economy, with Europe and the US growing just over 1%. In this background, the International Monetary Fund in its recent report has trimmed its economic growth forecasts for Asia to average 6.3% in 2011 from its earlier forecast of 7%. India remains no exception to this widening trend. The global economic turbulence has been one of the main reasons for Indian growth prospects being downgraded to below 8% this fiscal from 9% projected in the Budget 2011-2012. The World Bank has also recently said that India's growth was likely to slow to 7% to 8% in the next two years as a result of uncertainties weighing on investment, tighter macroeconomic policies intended to fight inflation and the base effect of the strong agricultural rebound last year.

If the world economy goes into a double-dip recession, it will have considerable negative impact on FDI inflows, flow of money into Indian bourses, and employment. The initial symptoms are already evident in the stock markets, where share values and wealth are eroding. FIIs have sold more than $2.2 billion worth of Indian shares between August and September this year.

Europe is one of India's largest trading partners. Austerity measures in European countries and falling consumer expenditure may affect Indian exports, especially in services. If European banks collapse due to exposure to countries such as Greece, Ireland and Portugal, the supply of foreign credit to emerging markets, including India, will dry up. That will put pressure on investment spending in emerging markets — already struggling with high capital costs due to tight monetary policies.

Early warning signs, such as low investor confidence and falling consumer demand across the board, signal a crisis at India's doorstep, which it cannot completely avoid. But India can considerably minimise the damage. And for that it is imperative that India looks inward and boost domestic demand to compensate for the shrinking world market. Huge domestic demand within India provides a buffer to global economic turbulence. In fact, India does have a significant control over its own destiny. Domestic consumption accounts for around 70% of its GDP. India can reinvigorate itself with domestic structural reform. The key is to spur business investment. However, a major problem is that India is sacrificing growth to fight inflation, with the Union Finance Minister hinting that India may continue to tighten monetary policy, in contrast to most other major emerging economies, to keep stubbornly-high inflation in check despite fears of a broader economic slowdown.

Every crisis offers opportunities as well. Indian policymakers need to maintain domestic demand and work towards gaining investors' confidence. The government must explore export markets like Africa and the ASEAN countries, and continue to reduce dependence on Europe and the US. Special tax incentives for exporters to Europe and the US may help them retain their competitiveness in these markets. Some of the pending reforms, whether they are FDI in retail, labour or financial and insurance sector reforms, need to be pushed ahead to maintain growth and investment. It is time to show that India is a safe haven for investment, and to do this, bold governance reforms are needed to improve the overall competitiveness of the Indian economy.

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