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RESEARCH PAPER

Global Impact of Recession and Its Effect on India and China

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ABSTRACT

In 2008 the international economy faced its most fearful crisis since the Great Depression of the 1930s. It all began in 2007, when exorbitantly high home prices in the United States went decisively downward, spread speedily, first to the entire U.S. financial sector and then to financial markets internationally. With none of the largest economies prospering, there was no evident engine to drag the world out of its recession, and both government and private economists predicted a slow recovery. Indian companies have major outsourcing deals from the America. India's exports to the America have also increased significantly over the years. The Indian economy was likely to lose between 1 to 2 percentage points in GDP growth in the coming fiscal year. In summary, at the large-level, a recession in the US may reduce GDP growth, but not by much. At the lower-level, specific sectors could be affected with it. Innovation now may be the engine for growth when the next boom occurs. No country, irrespective of its strength, can withstand the negative impact of the abovementioned factors. Economic history of the world is full of examples where huge expansion based on exports and disregard to local consumption ended up in failure. In the coming time, China and India will disrupt workforces, industries, companies, and markets in ways that we can barely begin to think. The upheaval will test America's commitment to the international trade system, and shake its confidence.

Key words: *Great Depression, Mortgage Lending, Sub-Prime crisis, Recession*

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INTRODUCTION

In 2008 the international economy faced its most fearful crisis since the Great Depression of the 1930s. It all began in 2007, when exorbitantly high home prices in the United States went decisively downward, spread speedily, first to the entire U.S. financial sector and then to financial markets internationally. The most affected in the United States included-

1. Investment banking industry,
2. Largest insurance company,
3. Two enterprises chartered by the government to facilitate mortgage lending,
4. Biggest mortgage lender,
5. Biggest savings and loan, and
6. Two of the largest commercial banks.

The damage was not limited to the financial sector, however, as companies that normally trust on credit suffered the most. The US auto industry, which pleaded for a federal bailout package, found itself at the brink. Still as an ominous sign, banks, trusting no one to pay them back, simply stopped granting the loans that most businesses require to regulate their cash flows and without which they cannot do commerce. In December the National Bureau of Economic Research, a private group recognized as the official arbiter of such things, found out that a recession had started in the United States in December 2007, which made this already the third longest recession in the U.S. since World War II.

By the end of the year, Germany, Japan, and China were also affected with the recession, as were many smaller economies. Many in Europe paid the price for having invested in American real estate securities. Japan and China mostly avoided that pitfall, but their export-oriented manufacturers affected as recessions in their major markets, the Americas and Europe cut deep into demand for their goods. Less-developed economies likewise lost business abroad, and their foreign investment, on which they had relied for growth capital, vanished. With none of the largest economies prospering, there was no evident engine to drag the world out of its recession, and both government and private economists predicted a slow recovery.

IMPACT OF RECESSION ON INDIA

Indian companies have major outsourcing deals from the America. India's exports to the America have also increased significantly over the years. The Indian economy was likely to lose between 1 to 2 percentage points in GDP growth in the coming fiscal year. Indian companies with big ticket investments in the US would see their profit margins fall. The anxiety for exporters will grow further as rupee strengthens further against the dollar. But experts predicted that the long-term prospects for India are stable. A weak dollar could fetch more foreign money to Indian markets. Oil may get cheaper brining down inflation.

A recession brought down oil prices to $70. The whole of Asia would be hit by a recession as it relies on the US economy. Even though local demand and diversification of trade in the Asian region will partly counter any fall in the US demand, one simply can't escape a reduction in the world's largest economy. The America’s economy accounts for 30 per cent of the world's GDP. The only silver lining is that the recession will not happen quickly, probably in six months or so. As of now, IT and IT-enabled services, textiles, jewellery, handicrafts and leather sectors will suffer losses because of their trade linkages. Few sections of commodities could face quick impact due to the volatile nature of these sectors. Profits of various re-export firms may be affected. Economies like China import commodities from India provide some value-addition and then export them to the US. The IT sector will be the badly hit as 75 per cent of its revenues come from the America. Low demand for services may force most Indian Fortune 500 companies to reduce their IT budgets. Besides companies from ITES and BPO, automotive components will be affected with the recession.

The US recession is mainly to have a dual impact on the outsourcing industry. Appreciating rupee along with dismal performance of US companies (law firms, investment banks and media houses) will affect the bottom line of the outsourcing industry. Small BPOs, which are doing business at a net margin of 7-8 per cent, will find it difficult to survive. Along and severe recession will largely affect the portfolio and fixed investment incoming. Corporate will also affect from volatility in foreign exchange rates. The export sector will have to find new strategies to increase productivity.

In summary, at the large-level, a recession in the US may reduce GDP growth, but not by much. At the lower-level, specific sectors could be affected with it. Innovation now may be the engine for growth when the next boom occurs. For US firms, who have long perceived at China as a better investment destination, this may be a good time to look at India as well. After all, 350 million people with huge purchasing power cannot be ignored. This is not a sales pitch for India, but only a gentle advice to American corporations.

IMPACT OF RECESSION ON CHINA

The current U.S. recession, which began in December 2007, will slow China's growth rate significantly. An internationally integrated China cannot escape global economic and financial market movements. China now worried that its economy is too hot and will soon worry that it is not hot enough. The U.S. sub prime mess has now spreaded throughout the credit markets in the Americas, and indeed to the global economies. The US Fed is on the case, reducing interest rates with more to come and economists are lowering their forecasts. Financial market volatility is huge and fear is replacing greed in the minds of many investors internationally. It is useful to remember that this is the first time in the modern world in which China's economy has become sufficiently engaged (trade and capital flows) with other economies that troubles in the U.S., Europe and Japan would affect China.

China has worked hard, and relatively successfully, to become a full-fledged player in the international economic and financial community. But officials in Beijing, for which control is everything, are now worrying about the slower growth that many China experts anticipate. This is a not so-gentle reminder that China's larger global role exposes the country to the global economy like never before. The U.S. acknowledged the recession only on Dec. 8, 2008, when the financial crisis had already hit consumers and businesses. Now, nothing is selling regionally, which includes houses, cars, merchandise, luxury holidays, travel, except food items. The U.S., Canada and the European economies have been linked with each other since the last five generations and will swim or sink together weathering the economic crisis.

Let us go through at a few known facts. China exports 64 percent of its gross national product to the world, mostly to Europe, United States and Japan. If these economies are in a serious recession bordering depression, how can China left behind its consequences? China is also telling the world that they have an economic package totaling US$586 billion to stimulate growth. As a matter of fact, this is not new money, but mostly already committed aid, which has been summed up to make it look big. It will be a great achievement, if Chinese economy does not shrink in 2009. One should discount the fat statistics provided by China, as conventional wisdom is that the Chinese economy probably did not increase at all in 2008 and will reduce further in 2009.

No country, irrespective of its strength, can withstand the negative impact of the abovementioned factors. Economic history of the world is full of examples where huge expansion based on exports and disregard to local consumption ended up in failure. In the late 1990s, Asia’s so called Tiger economies suffered a similar shock. They borrowed and made too much and too fast on exports and had to be bailed out by the International Monetary Fund and other financial institutions. China is in that position today. China’s US$586 billion economic growth package is trying hard to transfer some goods stored in warehouses to internal consumption. This may or may not work as internal expenditures generally take two to three quarters before their impact is felt.

The economic downturn has increased the crime rate in China. Officials of the Chinese Communist Party are concerned about minor protests, as the specter of Tiananmen Square protests of 1989 still haunts. So, current protests are quickly stamped as minor social and law and orders issues. In summary, China is in for a rude shock. The deep recession in the West will stay alive for the next four to six quarters. China will learn the hard way that only focus on exports has a cost.

CONCLUSION

In the coming time, China and India will disrupt workforces, industries, companies, and markets in ways that we can barely begin to think. The upheaval will test America's commitment to the international trade system, and shake its confidence. In the 19th century, Europe went through a similar shock when it found out a new giant the U.S. had arrived. "It is up to America to manage its own expectation of China and India as either a threat or opportunity," says corporate strategist Kenichi Ohmae. "America should be as open minded as Europe was 100 years ago." How these Asian economies integrate with the rest of the world will mainly shape the 21st century global economy.

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