



## INTERNATIONAL JOURNAL OF RESEARCH IN COMMERCE AND MANAGEMENT

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## GLOBAL RECESSION: IMPACT AND RECOVERY

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### **ABSTRACT**

*The Global recession in the international financial markets of advanced economies that started around mid-2007, has exacerbated substantially since August 2008. This recession began in the financial sector of USA extended to other countries of the world and has assumed as the most serious crisis for the world. This is the worst recession we had in the last 60 years and globally the worst financial crisis we had since the Great Depression. It has choked normal credit channels, triggered a worldwide collapse in stock markets around the world. Indian economy too felt the pinch of this crisis with respect to reduction in*

*exports performance, GDP, employment rate. However, over the last few months it has been observed that the global recovery is emerging. The strength of the upturn in 2010 is still uncertain and regionally uneven because the western economies are still undergoing the process of adjustment. In this paper, the factors responsible for global recession and its impact on World economy has been set out. It also outlines factors responsible for the global recovery and suggestions for the sustainability of the recovery.*

## **KEY WORDS**

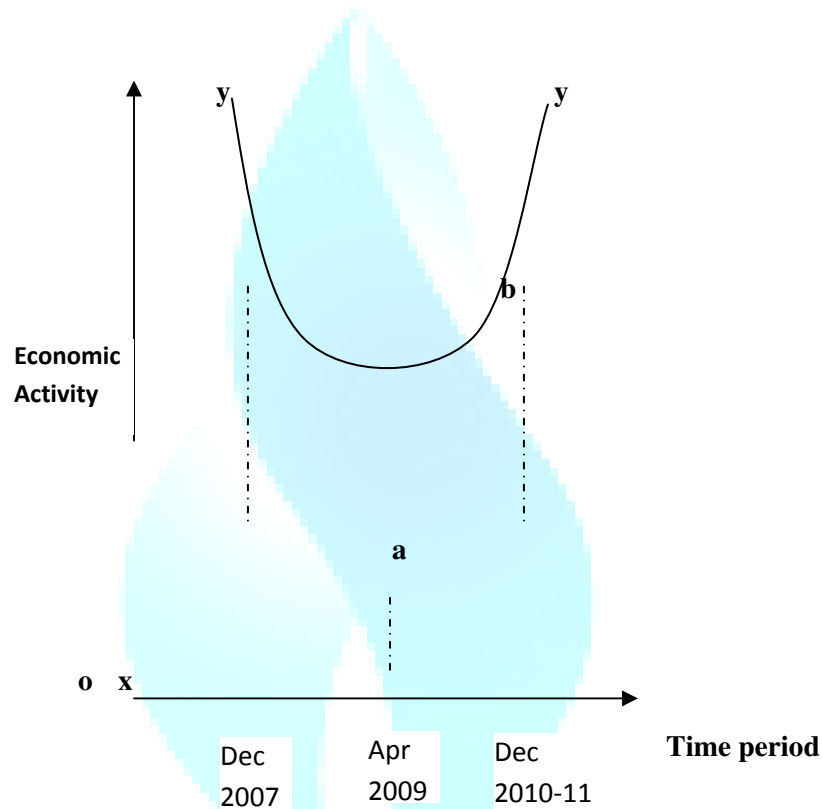
Global Recession, Recovery Sustainability

## **INTRODUCTION**

Global Recession, especially that began in the financial sector of USA extended to other countries of the world and has assumed as the most serious crisis for the world. The financial crisis, which a year ago seemed to be localized in one part of the financial system in the US, has exploded into a systematic crisis, spreading through the highly interconnected financial markets of industrial countries and has had its effects on other markets as well. It has choked normal credit channels, triggered a worldwide collapse in stock markets around the world. The real economy is clearly affected. Industrialised countries are expected to slow down in future.

In this paper, an attempt has been made to the impact of global recession on World Economy, challenges for Indian Economy, factors responsible for the global recovery and the likely way out for the sustainability of the recovery.

Survival from recession by the companies is a great challenge. For some it may be an opportunity and for majority is a sad experience as they fail to regain their pre recession growth rates for sales and profits. Recessionary trends seem to be U-shaped (figure 1). **Nouriel Roubini** of US in his presentation in a CII conference on March 22, 2009 at Delhi stressed that the recession is not V-shaped rather U-shaped.



**Figure 1: U-shaped crisis**

The world today is in the middle of U. it is almost two years into recession. It could last upto the end of 2010 despite the visible signs of recovery in most countries. The economists, management experts and business and financial analysts had been struggling hard to find the best strategy that can help the economies and the companies at micro level to come out of recession. The CEOs continue to face the challenges thrown up by the great recession of 2007, they are unsure about what strategic approaches to deploy. On carefully investigating the behaviour of companies during and after the past three global



recessions, it was found that the companies that were growth leaders coming into recession often can not retain their momentum; about 85% are toppled during bad times. The post-recession winners infact, are those corporations that are able to maintain the delicate balance-between cutting costs to survive today and, investing more to grow tomorrow. The strategy deploying the optimal combination of defense and offense moves are mostly adopted by the progressive companies and may be regarded as the best strategy for coming out of recession.

It is evident from the research conducted in USA by the management experts Wohlgezogen, Nitin Nohria and Ranjay Gulati at Harvard Business School that the the progressive companies recorded 13% rise in sales and 12.2% in profits which is higher than the record of prevention focus, promotion focus and pragmatic companies. In terms of average performance, these companies recorded double performance. Overall chances of growth after a recession are much higher (37%) in case of progressive companies in comparison to other categories of companies.

#### **Why the progressive companies do well after a recession?**

- The progressive companies attend to improving operations efficiency while adopting cost cutting devices.
- Invest in both existing and new business to enlarge their asset bases.
- They take advantage of depressed prices to buy properties plants and equipments.
- These companies also judiciously increase spending on R&D, and marketing which may produce only modest benefits during recession but adds substantially to sales and profits afterwards.
- In turbulent times, the progressive companies stay closely connected to customer needs.
- The progressive companies adopted diversification strategy in tough times as the CEOs exercise cost discipline, financial prudence and detect opportunities that offer returns in reasonable payback periods.

## IMPACT OF THE GLOBAL CRISIS ON THE WORLD ECONOMY

Emerging market countries were not the cause of this crisis, but they are amongst its worst affected victims. Recession will hit the export performance of developing countries and the choking of credit, combined with elevated risk perception, will lead to lower capital flows and reduced levels of foreign direct investment. The combined effect will be to slowdown economic growth in developing countries.

The global impact of the current crisis may be outlined as under:

- Open economies like USA, UK turning protectionist leading to tight visa and outsourcing norms.
- Massive job cuts in USA, UK, Japan by major companies.
- Adverse impact on exports and deferred capital expenditure.
- Slowing down of industrial output and corporate profits, finally resulting into lower GDP rate.
- Rise in Non-Performing Loans (NPL's) that would make the banks cautious in funding.
- China's economy is being battered by falling demand for its goods. It registered virtually no growth over the third quarter and things are going to get a lot worse before they get better. GDP rate in China fell from 10.73 in Jan 2006 to 8.2 in Jan 2009, in Japan it fell from 2.03 to 0.50 in 2009 and this downfall continued in USA also and it fell from 2.78 to 1.28 in 2009.
- Interest rates are also showing downfall in all the three countries i.e in China it fell from 5.58 in Jan 2006 to 5.31 in Jan 2009, in Japan it is 0.10 in Jan 2009, in USA it fell from 4.25 in 2006 to 0.25 in 2009.
- Stock Markets of China, Japan and USA had slumped due to the recession. In China it fell from 4383 in 2008 to 1863 in 2009, 15341 in 2006 to 7682 in 2009 in Japan and from 10667 to 7949 in USA.
- Global Financial Crisis leads to massive job losses as the slowdown has cut the demand for consumer products that result in the closing of factories also in some of the countries.

Unemployment rate in Japan rose from 3.80 in 2008 to 4.10 in 2009, in USA it rose from 4.90 in 2008 to 7.60 in 2009. The unemployment rate in China remains comparatively stable inspite of the global recession.

- Exports of goods and services constitute 39.7% of its GDP. A large number of sectors like textiles, leather, chemicals, auto-components, tyres, electronics and electrical items are likely to see a fall in their exports in January-March 2009 and April-June 2009, says a survey by FICCI. Exporters are thus in a bind over how to compete in potential markets. The fall in exports sector is faced by different countries. China's major exports are: office machines & data processing equipment, telecommunications equipment, electrical machinery and apparel & clothing. China's largest exports markets are European Union, United States, Hong Kong, Japan and South Korea. China's exports fell from \$109600 million in 2008 to \$90500 million in 2009. United States is also one of the most significant nation in the world when it comes to international trade. Main exports are: machinery and equipment, industrial supplies, non-auto consumer goods, motor vehicles and parts, aircraft and parts, food, feed and beverages. Main export partners are: Canada, European Union, Mexico, China and Japan. Recession had shown very severe impact on the export sector in US. It had fell from \$98753 million in Jan 2008 to \$77869 million in Jan 2009. In Japan also due to recession exports sector has shown a downfall from \$5643 million in 2007 to \$6113 million in 2008.

## IMPACT ON INDIAN ECONOMY

Ever since the current crisis began in the West, official-type Indians expressing the view that India was special and would not be affected because of superior Indian Financial regulation. **The US bankers once predicted that Indian banks would collapse because of their conservatism but the same thing now turned into a blessing.** Dr. B. Brahmaiah, Vice President, Sujana Group of Companies, while speaking

in a seminar organized by Vignana Jyothi Institute of Management (VJIM) Hyderabad in Dec 2008, argued that there is no proper planning by blue chip companies while recruiting people which results in uncertainty. This is not the case in India. This view however is not fully tenable as in one way or the other, Indian Economy too has felt the pinch of global economic turmoil. This is evident from the following statistical records.

### 1) Impact on GDP growth rate

India's economy is expected to grow about 5.1% in 2009 and 6.5% in 2010 according to the IMF. India's economy grew at an annual rate of 7% to 8% or more in the past three years, second only to China among the major economies, and the projections for FY2008 indicate that India's economic growth has been affected by the economic crisis which is shown in **the table 1**. As per the latest estimates made by **Suresh Tendulkar**, Economic Advisor to PM, the expected growth rate of GDP would be 6.5% to 7%. The reasons are the adverse impact of World recession on exports and export oriented industries. Another factor has been the outflow of foreign capital from the country.

**Table 1: India GDP growth rate**

Year	GDP rate
2001	4.63
2002	4.58
2003	7.33
2004	7.25
2005	8.68
2006	9.75
2007	9.15
2008	8.10

Source: www.tradingeconomics.com

**Graph 1**

source: India Central Statistical Orga

www.tradingeconomics.com

**2) Impact of the Crisis on IT sector**

The financial crisis in the advanced economies and the likely slowdown in these economies could have some impact on the IT sector. The current crisis parallels the 2001-2002 bust especially for India's IT sector approximately 61% of the Indian IT sector's revenues are from US clients. Between 1999 and 2008, the share of US financial services revenue as a 5 of total revenues for the Top 3 Indian players thus went up from 25% to 38%.

**3) Impact of Financial Crisis on Indian Financial Markets**

The Indian financial markets are in the grip of the bearish trend posing a threat to the investors. The key to successfully trading bear markets is to understand their primary driver and sentiment. The mission of a bear is to gradually hammer on investors until their perceptions of stocks radically change. Over the course of a bear, valuations are slowly eroded lower until stock prices are cheap relative to their earnings near the end of a bear. So bears rebalance both sentiment and valuations.

The global meltdown has impacted the interest rates (i.e., repo rates ,reverse repo rate, CSR). The Indian Government has reduced the repo rate(rate at which it lends to banks) by 1% from 7.5% to 6.5% and the reverse repo rate (rate at which banks lend to RBI) by 1% from 6% to 5%. SLR rate has also been cut down from 25% to 24% and Cash Reserve ratio from 9% to 5.5%.

#### 4) Economic Downturn

After a long spell of growth, the Indian economy is experiencing a downturn.

1. Industrial growth is faltering.
2. Inflation remains at double – digit levels.
3. The Current account deficit is widening.
4. Foreign exchange reserves are deleting.
5. The rupee is depreciating.

The most immediate effect of that crisis on India has been an outflow of foreign institutional investment from the equity market.

1. Foreign Institutional Investors, who need to retrench assets in order to cover losses in their home countries have become major sellers in Indian markets.
2. In 2007 – 2008, net FII inflows into India amounted to 4 20.3 billion. As compared they pulled out 411.1 billion of which \$ 8.3 billion occurred over April 1 to Oct 16, 2008.

This had 2 effects:-

1. in the stock market.
2. in the currency market.

As a result, the Sensex fell from its closing peak of 20,873 on Jan8, 2008 to less than 10,000 by Oct 17, 2008.

#### 5) Falling Rupee

In addition, this withdrawal by the FIIs led to a sharp depreciation of the rupee. Between January 1 and October 16, 2008, the RBI reference rate for the rupee fell by nearly 25 percent, even relative to a weak currency like the dollar from Rs.39.20 to the dollar to Rs. 48.86. This was despite the sale of dollars by the RBI, which was reflected in a decline of 425.8 billion in its foreign currency assets between the end of March 2008 and October 3, 2008. A second route through which the global financial crisis could affect India is through the exposure of Indian banks or banks operating in India to the impaired assets resulting from the sub-prime crisis.

#### **6) Exposure of Banks**

According to reports, the RBI had estimated that as a result of exposure to collateralized debt obligations and credit default swaps, the combined mark-to-market losses of Indian banks at the end of July were around \$ 450 million. Given the aggressive strategies adopted by the private sector banks, the MTM losses incurred by public sector banks were estimated at \$ 90 million, while that for private banks was around \$360 million.

#### **7) Credit Cutback**

A fourth effect is that, in this uncertain environment, banks and financial institutions concerned about their balance sheets, have been cutting back on credit, especially the huge volume of housing, automobile and retail credit provided to individuals. According to RBI figures, the rate of growth of auto loans fell from close to 30 percent over the year ending June 30, 2008, to as low as 1.2 percent. Loans to finance consumer durables purchases fell from around Rs6,000 crore in the year to June 2007, to a little over Rs. 4,000 crore up to June this year. Direct housing loans, which had increased by 25 percent during 2006-2007, decelerated to 11 percent growth in 2007-08 and 12 percent over the year ending June 2008.

#### **8) Impact on Exports in India**

India's export growth has become negative for the first time in five years. Exports have fallen to \$12.8 bn in October 2008 from \$14.8 bn in October 2007. There is a 12% decline in exports during October 2008.

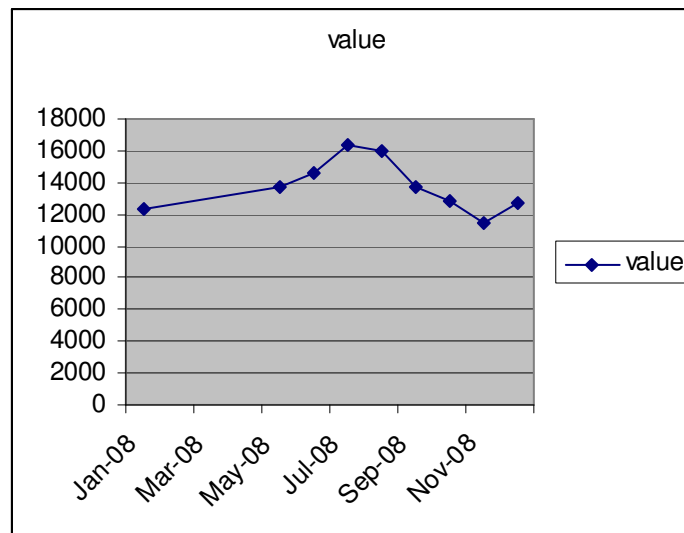
Foreign trade has become deficit of \$60 bn in 2008-09 due to falling export. There is a 60% trade deficit in 2008 compared to 2007 due to the reduction in export. There is a fall in exports due to low demand from key markets like the US, European Union and Japan. This falling trend in Exports is shown in Table 2.

**Table 2: Impact on Exports sector in India**

Date	Value
May-08	13782
Jun-08	14664
Jul-08	16345
Aug-08	16005
Sep-08	13748
Oct-08	12822
Nov-08	11505
Dec-08	12690
Jan-08	12381

Source: India Today, Meltdown hits Home, 23 March, 2009



**Graph 2 Trends in Exports Value**

## MEASURES TO TACKLE GLOBAL CRISIS

DEPRIVE a person of oxygen and he will turn blue, collapse and eventually die. Deprive economies of credit and a similar process kicks in. As the financial crisis has broadened and intensified, the global economy has begun to suffocate. That is why the world's central banks have been administering emergency measures, including a round of co-ordinated interest- rate cuts. Government and other policy makers are revising policies to stem the rot from the urgency of the situation. This time the economic turmoil has taken several general people in its spiral, creating fear and panic amongst all.

**The major steps in terms of stimulus package prescribed by the government of India are:**

### 1. Stimulus package for Export sector

- The Government of India provides Rs. 1450 cr to export sector.
- There is a 4% reduction in excise duty

- Export duty on iron ore fines has been withdrawn.
- The levy on export of iron lumps has been reduced to 5% from 15%.
- The RBI has extended the period of pre-shipment and post-shipment credit for export.

## 2. Stimulus package for Industrial Growth

- The RBI is providing Rs.7000 cr to Small Industries Development Bank of India (SIDBI) for direct lending to employment-intensive Micro and Small Enterprises (MSE).
- There is 4% reduction in excise duty on cars, steel, cement and a host of other products.
- The ad valorem tax on cement has been reduced from 12% to 8%.

## 3. Stimulus package for Real Estate Sector

- a. Housing loan granted by Housing Finance Companies (HFC's) from Rs.5 lakh to Rs.20 lakh and is given at concessional rate.

## 4. Stimulus Package for Infrastructure Growth

- The Government of India has decided to participate in infrastructure development by investing Rs.10000 cr.

India's stimulus package of Rs.30,700 cr which constitutes 0.6% of GDP is too small to save the economy from financial meltdown so, the central government has recently announced the second package of measures. While the main component of the first package announced in early December was increased government expenditure to boost aggregate demand, the second set of measures focuses on improving or facilitating the supply of credit.

### Steps taken under second package :

- Public Sector India Infrastructure Finance Company (IIFC) are allowed to borrow Rs.30000 cr from the market by issuing tax-free bonds.
- State Governments have also been allowed to borrow an additional 0.5% of their state gross domestic product from the market.

The government is hoping that these measures will result in additional credit supply of Rs.56000 crore.

## FACTORS RESPONSIBLE FOR THE RECOVERY FROM RECESSION

Following the eruption of the financial crisis in the United States, the decline in the world trade was led by declines in developing countries, but recent improvements have come mainly from emerging economies. The world economy is beginning to grow but the strength of the upturn in 2010 is uncertain and regionally uneven. Different economists are giving different factors responsible for the early recovery from this recession which are being discussed here

**Philip Suttle, Director of Global Macroeconomic Analysis at the IIF**, highlighted following factors responsible for the world growth:

- Rebuilding of inventories
- Ease of Global Financial conditions
- The return of capital spending
- The bottoming of housing markets and the speed at which households and firms restructure their balance sheets.

Carnegie's **Uri Dadush** similarly urged leaders to maintain current policies until the economic recovery is clearly established. He has highlighted several factors behind this stronger than expected recovery:

- Increase in the domestic demand of the developing countries
- Stimulus packages and the financial rescue efforts of the government of different countries

- The growing role of emerging economies which remain fundamentally strong during the period of financial crisis is supporting the global recovery.
- The corporate sector, particularly non-financial firms in the United States, reacted aggressively to the crisis which as a result shows a significant turnaround in their labor inventory and investment demand.

The optimistic outlooks given by few economists' shows that emerging economies are now contributing significantly to growth and investment than advanced countries which is supporting the global recovery.

The Indian economy is showing signs that it will bounce back from the global downturn quicker and stronger than almost any other country. The facts relating to this context is shown below:

### 1. Growth forecasts in terms of GDP are quite encouraging

As per the table 3 the growth record of India's real GDP from 2003-04 to 2007-08 was quite impressive with the average Growth rate of 8.8%. In 2008-09, GDP rate decreased to 8.10 and then to 7.2 per annum in 2009-10 and according to IMF forecasts, it is 8% during 2010-11.

**Table 3: Records of Growth rates**

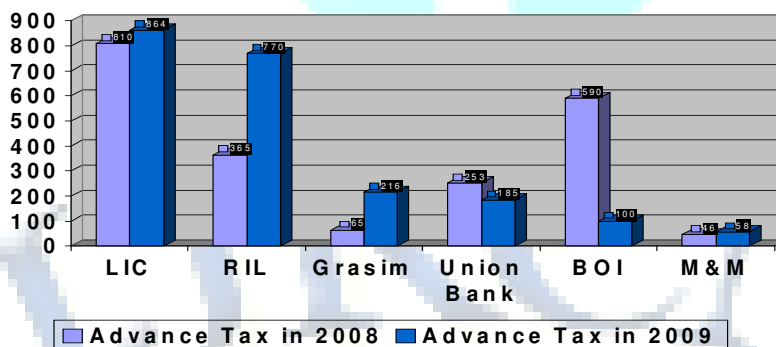
Period	Growth rate (in %)
2006-07	9.7
2008-09	8.10

2009-10	7.2
2010-11	8 (IMF)

2. Advance tax payments in 4<sup>th</sup> quarter of 2008-09 by most companies are higher in comparison to the year 2007-08. This is evident from table 4 and graph 3.

**Table 4: Advance Tax Payments in 4<sup>th</sup> quarter of 2009-10**

Companies	Advance tax paid (Rs. Crores) in 2009-10	Advance tax paid (Rs. Crores) in 2008-09
LIC	864	810
RIL	770	365
Grasim	216	65
UBI	185	253
BOI	100	590
M&M	58	46



**Graph 3: The Advance Tax payments trends by the Indian Companies.**

Since the advance tax payments in 4<sup>th</sup> quarter of 2009-10 are significantly higher over the previous year, it is clear indication of Indian business companies being out of recession.

**3. Growth in Media & Entertainment industry.**

During 2009-10 the growth of media and entertainment was 1.4% over the previous year and over next five years; the industry is projected to grow at a compound annual growth rate of 13%. This is shown in graph 4. The rising trend is also an indicator that Indian business companies are coming out of recession as these are offering greater businesses to media and entertainment industry.



**Graph 4: The growth trends in terms of Billion Rs. of Media & Entertainment industry**

**4. Trends in Industrial Production**

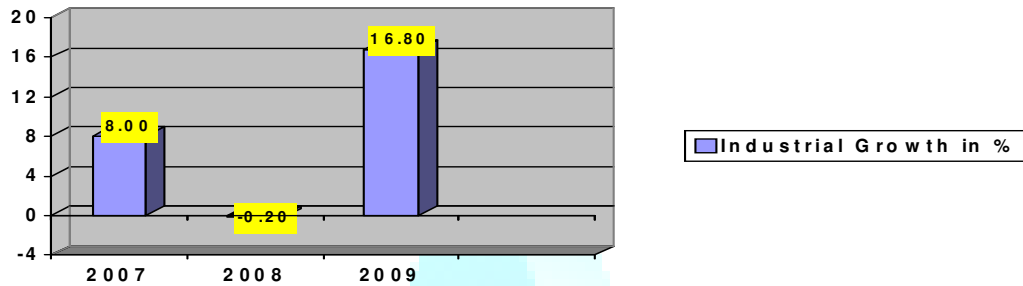
Trends in industrial production are evident from table 5 and graph 5 which shows that its growth rate which was negative in 2008, increased to 16.8. Table 6 and graphs 6 & 7 reveal the rising net sales and net profit for prominent Indian industries.

**Table 5: Trends in industrial production**

Year	Growth %
2007	8

2008	-0.20
2009	16.80

Source: Ministry of Planning & Reporting



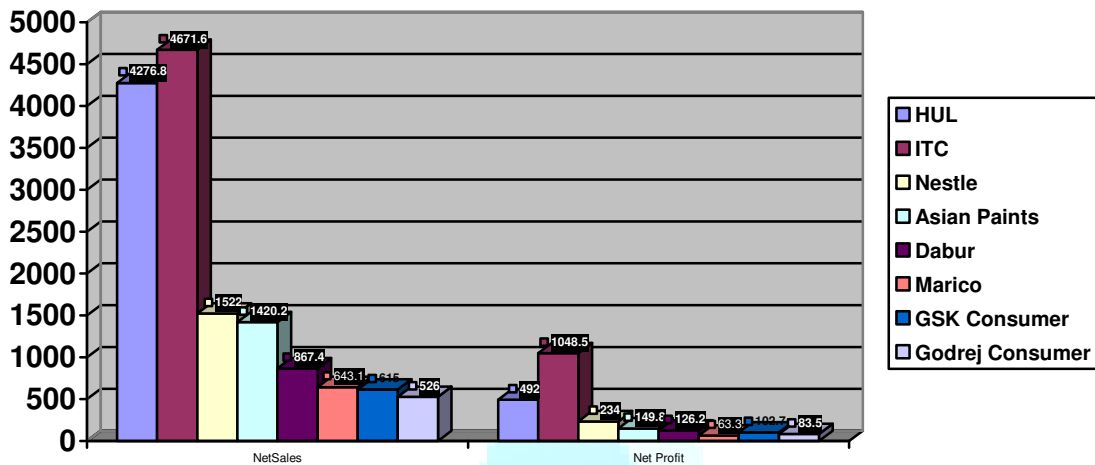
Graph 5: Trends in the industrial production for Indian industries.

Table 6: FMCG companies’ sales and profit trends for the quarter ended March 2010 against the corresponding quarter in the previous year.

Companies	Net Sales	Change (%)	Net Profit	Change (%)
HUL	4276.8	7.2	492.0	24.6
ITC	4671.6	20.0	1048.5	29.6
Nestle	1522.0	20.2	234.0	18.6
Asian Paints ^	1420.2	-0.3	149.8	38.1
Dabur ^	867.4	18.5	126.2	19.9
Marico ^	643.1	14.6	63.3	42.8
GSK Consumer Healthcare	615.0	14.0	102.7	22.4
Godrej Consumer ^	526.4	53.6	83.5	40.6
<b>Total</b>	<b>14542.5</b>	<b>14.1</b>	<b>2299.9</b>	<b>27.6</b>

^ Based on consolidated quarterly results.

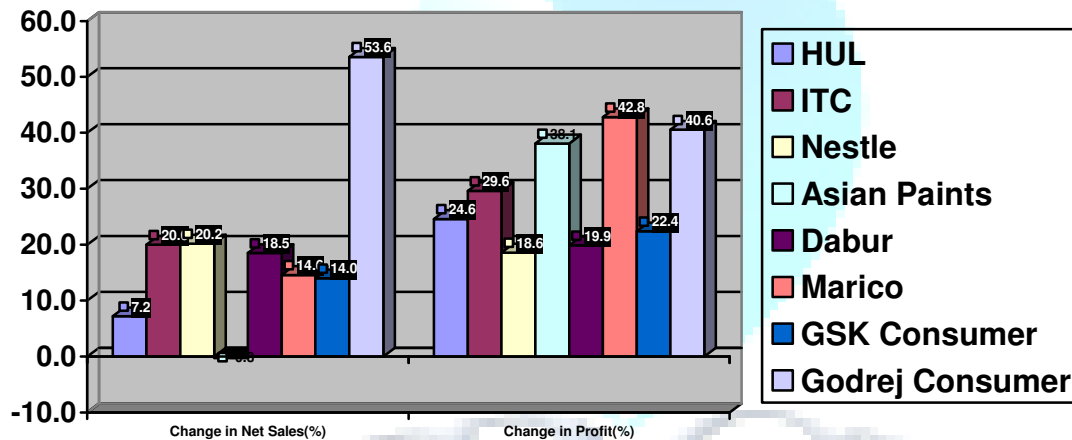
Source: Angel Broking, Sharekhan, ICICI Securities and ETIG



Graph

6: The net sales & net profit for the FMCG sector for the quarter ended March 2010

Source: Economic Times, April 16, 2010



Source: Economic Times, April 16, 2010

Graph 7: The percentage change in sales & profit for FMCG sector for the quarter ended March 2010



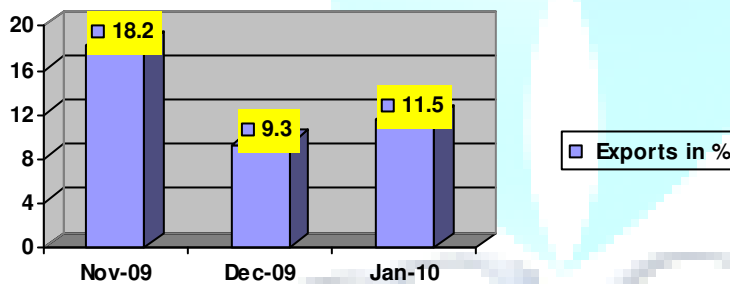
Table 6 and graphs 6 & 7 pertaining to FMCG companies in respect of trends in net sales and net profit also indicate fast recovery from recession as the average net sales and net profits increased 14% and 28% respectively against the corresponding quarter in the previous year- the year of recession.

**5. Trends in growth of exports.**

**Table 7: Trends in growth rate of exports**

Year	Growth %
Nov 2009	18.2
Dec 2009	9.3
Jan 2010	11.5

Source: Directorate General of Commerce



**Graph 8: Rising trends in export sector**

Table 7 and graph 8 shows the rising trends in export sector. It is evident that export sector was affected very hard on account of recession but in India in January 2010, the recovery of growth rate of exports increases from 9.3% in December 09 to 11.5%.

## 6. Trends in IT Industry

The Indian IT industry has survived the global financial slowdown despite initial negative impact in terms of steep fall in overseas order for Indian IT products. Recently for TCS, Infosys, Wipro, HCL, operating margins increased by 5 to 7% in 2009-10 over the previous year in terms of growth rate in revenue after fall from 25-30% during 2005-07 to 10-15% during 2007-09, it is expected to rise by 15-18% during 2010-11. This is shown in table 8.

**Table 8: Growth rate in Revenue**

Year	Growth rate in revenue
2005-07	25-30 %
2007-09	10-15%
2010-11	15-18%

**Source: Days of heady growth over for Indian IT Cos. March 25, 2010, Economic Times (ET).**

The facts stated above clearly prove that Indian economy is coming out of recession very fast in comparison to western countries. Although the areas of concern in Indian economy are, rising inflation, high fiscal deficit, sudden stoppage of foreign capital inflows, and infrastructure bottlenecks; India is shown to have the highest probability to be the superpower in the world.

## SUGGESTIONS

Economists outlined the challenges that policy makers face in the coming year, and offered suggestions for solutions:

1. Fiscal policy should remain stimulative in the near term, for this leaders need to begin engineering a shift in demand from public to private sources.
2. Monetary policy should remain supportive
3. Efforts should be made by the government of the countries to promote credit
4. Policy should accommodate the permanent shift in the structure of the World economy so that these shifts if managed, with long term considerations like climate change in mind have the potential to create new sectors that will help drive future growth.

## CONCLUSION

The global financial crisis, caused by an excess of liquidity and inadequate regulation of a highly integrated International financial system, has pushed the world's economy to the verge of recession. But now, the world economy is beginning to grow as per the market projections. The recent favourable growth trends are because of the growing role of emerging economies which remain fundamentally strong rather than advanced countries. According to Nitin Jain, Principal Fund Manager- Long Only Strategy, Kotak Mahindra (UK) Ltd., the Indian economy is showing quicker and stronger signs of recovery than almost any other country in Asia because of its high savings rate, attractive demographics and rising urbanization. India is capable of delivering superior growth in future also as a huge market in India remains untapped and our Government is focusing on strengthening the rural economy which will help to boost the consumer spending.

Economist Intelligence Unit (EIU), the research arm of London based Economist magazine predicted that “India will overtake China to become world’s fastest growing economy by 2018”. The primary drivers behind India’s Growth are:

- **Favourable demography-** higher percentage of working population.
- **Strong domestic consumption-** rising income and growing middle class.
- **High savings and investments-** rising inflow of investment through FIIs (\$75 billions in 2014 from \$36 billions in 2010).

Since the biggest hurdle to achieve higher growth is the high inflation and infrastructural bottleneck, India will have to continue with economic reforms. Thus, we can say that the global recovery is real, but it continues to rely on critical government support and if leaders prematurely abandon measures the recovery could be thwarted.

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