International financial crisis exposes vulnerability of Indian economy

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The global financial crisis and looming recession have quickly exposed the weakness of the Indian economy and shattered illusions in the country's so-called economic miracle. In the course of last week, the Sensex index on Bombay Stock Exchange (BSE) plunged by almost 16 percent and the rupee devalued further against the US dollar amid fears of a marked economic slowdown.

The BSE Sensex dropped by nearly 10 percent on Friday before the Reserve Bank of India (RBI) intervened for the second time that week to cut the cash reserve ratio by 1 percent to 7.5 percent, injecting 600 billion rupees (about $US13 billion) into the financial system. The BSE Sensex ended the day at 10,527.85, down 7.1 percent and the broader National Stock Exchange (NSE) Nifty index lost 6.65 percent.

India's largest private sector financial group, ICICI Bank, dropped by as much as 28 percent, before ending the day down 20 percent. Its shares have dropped by 46 percent since the end of September amid concerns about the group's extensive operations in the global financial markets. India's second largest mobile phone company, Reliance Communications, fell 21 percent, while the biggest real estate developer DLF Ltd fell 8.8 percent and top engineering firm Larsen & Toubro lost 8 percent.

The RBI had already cut the cash reserve ratio, or the proportion of deposits held by the central bank, by 0.5 percent on Monday when the BSE Sensex fell by 725. On the same day, the Stock Exchange Board of India lifted restrictions on foreign institutional investors imposed in October last year to defend the weakening rupee. The rupee fell to 49 to the US dollar on Friday, down from 39 in January.

Share values plunged on Friday despite government reassurances. Emerging from the weekly cabinet meeting on Thursday, Finance Minister P. Chidambaram declared that there was no need for panic. "Indian banks are well capitalised and financially strong," he said. Behind closed doors, however, the cabinet had decided to set up an emergency finance committee and discussed whether Prime Minister Manmohan Singh should address the nation.

The *Times of India* reported on Saturday that the Federation of Indian Air Lines (FIA) had requested $1 billion in interest free loans as well as other concessions to bail out the airlines. In a presentation to the prime minister's office, FIA officials expressed concerns about the impact of the international credit crunch, tough global competition and declining passenger numbers.

The BSE Sensex has fallen by almost 50 percent in the course of the year, from a high peak of 20,873 on January 8 to last Friday's close of 10,528. The cumulative market capitalisation of Indian shares, which was $1.8 trillion in January, has slumped even more dramatically to $760 billion as the rupee has devalued.

Foreign investors have left the Indian market in droves, selling off $9.6 billion worth of shares in the first nine months of this year. This is a sharp reversal of last year's record inflow of $17.2 billion into the Indian capital market. Some analysts predict that the final outflow for 2008 could reach $13.5 billion.

Economic statistics for August released last Friday reveal that the economy is already slowing. Infrastructure sector output for the month grew by only 2.3 percent, compared to 9.5 percent in August last year. Industrial growth for August slowed to just 1.3 percent as against 10.9 percent last year.

M. Govinda Rao, a member of the prime minister's Economic Advisory Council, acknowledged that the figures pointed to "industrial recession." He admitted that the Gross Domestic Product (GDP) growth rate could fall to 7 percent next year, adding: "We are going to have a much more serious problem." Since 2003, the Indian economy has grown at an average of 8.7 percent and the government had previously predicted 9 percent this year, rising to 10 percent by 2012.

India is vulnerable to a global downturn. Over the past two decades, successive governments have transformed the country into a huge cheap labour platform, particularly for hi-tech information technology (IT) and related business services. Prime Minister Singh and Finance Minister Chidambaram both played a central role in initiating the sweeping restructuring measures in the early 1990s.

In an interview with *Figaro* this month, Singh admitted that a global slowdown would "compromise India's export markets." North America and the European Union, which are both heading for recession, accounted for 16 percent and 21 percent respectively of India's exports. The fastest-growing sector--IT and services known as Business Process Outsourcing (BPO) and Knowledge Process Outsourcing (KPO)--is likely to be seriously affected.

India is sometimes dubbed the "office of the world" because major corporations from around the globe have exploited its large supply of highly-trained, English-speaking graduates to cut business service costs. In 2003-2004, BPO and KPO services earned $ 3.1 billion in export revenues, rising to $8.4 billion in 2006-2007. Nasscom reported that the number of jobs in this sector rose from 216,000 to 553,000 over the same period, and was expected to reach 700,000 this financial year.

Last year 61 percent of India's BPO and KPO exports were to the US. About 40 percent of Fortune 500 companies in the US favour India for outsourcing their business services. IDBI Capital Market services research head Shahina Mukadam warned: "The slowdown is going to impact on the BPO firms in India. This will eventually result in an overall slowdown of the BPO industry."

The *Economic Times* explained: "In India, around 60 percent of the companies operating in the IT-BPO sector have been working for American financial corporations like Goldman Sachs, Washington Mutual, Citigroup, Bank of America, Morgan Stanley and Lehman Brothers. Tata Consultancy Services and Satyam Computers have been working for Merrill Lynch, and Wipro has a number of American corporations as its clients that are bruised by the present collapse."

The article added: "It is anybody's guess that layoffs are certain to take place in Bangalore, Hyderabad, Chennai, Gurgaon, Noida, etc." It predicted that 2.3 million young employees working in BPO and other IT sectors would be affected by the financial crisis.

Hardest hit by the economic crisis will be the poorest layers of Indian society whose living standards have already declined as a result of nearly two decades of economic restructuring. The social gulf between rich and poor in India is immense. In March, *Forbes* magazine reported that the number of billionaires had increased to 53 and their combined wealth was equal to 31 percent of the country's GDP. At the same time, a recent World Bank report found that 42 percent of the population or 456 million people are living below the official poverty line of $1.25 a day.

A global recession will undermine other major export sectors of the Indian economy, including textile and clothing, and lead to mass layoffs. At present, 14 million young people enter the labour market every year but only 10 million get jobs, most on very low wages. Price rises are already eroding living standards. India's inflation rate reached a 13-year high in August of 12.63 percent and is still hovering around 12 percent. A weakening rupee will drive prices up further.

While billions of dollars are being channelled into the financial system to prop it up, the Congress-led coalition government has no plans to alleviate the suffering of the urban and rural poor. Congress won office in 2004 as a result of widespread anger over the social impact of the economic reforms of the previous Bharathiya Janatha Party (BJP)-led government, but implemented only limited social measures, including a national rural employment guarantee scheme.

Inevitably, as the Singh government moves to protect the wealthy elite in the finance and business sectors, those who will pay the price will be hundreds of millions of ordinary working people who are already struggling to survive from one day to the next.