

FOREWORD

The Global Financial Crisis, which has been compared with the Great Depression of the 1930s, in intensity and impact, has shown signs of moderation, lately. The crisis, which surfaced within the narrow confines of the subprime mortgage sector in the US in August 2007, metamorphosed into a global financial crisis in September 2008 following the collapse of Lehman Brothers. Recent developments in Europe suggest that there are still some remaining weak spots in the global economy.

With the benefit of hindsight, a number of macro - and micro-economic factors have been identified in the literature as the proximate causes of the crisis – role of easy money, global imbalances and financial innovations on the one hand to regulatory and supervisory loopholes both at the national and global level on the other. A comparison of the current crisis with the various episodes of crises in the past reveals that some semblance can be found amongst them with regard to the underlying causes.

In terms of impact, however, the recent crisis seems to have been more widespread than many other previous episodes. Almost all segments of the global financial markets experienced tremors of the financial crisis, though at varying degrees. Interbank markets in advanced economies were the first one to be affected with severe liquidity pressures as banks became reluctant to lend to each other on fear of counterparty risks. EMEs were also adversely affected by the spillover effects of the macroeconomic turbulence emanating from global financial meltdown. The crisis evoked unprecedented policy responses, both domestically and internationally. Monetary authorities all over the world went far beyond their customary roles and resorted to aggressive monetary easing, so much so that policy rates reached record lows. The forceful and coordinated policy actions appear to have been successful in preventing a catastrophe. India could not remain unscathed and the global developments affected the financial and real activities in the second half of 2008-09.

Every crisis provides us powerful lessons. What we carry forward from this crisis is the need for some new regulatory and supervisory institutions with emphasis on a system-wide approach, some new objectives for the central banks, importance of communication, transparency and coordination in central bank functioning, a new design of the international financial architecture and renewed faith in some of the safeguards adopted by the emerging market economies. This crisis has raised questions about the adequacy and efficacy of the current international financial architecture to prevent and manage global crises. In fact, the speed and intensity with which the US subprime crisis exploded into a global financial crisis and then into a global economic crisis has led to a whole new debate on dominant tenets of macroeconomics and has challenged established views on self correcting market mechanisms and the role of public policy. The depth and breadth of the crisis tested the limits of conventional and unconventional policy options available to policymakers around the world.

Against this backdrop, it was felt that it will be timely to reflect upon the global crisis to make an objective assessment of its impact on the global economy and the Indian economy, in particular, and to draw some policy lessons. **Accordingly, the theme of this Report for 2008-09 was selected as “Global Financial Crisis and the Indian Economy”.** The Report undertakes an in-depth analysis of causes of the crisis, the policy measures undertaken and the impact on the global as well as the Indian economy.

It may be recalled that from 1998-99, the Report on Currency and Finance has become theme based. So far nine Reports have been published as follows;

Year	Theme
1. 1998-99	The Structural Transformation of the Indian Economy
2. 1999-2000	Financial Sector and Market Integration
3. 2000-01	Revitalising Growth
4. 2001-02	Stock taking of the Reform Process and its Outcomes
5. 2002-03	Management of the External Sector in an Open Economy Framework
6. 2003-04	The Evolution of Monetary Policy
7. 2004-05	The Evolution of Central Banking in India
8. 2005-06	Development of Financial Markets and Role of the Central Bank
9. 2006-07 and 2007-08	The Banking Sector in India : Emerging Issues and Challenges
10. 2008-09 (Current)	Global Financial Crisis and the Indian Economy

This Report has been prepared in the Department of Economic Analysis and Policy by a team of officers led by Shri S.V.S. Dixit, Adviser and Dr. Rajiv Ranjan, Director under the overall supervision and guidance of Shri Deepak Mohanty, Executive Director. The core team comprised Jeevan K. Khundrakpam, Rekha Misra, Bhupal Singh, Sunil Kumar, Abhiman Das, S.C. Dhal, Anupam Prakash, Rajeev Jain, Atri Mukherjee, Saurabh Ghosh, Sangita Misra, S.M. Lokare, Pankaj Kumar, Rakesh Kumar, Subrat Seet, N.Arun Vishnukumar, Indrajit Roy and S.Suraj. Valuable inputs from officers of other Departments are highly appreciated.

Many of the issues raised in the Report are still evolving and it will take some time for them to settle down. This group of young economists, who undertook the challenge of drawing a fine balance, did so, with courage, determination and forthrightness. I place on record my deep appreciation of their efforts.

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July 1, 2010