EURO CRISIS-ITS IMPACT ON INDIAN ECONOMY

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Abstract

All economies are interdependent, so there will be positive and negative repercussions, when countries are involved in trade. This fact is very much apparent when there was a global recession in the year 1933. History has again proved that economic crisis has affected all world economies, the American recession in 2008 and now the Euro crisis. But what concerns is the stability of the world economies. This applies to the Indian Economy as well. The Euro was the outcome of the Maastricht treaty and is a powerful traded currency amongst developed and emerging economies. The Euro as the single currency of the European Union and equally powerful as US dollar is now facing a weakening due to debt in its member countries and this crisis has affected Indian capital markets with a decline due to large sales by FIIs resulting in a bearish outcome of the stock market. The present paper is an attempt to study the causes for downtrend of Euro and its impact on India.

Keywords: Euro, Maastricht treaty, European Union, foreign institutional investors (FIIs)

I. Introduction

Today it is a world of uncertainty in the economic environment of business. The current Euro crisis has affected the financial health of the economy of India. As we all know the Euro is the second largest currency in the world and presently has 27 member states. The Euro area consists of 17 member states that accounts for over 75% of the European Union’s GDP. It all started in 2009 when Greece one of the prominent members revealed fiscal debts that shook the entire economy. Gradually, Ireland, Portugal, Spain and Italy also witnessed a severe debt that led to rise in borrowing costs.

The current global financial crisis is due to trade cycles which affects levels of employment, prices, output and overall economic growth as J M Keynes rightly says,” a trade cycle is composed of periods of good trade characterized by rising prices and low unemployment percentages, shifting with periods of bad trade characterized by falling prices and high unemployment percentages.” It has been said that the European sovereign debt crisis is due to
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factors such as globalization of finance, trade imbalances, fiscal debts, high spending, trying to bail out sick industries resulting in slow pace of economic progress affecting employment, trade adversely. But according to Martin Wolf a Financial Times journalist, the root cause was Germany which experienced public debt and fiscal deficit compared to GDP than the affected member economies from 1999 till 2007.

India which has a close economic linkage with the Euro zone is also affected by its crisis, mainly the financial or the capital market has been hit hard due to the Euro crisis and a deficit in current account balance. Nevertheless, measures are undertaken both at the fiscal and monetary levels to reduce the adverse effect of Euro crisis on its economy. The present paper studies the causes that resulted in Euro crisis and its impact on India.

I) FORMATION OF EURO CURRENCY

The Euro is the currency used by the Institutions of the European Union and is the official currency of the Euro zone which consists of 17 members of the European Union namely Austria, Belgium, Cyprus, Estonia, Finland, France, Germany, Greece, Ireland, Italy, Luxembourg, Malta, the Netherlands, Portugal, Slovakia, Slovenia and Spain. But Denmark, Sweden and the United Kingdom chose not to join the Euro zone.

It is the second most traded currency in the world. According to International Monetary Fund (IMF) estimates of 2008 GDP and purchasing power parity among the various currencies, the Euro is the second largest economy in the world. The name Euro was officially adopted on 16th December 1995. It was introduced to the world financial markets on 1st January 1999. Euro coins and bank notes were circulated in the year 2002 on 1st January. It has been equally powerful traded currency but off late, it has weakened due to crisis in Greece, Italy, Spain and Germany.

The Euro is administered by the European Central Bank (ECB) and consists of Euro system which comprises of the central banks of the Euro zone members. The Euro was the outcome of the 1992 Maastricht treaty. The name ‘Euro’ was officially adopted in Madrid on 16th December 1995.

Maastricht Treaty: The Maastricht Treaty formally known as the Treaty on European Union was signed on 7th February 1992 by the members of the European Community in Maastricht, Netherlands. The European Council drafted the treaty which came into force on 1st November, 1993 that created the European Union and the outcome was the introduction of the currency Euro. This treaty has been amended by the treaties of Amsterdam, Nice and Lisbon. This Maastricht established the three pillars of the European Union known as the European Community (EC), Common Foreign and Security Policy (CFSP) and the Justice and Home Affairs (JHA). This treaty enabled the European Union to function as a single market that would ensure the free movement of capital, goods and services.

II) FACTORS THAT LED TO EURO CRISIS
The European sovereign debt crisis can be attributed to factors such as globalization of finance, trade imbalances, fiscal debts, slow economic growth, high spending and trying to bail out sick industries. Germany’s trade balance improved later but its counterparts Portugal, Ireland, Italy, France and Spain had trade deficits.

The economy of Greece was one of the fastest growing in the Euro zone community in which the Government took advantage that resulted in deficit that has been observed mainly due to high spending and not so good relations with Turkey. The prime industries of Greece namely shipping and tourism were adversely affected due to fluctuations in trade cycles. The Euro debt crisis began in 2009, when the new Greek Government announced that its predecessors had wrongly reported the data on Government budget which eventually had deficit at high levels and its extravagance spending during 2004 Olympic Games.

As a result, the country’s debt began to increase rapidly. Consequently, this created a panic amongst the Euro countries On 23 April 2010, the Greek Government requested an initial loan of €45 billion from the EU and International Monetary Fund (IMF) and in May 2010, Greece received a financial assistance package (loans) from other Euro zone Governments and the IMF. though the Government expenditure increased by 87%, its revenue grew by only 31%.

Euro being second foreign exchange reserve currency, there were hedge funds against Greece, that the crisis spread to countries like Portugal, Ireland, Italy and Spain. Starting from Greece, Ireland, Italy, Portugal and Spain (GIIPS), these Euro zone economies have witnessed a severe downgrade in the rating of their sovereign debt, fears of default, and a sudden rise in borrowing costs. Greece, Ireland and Portugal have lost access to international capital markets and are now getting bail-outs by the IMF, European Financial Stability Facility.

Some causes for Euro debt crisis also include large pension obligations and poor demographics/ageing population, high safety net and social services, cyclically weak tax receipts resulting from higher unemployment, lower property values and lower business activity, high business tax rates and uncompetitive minimum wage levels.

The Euro zone banks have failed to adjust their balance sheets to the new post-global financial crisis environment. These banks continue to have weak capital ratios. Therefore, the fragility of European banks has been magnified in the current environment.

Due to this crisis, unemployment rates have increased since 2009 in Spain and Ireland. In Spain, unemployment increased, from 8% to 18%, and in Ireland, from 5% to 12%. In Germany also unemployment increased to 9.5% and similar increases in Portugal, Greece and France.

III) EURO CRISIS- IMPACT ON INDIA
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Just as India could adjust its economy with the American crisis, another crisis in the form of Euro crisis surfaced the economy, making it difficult to return to normalcy that held to deficit in its current account balance.

The crisis in Greece has been viewed as the tip of an ice burg which will lead to a slowdown in growth in Europe that would impact India, with financial crisis in USA and Europe can hamper business for India.

The Maplecroft study states that India ranks 85th in a list of 169 countries outside of the Euro zone that have close economic linkages with the Euro zone economies.

This crisis resulted in falls in exports, deficit in balance of payments, decline in capital inflows and fall in the economic growth rate.

India’s economy is currently facing inflationary pressures, trade deficits and public debt. These internal weaknesses, together with an adverse international environment, have prompted the IMF to revise India’s growth prospects downwards in 2013 to around 4.9% and 6% respectively.

The EU countries have a share of 18.6 percent in India’s exports and it is the second largest destination for our exports. The Euro area’s instability has been negatively reflected in India’s exports. India’s total exports has declined from 20.2 percent in 2009-10 to 18.6 percent in 2010-11. The impact is negatively felt in textile and apparel exports as both Europe and US are major importers. Europe accounts for nearly 50 per cent of India's total apparel exports and hence it is no surprise that its debt crisis has adversely hit apparel exports from India.

The Euro crisis has also affected India’s stock market. Due to crisis in USA in 2008-09 foreign institutional investors (FIIs) had pulled out money from India for most part of the year because the many of these investors were facing difficulties in their home markets. The reduced savings and lack of confidence among investors has resulted in lower investment flows.

In order to combat the crisis, the finance minister stated that liberalization in external commercial borrowings (ECB) policy and portfolio investment norms and also it improve access to corporate bond market through Infrastructure Debt funds. The Reserve Bank of India (RBI) has tried to control speculation in the forex market by raising of NRI deposit interest rates, easing availability of export credit and stipulation that 50 per cent of balances in the Exchange Earner's Foreign Currency Account be converted into rupees balances.
IV FINDINGS OF THE STUDY

- On 1 May 2010, the Greek government announced a series of security measures to secure a three year €110 billion loan.
- The EU, ECB and IMF offered Greece a second bailout loan worth €130 billion in October 2011, but with the activation being conditional on implementation of further austerity measures and a debt restructure agreement.
- Due to an alarming current account deficit, the finance ministry in India has announced a hike in import duty on gold thereby discouraging the purchase of physical gold and platinum also turned costlier.
- India is also the world’s largest producer of organic cotton, with annual production exceeding 75,000 tons.
- India in its capacity as the Co-Chair of the Working Group on the Framework for Strong, Sustainable and Balanced Growth trying to attain the objective of sustainability of economic growth.
- The EU is India’s largest trading partner and observed a compound annual growth rate (CAGR) of over 15% during the last decade from $21 billion in 2000-01 to over $91 billion in 2010-11.
- India-EU trade relations are of great importance as the EU receives over 18% of India’s global exports and is also the source of over 12% of India’s imports.

V CONCLUSIONS OF THE STUDY

Euro zone debt problem is likely to remain a concern in the near future. The world still holds the US-$ as the majority of their foreign exchange reserves, the Euro is a close second (about 25% of holdings) Since the world reserve currency also acts as the international pricing currency for oil, gold, and other products traded on world markets, the decline of the value and the confidence in the Euro could have a devastating impact on all aspects of global trading. The impact of aggravating international business uncertainty and volatility in the stock market will at length affect the businesses and economy of India. The Government can emphasize more on exports, as exports act as an important means to measure the competitiveness of a country’s industries.

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