2nd Internal Prep

Discuss the trends of recession faced by India in the past and explain how the upcoming recession is different from the past downturns?

The recession faced by India during the global financial crisis of 2008, as well as potential differences that could characterize an upcoming recession:

Recession Faced by India in 2008:

- India experienced a slowdown in economic growth during the global financial crisis.
- The country's GDP growth rate dropped from around 9% to around 6% in 2008-2009.
- Demand for Indian exports declined, affecting sectors like textiles, gems and jewelry, and IT services.
- Foreign direct investment (FDI) inflows decreased, impacting real estate and infrastructure sectors.
- India's financial system remained relatively stable due to cautious banking practices and Reserve Bank of India's measures to maintain liquidity.

Potential Differences in an Upcoming Recession:

- Causes and triggers of the recession may be different from the 2008 crisis.

- Global economic conditions and dynamics have evolved since 2008, which can influence the severity and nature of a future recession.
- India's economic resilience and policy frameworks have evolved, which could lead to different strategies for mitigating the impact of a future recession.
- The sectors most affected by a future recession may differ from the 2008 crisis, depending on changes in India's economic structure.
- The specific impacts of a future recession are subject to various factors and can vary significantly depending on the circumstances.

What is meant by recession? What steps has the Government of India taken so far to tackle the current ongoing recession in the country?

A recession refers to a significant decline in economic activity over a sustained period. It is characterized by a contraction in gross domestic product (GDP), reduced consumer spending, decreased investment, rising unemployment, and a decline in business profits. Recessions are typically caused by various factors such as a financial crisis, economic imbalances, reduced consumer confidence, or external shocks.

An overview of some steps that the Indian government has historically taken during recessions:

1. Fiscal stimulus packages: The government may introduce fiscal measures to stimulate economic activity, such as increasing government spending, providing tax incentives, or offering subsidies to specific sectors. These initiatives aim to boost consumption, investment, and employment.
2. Monetary policy adjustments: The Reserve Bank of India (RBI), India's central bank, plays a crucial role in managing the economy during a recession. The RBI can implement measures like reducing interest rates, lowering reserve requirements for banks, or injecting liquidity into the financial system to encourage borrowing and investment.
3. Infrastructure development and investment: Governments often prioritize infrastructure projects during recessions to create employment opportunities and stimulate economic growth. Investments in sectors like transportation, energy, and housing can have a positive multiplier effect on the economy.

4. Support for affected sectors: Governments may provide targeted support to industries heavily impacted by the recession. This support can include financial assistance, loan restructuring, tax relief, or specific policies tailored to address sector-specific challenges.
5. Reforms and policy adjustments: Recessions may prompt governments to undertake economic reforms and policy adjustments aimed at improving the business environment, attracting investments, and boosting productivity. These reforms can contribute to long-term economic growth and resilience.

How does an Economy get affected during a financial crisis?

During a financial crisis, an economy can be significantly affected across various sectors and dimensions. Here are some ways in which an economy can be impacted during a financial crisis:

1. Contraction in economic activity: A financial crisis often leads to a sharp decline in overall economic activity. Businesses may reduce production, leading to lower GDP growth. Consumers and investors become cautious, leading to decreased spending and investment.
2. Financial market disruptions: Financial crises are often characterized by disruptions in financial markets. Stock markets may experience sharp declines, and there may be a lack of liquidity in credit markets. Banks and financial institutions may face difficulties in accessing funding, leading to credit crunches and reduced lending.
3. Asset price declines: Financial crises can result in significant declines in asset prices, such as stocks, real estate, and commodities. This can have negative effects on households' wealth, leading to reduced consumer spending and a decrease in investment.
4. Increase in unemployment: Financial crises can lead to widespread job losses as businesses struggle and cut costs. Reduced economic activity and business failures contribute to higher unemployment rates. This, in turn, affects consumer spending and further dampens economic growth.
5. Decline in business and investor confidence: Financial crises erode business and investor confidence. Uncertainty about the future and concerns about

economic stability can lead to a reluctance to invest and make long-term commitments. This can further weaken economic growth prospects.

6. Government budget pressures: During a financial crisis, governments often face increased budget pressures. Tax revenues may decline due to lower economic activity, while government spending may increase to support the economy, provide social safety nets, and stabilize financial institutions.
7. International trade disruptions: Financial crises can have spillover effects on international trade. Decreased consumer spending and weakened global demand can lead to reduced exports. Trade imbalances and protectionist measures may also emerge as countries try to safeguard their domestic industries.
8. Confidence and contagion effects: Financial crises can generate fear and panic in financial markets. This loss of confidence can spread to other countries and economies, leading to contagion effects. Global interconnectedness and interdependencies can amplify the impact of a financial crisis, affecting economies beyond the initial epicenter.

▼ Financial Contagion

Financial contagion refers to the spread of financial distress or instability from one market or country to others, creating a domino effect and amplifying the impact of a financial crisis. It occurs when problems in one sector or region spill over to other interconnected sectors or regions, leading to a broader and deeper crisis.

Financial contagion can manifest in various ways:

1. Cross-border contagion: Financial distress in one country can spread to other countries through channels such as trade, investment, and financial linkages. For example, a banking crisis in one country can lead to a loss of confidence in the banking systems of other countries, resulting in capital flight and disruptions in the global financial system.
2. Contagion within sectors: Financial distress in a particular sector, such as banking or housing, can spread to other sectors. For instance, if a banking crisis leads to a credit squeeze, it can impact businesses' ability to borrow and invest, thereby affecting other sectors of the economy.

3. Contagion through financial markets: Turmoil in one financial market, such as stock markets or bond markets, can spill over to other markets. Panic selling and a decline in asset prices can trigger a broader sell-off, impacting investor sentiment and leading to contagion effects across different markets.
4. Psychological contagion: Market participants' behavior and psychology can contribute to contagion effects. Negative sentiment, fear, and loss of confidence can spread rapidly, intensifying the crisis. Investor herd behavior and mass withdrawals from financial institutions can exacerbate the contagion.

Financial contagion is facilitated by factors such as interconnectedness, globalization, and information flows. Increased financial integration, cross-border capital flows, and complex financial products can amplify the transmission of distress across borders and sectors.

Addressing financial contagion often requires coordinated efforts by policymakers, central banks, and international institutions. Measures can include injecting liquidity into the financial system, providing emergency funding to stabilize institutions, implementing regulatory reforms to enhance resilience, and fostering international cooperation to restore confidence and stabilize markets.