



India's Recession Phase- a Review

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1. Prologue

India's growth rate picked up from 4% during (pre-reform period) to 9 % during the first decade of this century (2001-10). Earlier India was affected less by external world depressions as it relied more on internal consumption, saving and import substitutions. However, after reforms picked up, its economy was opened to global players, share of exports, both goods and services, in GDP grew significantly. There is a consensus among economists that every economic expansion is followed by recession. During the boom, when economic growth is too fast and unsustainable, inflation increases. To reduce it, the governments deflate the economy by various ways which result into credit crunch and falling prices. Cost push inflation squeezes incomes and reduces disposable income. This causes a collapse in confidence of finance sector and 'real economy'. Indian economy also passed through these stages during 2008-12. The economic growth rate was above 8% for consecutive period of three years since 2006. However by the time it reached 2012 the GDP growth rate fell to 5% approximately as forecasted by Sachdeva (2009). This paper is an attempt to explore the reasons for India's recent fall of growth in GDP. It needs to validate whether India's economy has shifted back to pre-reform stages. Section II reviews and explores pre-reforms and post-reforms scenario analysing the data from April, 1971- March 2012 (in short 1971 to 2011), Sections III examines short term quarterly data from 2008 to 2012 to explore affected sectors, Section IV concludes.

2. India's transformation

2.1 Pre reform Scenario

Until the 1991 reform measures, government control over production, investment, technology and location choice, prices and foreign trade had become so extensive that there was no possibility of exercising the discretion vested in the layers of bureaucracy by the system of controls in a rational manner. It was a chaotic system of incentives and opportunities of rent seeking. India's share of foreign trade (exports plus imports) globally fell from its level above 2% at the independence to about 0.5% in 1990. The share of foreign trade (exports plus imports) in GDP at market prices was virtually

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unchanged, increasing from 12% in 1950-51 to 14% in 1990-91, (Chandra Bipin et al, 1999).

Srinivasan (1996) observed that extent of poverty went down since independence, and reduction in poverty arising from a more rapid debt-led growth without structural reforms, meant its future sustainability was doubtful. In contrast to the targets for income growth of 5.5% - 7.5% per year in the various five-year plans since the second, except the fifth, national income grew only at an average rate of less than 4% per year in the forty years period (1950-51 to 1990-91). Self-sufficiency, at very modest levels of consumption, has been achieved in a number of commodities including food grains. The share of gross domestic capital formation in GDP almost doubled from 14.7% in 1950-51 to 23.6% in 1990-91. However there was no commensurate increase in the rate of growth of GDP because of capital-intensive character of the investment.

2.2 Post Reform Scenario

Restructuring measures by domestic industry, overall reduction in domestic interest rates, improved corporate profitability, a benign investment climate amidst strong global demand and commitment rules-based fiscal policy led to real GDP growth. Gross domestic savings increased continuously from an average of 9.6 per cent of GDP during the 1950s to almost 35 per cent of GDP by 2012; over the same period, the domestic investment¹ rate also increased continuously from 10.8 per cent in the 1950s to approximately 36 per cent by 2008-09². Public sector also showed improvement. The savings rate of the overall public sector improved from (-) 2.0 per cent of GDP in 2001-02 to near 3.5 per cent of GDP in 2008-09. Public sector savings gave an indirect lift to private domestic savings from 23.5 per cent to 34.8 per cent over the same period. The public sector investment rate increased from 6.9 per cent of GDP in 2001-02 to 7.8 per cent in 2008-09, but this level is still significantly lower than the public sector investment rates of the 1970s, 1980s and early 1990s. The macroeconomic review of the Indian economy does suggest a strengthening of the fundamentals in terms of movement to a higher growth path in recent years, supported by investment, savings and improvement in productivity, (Rakesh, 2008).

Compounded annual growth rate (CAGR) of GDP at Market (Constant) prices was 4.47% during 20 years of pre-reforms period of 1971-72 to 1990-91 (in short 1971 to 1990)³. CAGR of GDP at Market (Constant) prices was 6.82% during 20 years of post reform period of 1992-2011. Though these CAGRs are not statistically significant, yet they give a clue how economy moved pre and post reforms. Share of

¹ Broadly difference of capital formation and saving rates remained only 1% GDP in India since 1991.

² Indian financial years is April to March

³ Year April 1991 to March 1992 has not been considered for calculation due to high volatility during the year.

Capital formation was 23.39 in 1990 growing at the rate of 5.66% during pre reform period. Same increased to 32.03% in 2011-12 growing at the rate of 9.58% compounded annually. Share of private final consumption was above 80% in 1960s, settled to 67.28% in 1990. After reforms private consumption has increased by 6.08% compounded annually and its share in GDP is 57.93. Share of Government expenditure in GDP remains same and growth rate remains same. After reforms, per capita income is increasing at the rate of 5.08% annually, remarkable change for individuals.

Table 1 Growth rate of Components of GDP at Market Prices (pre and post reforms)

Period	1971-72 to 2011-12		Share in GDP	
	1971-90 CAGR	92-2011 CAGR	As in 1990	As in 2011
GDP at Market Prices	4.47	6.82		
Net domestic capital formation	5.66	9.58	23.39	32.03
Private final consumption expenditure	4.06	6.08	67.28	57.93
Government final consumption expenditure	6.08	6.24	12.33	11.22
Exports	5.88	14.29	6.78	25.23
Imports	7.30	13.93	7.74	32.62
Per Capita NNP at factor cost (Rupees)	1.99	5.08		

Calculated by author at 2004-05 constant prices

It is clear from Equation 1 that during 1971 to 1990 private final consumption was only significant to increase GDP. 1.4 times change in GDP increased in one unit change in GDP. Government expenditure, investment and terms of trade were not statistically significant in increasing the GDP. However, during 1992 to 2011 private consumption, investment and terms of trade have become statistically significant in increasing terms of trade. Hence, after reform investment and globalisation has positive effect in moving the economy up.

$$\begin{aligned}
 &\text{Period 1971-72 to 1990-91} \\
 \Delta \text{GDP}^1 &= 1.4107\Delta \text{PFCE} + 0.798\Delta \text{GFCE} + 0.206\Delta \text{GFCF} + 0.31\Delta \text{BOT} \dots (\text{Eq 1}) \\
 &\quad (6.3996^*) \quad (0.9566) \quad (0.4420) \quad (0.7490) \\
 &\quad R^2 = 0.96, N = 20, F = 54.65 \\
 &\quad (\text{Calculated by author}) \\
 &\text{Period 1992-93 to 2011-12} \\
 \Delta \text{GDP} &= 1.6036\Delta \text{PFCE} + 0.1687\Delta \text{GFCE} + 0.43624\Delta \text{GFCF} + 0.579\Delta \text{BOT} \dots (\text{Eq 2}) \\
 &\quad (6.2614^*) \quad (0.2083) \quad (1.9247^{***}) \quad (2.1370^{**}) \\
 &\quad R^2 = 0.98, N = 20, F = 157.198^2
 \end{aligned}$$

¹ ΔGDP , ΔPFCE , ΔGFCE , ΔGFCF , ΔBOT are first difference in GDP, Private Final Consumption Expenditure, Gross Final Capital Formation (which is almost equal to investment and 1% less than saving rate) and Balance of Trade (Exports – Imports)

² Calculated by author by taking first difference of times series from RBI (Reserve Bank of India) database.

(Calculated by author)

(Figures in brackets are t-stats, * 1% significance level, ** 5% significance level and *** 10% significance level)

The CAGRs of sectors of GDP pre and post reforms have been shown in **Table 2**. Post reforms construction sector has gone up at the rate of 8.39% compounded annually. Trade, hotel, transport and communication have shown significant increase at the rate of 9.57% annually after the reform. Finance, Insurance and Real Estate and business have shown remarkable increase at the rate of 8.87% annually. The sad part of the story is the agriculture and allied activities which grew only at the rate of 2.82% annually and there is not a much change from pre-reform era in case of growth rate.

2.2.1 Exports

After reforms share of exports in GDP have increased wonderfully to 25.53%. The compounded growth rate of exports is 14.29% annually. Table 1 clearly depicts Indian economy is now integrated with world economy, if external trade is taken into consideration. Total trade flows (receipts and payments on merchandise and invisibles¹), as a proportion of GDP, rose from 20 per cent to 53 per cent during the period 1990-91 to 2008-09. Capital flows (inflows plus outflows) had been just 12 per cent of GDP in 1990- 91, and in 2007-08 they rose to 64 per cent of GDP. Interestingly, these ratios are significantly higher than those in the US for which in 2007 trade in goods and services constituted a lower 41 per cent of GDP and capital flows were only 25 per cent of the GDP in that year, (Rakesh, 2008).

Table 2 Growth rate of Sectors of GDP at Factor (pre and post reforms)

	1971-90	1992-2011
	CAGR	CAGR
Agriculture & allied activities	2.70	2.82
Mining & Quarrying	6.74	4.45
Manufacturing	5.13	7.18
Electricity, Gas & Water Supply	7.82	5.87
Construction	3.77	8.39
Trade, Hotel, Transport and Communications	5.54	9.57
Finance, Insurance, Real Estate & Business Services	6.74	8.87
Community, Social & Personal Services	5.10	6.77

Calculated by author at constant 2004-05 constant prices

However, Sharma et al (2003) analysed the data from 1971 to 2000 by Johnson's cointegration procedure and found that a cointegration relationship between exports and GDP did not exist. Granger causality test also did not provide any evidence that there was any relation between exports and GDP. But Shome, (2006) feels that

¹ Invisible receipts are mostly from exports of services like software exports.

despite high household savings, consumers are credit rich. Domestic demand is expected to remain high.

India has faced three major crisis since 1980s,- i) 1991-92 balance of payment (BOP) crisis; ii) 1997-98 fallout from the Asian financial crisis; and iii) 2000-02 crisis caused by the worldwide bursting of the dotcom bubble and 9/11 incident. Rajiv et al (2009) find that export growth slumped by 12 percentage points during the crisis periods. But the export sector recovered in just one year after the slump in all the three major crises. The sudden recovery of exports can be due to the huge depreciation of rupee that is seen during the crises period. He further noted that import growth starts falling two years prior to the crises. The fall in import growth in the three major crises is greater than the fall seen in export growth. Import growth fell at an average of 14 percentage points and recovery also takes longer than for exports. The sharp depreciation during the crisis period makes the imports more expensive, hence, leading to their prolonged slump.

2.2.2 Government Expenditure

As in Equation 1 and 2 Government expenditure was not statistically significant both during 20 years pre reforms and post reforms. Indian experience shows that high fiscal deficit hurts economic growth. This high fiscal deficit marks a sharp reversal of fiscal consolidation happening over the last 6 years. Attempts to raise public sector consumption to revive aggregate demand, crowd out both private consumption and investment. It has no longer impact on output. On the other hand, government expenditure on infrastructure investment crowds in private investment; and public investment in manufacturing adversely affects private investment. The fiscal deficit (including states) always remained above 10 percent and could be higher if the GDP growth slows down further.

2.2.3 Capital Formation

Eq 1 and Eq 2 show that during pre reform period of 20 years capital formation did not help to increase GDP and however after reforms Capital formation is statistically significant at 10% to increase GDP. According to Sakthivel and Yadav (2007), the percentage share of development expenditure to total expenditure has been declining whereas the percentage share of non-development expenditure to total expenditure has been rising during the period of post reforms. The expenditure pattern of India has been gradually shifting from development activities to non-developmental activities, such as defence, tax collection expenses, interest payments obligations on public debt and expenditure incurred in maintaining internal security during the past decade. This shift of expenditure pattern from development expenditure to non-development expenditure has deteriorated the fiscal position of India. the revenue expenditure to GDP ratio stagnated around 28% while there was a steep decline in capital expenditure until 2003-04 when a sudden rise was observed. Wagner's Law

runs from the economy's national income to public expenditure i.e., as the national income of the economy increases the public expenditure also increases accordingly. Keynesian opinion runs from the public expenditure to economy's national income. The estimated Granger causality tests showed a bidirectional relationship between national income and public expenditure in India. Similarly, a feedback relationship between national income and India's expenditure on economic services was reported. The causality between national income and India's expenditure on social and defence services were found to be independent and a unidirectional relationship between national income and India's debt obligations (interest payments) was found to be from GDP to interest payments. Thus, in the study by Sakthivel and Yadav (2007), both Wagnerian and Keynesian propositions are rejected. Hence, it was concluded that public expenditure and national income in India during the study period share a feedback relationship with each other.

3. Impact of World Recession after 2nd quarter of 2008

The global financial sector meltdown precipitated by the collapse of Lehman Brothers in September 2008 and the subsequent virtual nationalization of AIG, the world largest insurance company, impacted India at a time when the economy was already in the midst of a cyclical slowdown. Spooked by market rumors and some circumstantial evidence, depositors sought safety by shifting their deposits away from private banks to large public sector banks as reflected in the State Bank of India (SBI) seeing an increase in deposits of more than Rs. 1000 crore per day during that period. Foreign institutional investors (FIIs) withdrew from the Indian markets to provide the much-needed liquidity to their parents in the US or Europe. This resulted in a net repatriation of about \$ 13 billion by the FIIs in 2008 on account of equity disinvestment, though small, has resulted in a sharp decline in equity prices and market capitalization.

3.1 What went wrong?

It is observed during 16 quarters from 2008 to 2011¹ that private consumption and capital formation are decreasing at the rate of 2% annually, (Table 3). Exports of goods and services, which were increasing at the rate of 14.29%, are growing only at the rate of 2.75%. The sectors which have been affected more by this fall in export and consumption and investment are manufacturing, electricity, gas and water supply and construction. They are falling at the rate of 3.74%, 2.71% and 1.64% respectively, (Table 4). Trade, hotel, transport and communication business is almost stagnant during the last four years. Finance, insurance, real estate etc. are growing at the rate of 1.52% annually against the growth rate of 8.87%.

¹ 2008-09 to 2011-12

Table 3 Yearly growth rate of Shares of GDP Components calculated on 16 quarter from 2008-2011

Components of GDP	Yearly growth rate on quarterly data ¹
PFCE	-1.99
GFCE	2.20
GFCF	-2.03
Export of goods & Services	2.75
Import of goods & Services	1.28

(Calculated by author)

Table 4 Yearly growth rate of Shares of GDP sectors calculated on 16 quarters from 2008-2011

Sectors of GDP during 2008-09 o 2011-12	Growth rate
Agriculture & Allied Activities	0.39
Mining & Quarrying	1.40
Manufacturing	-3.74
Electricity, Gas & Water Supply	-2.71
Construction	-1.64
Trade, Hotel, Transport and Communications	0.10
Finance, Insurance, Real Estate & Business Services	1.52
Community, Social & Personal Services	2.54

(Calculated by author)

Same model as in Equation 1 and 2 has been used, Equation 3 clearly indicates that private consumption and external trade are not statistically significant. During this four years time, a new pattern has emerged when government expenditure and capital formation have become statistically significant as observed from 16 quarters during 2008 to 2011.

Quarter data 2008-09 to 2011-12

$$\Delta GDP_Q = -0.5081\Delta PFCE_0 + 2.8246\Delta GFCE_0 + 1.0704\Delta GFCF_0 + 0.1839\Delta BOT_0. \text{ (Eq 3)}$$

(-1.5770) (5.3899*) (2.4524**) (0.7975)

$R^2 = 0.94, N = 16, F = 23.18$

¹ Quarterly growth rate was converted to yearly growth rate

The quarterly data for 16th quarter during 2008 to 2011 also shows that government expenditure and investments are statistically significant at 1% and 5% respectively. Economists believe that budgetary deficit rises with the rise in government expenditure and it may escalate the interest rate which will, in turn, reduce employment and increase inflation. Rise in budget deficit may reduce investment by increase in the rate of interest and therefore trade deficit may not rise. Ricardian Equivalence hypothesis, however, emphasises the adjustment in savings to budget deficit, (Suparna et al, 2005).

Table 5 Compounded growth rate of GDP for last four years using quarterly data

Compounded growth rate 2008-11 Last 4 years	8.90
Compounded growth 2009-11 Last three years	7.29
Compounded growth 2010-11 Last two years	5.44
Compounded growth 2011-11 Last one year	5.55

Table 5 shows during last two years CAGR is approximately 5.5%. By ARIMA (1,1), GDP was calculated taking 40 years yearly data, it was estimated that GDP would grow at 5.79% in 2013-14 and 5.50% in 2014-15. The same confirmed by taking quarterly data also and it was almost a fact for these years.

3.2 GDP and Money Supply

So, from the above discussion it is seen the main culprit for decreasing GDP is fall in exports and consumption. Exports have fallen because of world recession. Then, why consumption has decreased? Table 6 shows the growth rate of money supply in pre and post reforms, the growth rate has marginally increased in case of demand deposit and has fallen in case of time deposit. Due to Reserve Bank of India's stringent measures through rate of interest and Cash Reserve ratios compulsions to banks, year on year growth rate M_0 has decreased in 2011 (Table 7). There is hardly any change in the growth rate of narrow money and broad money. When components of money stock were observed, the major change is seen in case of net foreign exchange assets of banking sector. The foreign exchange assets are growing at the rate of 22.9% annually.

During 1971 to 1990 there was bidirectional Granger relationship between GDP and money supply. However, in 1992 – 2001 there is a unidirectional Granger relationship. GDP does not Granger cause money supply. But money supply causes GDP.

Table 6
Growth rate of Money supply and its sources pre and post reforms

	1971-90	1992-2011
Currency with the Public	13.40	14.64
Demand Deposits	12.56	15.26
Time Deposits	21.93	18.00
Reserve Money (M_0)	15.90	13.72
Narrow Money (M_1)	13.03	14.75
Broad Money (M_3)	17.52	17.02
Net Bank Credit to Government	17.82	13.51
Bank Credit to Commercial Sector	18.05	18.24
Net Foreign Exchange Assets of the Banking Sector	14.01	22.94

(Calculated by author)

Table 7
Year on year growth rate of M_1 and M_3 after 2001

Year	YoY Growth M_1	YoY growth M_3
2001	11.5	16.0
2002	12.0	16.1
2003	15.5	13.0
2004	17.2	14.3
2005	18.8	15.5
2006	19.8	20.0
2007	15.9	22.1
2008	14.5	20.5
2009	15.8	19.2
2010	16.8	16.2
2011	5.8	15.8

(Calculated by author)

Table 8 Granger Causality test on GDP and Money supply

Period		F		F
1971-90	$GDP \rightarrow M_1$	12.3321*	$M_1 \rightarrow GDP$	5.1008**
1992-2011	GDP does not Granger cause M_1	1.1152	$M_1 \rightarrow GDP$	13.41*

(Calculated by author)

3.3 FDP and FPI

The inflows of foreign capital into India have been a mixed blessing for the economy. Capital inflows have been associated with increased investment and rising Gross Domestic Product (GDP). GDP is strongly related to the exchange rates of Indian rupee per unit of US dollar, pound sterling and SDR. This suggests that the prevailing exchange rates helped in the growth of Indian GDP. It also focuses on the effects of inflows of foreign capital on some macroeconomic variables in India.

Kishor K Guru-Gharana (2012) confirms that the post liberalization period in India exhibits significantly different characteristics than the pre-liberalization period. If both periods are combined, the only significant causality in the Granger sense is seen from GDP towards Exports but not from Exports towards GDP. Thus, the Export led Growth hypothesis does not get support. It seems, however, that there has been a significant structural transformation in the Indian Economy in recent decades. As a result, there is significant causality running bidirectional between Export and GDP and unidirectional from FDI towards both GDP and Exports in the post liberalization period. Thus modern reforms in India have indeed facilitated the linkages between Exports and GDP on the one hand and FDI and GDP on the other. On the other hand, FDI stands out not only for having a direct causal link fostering GDP but also an indirect channel of influencing GDP through positive impact on Exports. FDI seems to be largely decided by factors other than GDP or Exports, exhibiting some kind of “Exogeneity” or “external force” behavior. India needs to catch up fast. Kishor K Guru-Gharana (2012) suggest that some policy changes have to be made to modify the largely “Exogenous” or “independent,, behavior of FDI. The unidirectional causality relations between FDI and Growth on the one hand and between FDI and Exports on the other, have to be somehow converted to bidirectional linkages. In other words, FDI has to be reinforced also by the prospects of Export promotion and accelerated growth. It has to be “internalized” with the system so that the three macro variables keep reinforcing each other to lead towards accelerated and sustained Growth.

3.3.1 Exchange Rate

One of the most important features of the capital inflows into India since 1992, is the change in its composition from debt to non-debt creating sources. External commercial borrowing, which was the major source of the foreign capital inflows during the 1980s, became less important during the 1990s. The magnitude of the capital inflows into India during the 1990s was comparatively less than that in other countries. For example, the peak level of capital inflow in India was 3.5% of Gross Domestic Product (GDP) in 1993-94, whereas the peak levels of capital inflows were above 20% in Malaysia, 13% in Thailand, 10% in Singapore and Philippines between 1990 and 1993. Capital inflows exert pressures on nominal and real exchange rates. A market based exchange rate will change whenever the values of either of the two components of currencies change. A currency will tend to become more valuable whenever its demand is greater than the available supply. It will become less valuable whenever its demand is less than the available supply. Increased demand for a currency is either due to increased transaction demand for money, or increased speculative demand for money. The transaction demand for money is highly correlated to the country's level of business activity, GDP and employment levels. Capital inflows have been associated with increased investment and stock market activity, and rising GDP, and have resulted in a buildup of inflationary pressures. Further the correlation between the money supply and exchange rates (rupees per unit of US dollar, pound sterling and SDR) is very strong. The WPI increased from 100 in 1993-94 to 210.4 in 2006-07, 268 in 2010-11 and 307 in 2012. Similarly, the exchange rate of Indian rupee per unit of US dollar increased from Rs. 31.37 in 1993-94 to 40.24 in 2007-08 to 49 in 2010-11 and 56 in 2012. In other words, inflation increased faster than the depreciation in Indian rupee.

3.4 Inflation

The money supply is increasing and it has affected the inflation. The growth rate of whole sale price of food article is increasing at the rate of 9.25% annually, (Table 9). The whole sale price of food articles have almost doubled during the last seven years. It has been observed that during 2000 to 2012 that 7% change in narrow money increased 1 point of whole sale price index.

Table 9, how many times inflation increased?

Period	All commodities Wholesale prices	Food articles Wholesale prices
1971 to 1990	4.9	5.3
1992-2011	6.9	9.2

According to Rao and Lodh (1983), in the medium-run inflation is not only a monetary phenomenon but also caused by a host of other factors: external inflation, foreign interest rates, low productivity growth, labour market tightness, domestic energy pricing and indexation of wages to CPI, a measure of inflation that reflects both domestic and foreign price pressures. The restrictive aggregate demand policies alone will not make a significant dent in inflation without incurring substantial loss in output and employment. The inflation can be fought by using a balanced mix of aggregate demand and supply management policies and incentive based income policies. Inflation contributes to social unrest as it erodes the real income of various sections of the population. Robert (2000) reports a significantly negative correlation between inflation and GDP growth for average inflation rates above 10%. According to Fischer (1993 in Max, Harris and Laszlo, 2004), inflation lowers the rate of return on capital, both human and physical following Ramsey-Cass-Koopmans and Lucas (1988 in Max, Harris and Laszlo, 2004). According to Kenji Miyazaki (2010), inflation affects balanced growth path (BGP) with non-constant time preferences, even when the labor decision is inelastic. The higher the rates of money supply, the lower are real balances and the higher are transaction costs, which discourages consumption or increases the ratio of capital to consumption. Kent (1986 in Kenji Miyazaki (2010)), Friedman (1969, in Kenji Miyazaki (2010)) argued that the optimum rate of inflation is the negative of the real interest rate. If inflation proceeds at such a pace, the private cost of holding money, the nominal interest rate, will be zero and thus equal to the social opportunity cost of supplying money. Individuals will thus be induced to hold the optimum quantity of money — the level of real balances at which marginal benefit and marginal cost are equal. Mahmood Arai, Mats Kinnwall And Peter Skogman Thoursie (2004) argue that inflation is not in general harmful to GDP growth. On the other hand, there is a negative correlation between contemporaneous intra-country inflation and growth for periods characterized by positive oil-price shocks According to Athanasios Koulakiotis, Katerina Lyrودي & Nicholas Papasyriopoulos (2011), there is strong link between the link between inflation and GDP—not only in Europe but also in Asian or the U.S.—in order to see if there is a statistically unidirectional relationship between inflation and GDP. Their results show that the economic growth of the above mentioned countries is strongly influenced by the inflation. Marco et al (2007) say *unanticipated* inflation can be beneficial when there are nominal rigidities. Rao and Lodh (1983), further argue that systematic reductions in the rate of growth of money supply (M_1) does not reduce inflation. On the contrary, the inflation rate increases. Those opposed to the monetary explanation of inflation argue that the primary causes of inflation are associated more directly with movements in world raw material prices, especially energy and food, movements in prices of imported manufactured products, poor productivity performance, and the downward rigidity of price expectations.

4. Concluding Remarks

FDI and FPI played a significant role to increase foreign exchange assets of banking sector. This resulted in increase in money stock which helped to increase GDP directly or indirectly. Increase in money stock and overheated economy resulted in rise of commodity prices, especially food prices. In the meantime, world started witnessing recessionary trend since 2008. There was a affected rigorously on exports. To check inflationary trends, monetary policies were initiated to control velocity of money stock through the measures of interest rate. This resulted in slowing down of economy; consumption, manufacturing, trade, services all fell.

With the increased linkage with the world economy, India cannot remain immune to the global crisis. Basically there are three channels through which India is affected by the global crisis: (i) financial markets, (ii) trade and (iii) exchange rate. Major Causes of slowdown in India during 2008-09 are i) Impact of Monetary Tightening ii) Industrial Sector Weakness and iii) Monsoon-dependent Agriculture iv) Investment weakness v) Fiscal measures.

Economy would not take a positive turn beyond 5% growth till 2016. In the meantime, India is a heaven for foreign investment due to higher rate of returns. Foreign investments, direct or portfolio, will go on fuelling money stock. Government's efforts to control inflation through interest rates would further affect manufacturing and other sectors. Share markets will not go down but GDP would not rise till 2016.

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