

RECESSION AND ITS EFFECTS ON STOCK MARKET IN INDIA

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Abstract

This paper discuss that recession is a word which has rocked the entire world. US market which is a feeder of the world market crashed and it had effect on all the major markets and India is one of them thousands of people became jobless and a number of people committed suicide due to recession problems. This recession had effect on all the sector and mainly service sector affected a lot. Sensex lost a number on points and lakhs of people lost there money on BSE. Government tried to rescue many financial houses by extending them good financial packages. In this paper, the author tries to explain the effect of recession on stock market as well as global market.

Keywords: Recession, Economy, Stock Market, India, Government.

Introduction

The fear of a recession looms over the United States and as the cliché goes, whenever the US sneezes, the world catches a cold. This is evident from the way the Indian markets crashed taking a cue from a probable recession in the US and a global economic slowdown. Weakening of the American economy is bad news, not just for India, but for the rest of the world too. A recession is a decline in a country's gross domestic product (GDP) growth for two or more consecutive quarters of a year. A recession is also preceded by several quarters of slowing down.

An economy which grows over a period of time tends to slow down the growth as a part of the normal economic cycle. An economy typically expands for 6-10 years and tends to go into a recession for about six months to 2 years. A recession normally takes place when consumers lose confidence in the growth of the economy and spend less. This leads to a decreased demand for goods and services, which in turn leads to a decrease in production, lay-offs and a sharp rise in unemployment. Investors spend less as they fear stocks values will fall and thus stock markets fall on negative sentiment.

Theoretical Background

The investment through Foreign Institutional Investors (FIIs) has become a powerful force within the development of Indian stock market and it is increasingly viewed as an important reason for stock market unpredictability. This situation has powered researchers to analyze the nexus between FIIs capital moves and stock exchange volatility. To be able to ascertain the hyperlink between the two, present researches make a moderate attempt to

create an understanding from the FIIs investment decision and its effect on stock market movements. To check the actual non-stationarity of times series the particular Augmented Dickey-Fuller (ADF) device root examination is used. In present study, statistical tools such as mean, difference, standard deviation, skewness as well as correlation evaluation are used to analyze the impact associated with FIIs influence on Indian currency markets volatility. Along with these tools, GARCH model will be also utilized to study the effect of FIIs capital flows on stock market volatility. The research reveals there is significant relationship between FIIs capital flow and stock market volatility. Furthermore, FIIs purchase has statistically significant impact on a volatility of NIFTY and SENSEX, used as proxy to be able to Indian industry. (Mahul Brahma & Ruchika Gupta; 2018) [4]

FII refers to an institution established or incorporated outside India, which suggests to make investment decision in Indian stock market. In order to trade in Indian stock market foreign corporations must register with the Securities as well as Exchange Board of India as an international institutional investor. One of the major market regulations pertaining to FIIs involves placing limits on FII ownership in Indian companies. As a way to invest in the stock markets, it is very essential that unknown investors have a very good thought about NSE, BSE etc. There are Institutional investors that include hedge funds, insurance companies, pension funds and mutual funds. According to research there are 1484 Foreign Institution Investors and 38 foreign brokers registered to securities & Exchange Board of India (SEBI). (Mahul Brahma & Ruchika Gupta; 2018) [5]

Global Impact

The economy and the stock market are closely related. The stock markets reflect the buoyancy of the economy. In the US, a recession is yet to be declared by the Bureau of Economic Analysis, but investors are a worried lot. The Indian stock markets also crashed due to a slowdown in the US economy. The Sensex crashed by nearly 13 per cent in just two trading sessions in January. The markets bounced back after the US Fed cut interest rates. However, stock prices are now at a low ebb in India with little cheer coming to investors.

The defaults on sub-prime mortgages (home loan defaults) have led to a major crisis in the US. Sub-prime is a high risk debt offered to people with poor credit worthiness or unstable incomes. Major banks have landed in trouble after people could not pay back loans. The housing market soared on the back of easy availability of loans. The realty sector boomed but could not sustain the momentum for long, and it collapsed under the gargantuan weight of crippling loan defaults. Foreclosures spread like wildfire putting the US economy on shaky ground. This, coupled with rising oil prices at \$100 a barrel, slowed down the growth of the economy.

The US economy has suffered 10 recessions since the end of World War II. The Great Depression in the United States was an economic slowdown, from 1930 to 1939. It was a decade of high unemployment, low profits, low prices of goods, and high poverty.

The trade market was brought to a standstill, which consequently affected the world markets in the 1930s. Industries that suffered the most included agriculture, mining, and logging. In 1937, the American economy unexpectedly fell, lasting through most of 1938. Production declined sharply, as did profits and employment. Unemployment jumped from 14.3 per cent in 1937 to 19.0 per cent in 1938. The US saw a recession during 1982-83 due to a tight monetary policy to control inflation and sharp correction to overproduction of the previous decade. This was followed by Black Monday in October 1987, when a stock market collapse saw the Dow Jones Industrial Average plunge by 22.6 per cent affecting the lives of millions of Americans. The early 1990s saw a collapse of junk bonds and a financial crisis. The US saw one of its biggest recessions in 2001, ending ten years of growth, the longest expansion on record. From March to November 2001, employment dropped by almost 1.7 million. In the 1990-91 recession, the GDP fell 1.5 per cent from its peak in the second quarter of 1990. The 2001 recession saw a 0.6 per cent decline from the peak in the fourth quarter of 2000. The dot-com burst hit the US economy and many developing countries as well. The economy also suffered after the 9/11

attacks. In 2001, investors' wealth dwindled as technology stock prices crashed.

Recession on India

In other words, the effects of this recession on India may be quite distinct from those of the past. Here are some areas worth following:

1. A credit crisis in the United States might lead to a **restructuring of asset allocation** at pension funds. It has been suggested that Cal PERS is likely to shift an additional US\$24 billion to its international portfolio. A large portion of this is likely to flow into India and China. If other funds follow suit, a cascading effect can be expected. Along with the already significant dollar funds available, the additional funds could be deployed to create infrastructure--roads, airports, and seaports--and be ready for a rapid takeoff when normalcy is restored.
2. In terms of specific sectors, the **IT Enabled Services sector may be hit** since a majority of Indian IT firms derive 75% or more of their revenues from the United States--a classic case of having put all eggs in one basket. If Fortune 500 companies slash their IT budgets, Indian firms could be adversely affected. Instead of looking at the scenario as a threat, the sector would do well to focus on product innovation (as opposed to merely providing services). If this is done, India can emerge as a major player in the IT products category as well.
3. The **manufacturing sector has to ramp up scale economies**, and improve productivity and operational efficiency, thus lowering prices, if it wishes to offset the loss of revenue from a possible US recession. The demand for appliances, consumer electronics, apparel, and a host of products is huge and can be exploited to advantage by adopting appropriate pricing strategies. Although unlikely, a prolonged recession might see the emergence of new regional groupings--India, China, and Korea?
4. The tourism sector could be affected. Now is the time to **aggressively promote health tourism**. Given the availability of talented professionals, and with a distinct cost advantage, India can be the destination of choice for health tourism.
5. A recession in the United States may see the **loss of some jobs** in India. The concept of Social Security, that has been absent until now, may gain momentum.
6. The Indian Rupee has appreciated in relation to the US dollar. **Exporters are pushing for government intervention** and rate cuts. What is conveniently forgotten in this debate is that a stronger Rupee would reduce the import bill, and narrow the overall trade deficit. The Indian central bank (Reserve Bank of India) can

intervene anytime and cut interest rates, increasing liquidity in the economy, and catalyzing domestic demand. A strong domestic demand would also help in competing globally when the recession is over.

In summary, at the macro-level, a recession in the US may bring down GDP growth, but not by much. At the micro-level, specific sectors could be affected. Innovation now may prove to be the engine for growth when the next boom occurs.

For US firms, who have long looked at China as a better investment destination, this may be a good time to look at India as well. After all, 350 million people with purchasing power cannot be ignored. This is not a sales pitch for India, but only a gentle suggestion to US corporations.

Counter Strategy

Karthik Ananth, senior consultant, business development, Zinnov, says there is already a shift in business strategies of corporate India. Large IT and BPO firms have started looking at other markets like Europe, and even the domestic market, to spread their risks and reduce the impact of the rising rupee. This can be best seen with Infosys setting up an India centric team.

K. Ramachandran, head, advisory desk, BNP Paribas Private Banking, says Indian companies will have to adopt a multi-pronged strategy, which includes diversification of the export markets, improving internal efficiencies to maintain cost competitiveness in a tight export market situation and moving the product portfolio up in the value chain to impart resilience.

The IT sector too is keen to defend its position. R.S. Rethinasamy, Vice-President, Finance Aditi Technologies, says that in case of a full-blown US recession, the onsite staffing business will see a decline in sales and profit. "At the same time, it can increase the offshore work. Recessions at this juncture may not last for more than two to three years. Smart companies will continue to make investments so that they can be ahead of the competition when the US economy comes out of recession", he says.

This means corporate India will have to spend a lot more to develop market and supply chain links in alternate markets like Asia and Europe. Experts say the export dependent sectors of the economy need to re-focus on local demand and income from non-dollar economies.

The European, West Asian and the African countries may offer viable short-term alternatives to our export-dependent sectors. BPOs, for

example, will have to re-negotiate with their clients and fix appropriate price for their services.

Can India be a market option? Zinnov says IT firms can definitely find a market in India, but the deal sizes are likely to be small. India has a huge, small and medium enterprise base and it is the right time to tap this segment. As for automotive components, consumer electronics and mobile devices, they have already found a market in India and have also started looking at tie-ups in China and other BRIC countries.

Consequences of US Recession on India Job Market

Worst affected because of US recession will be the service industry of India. Under service industries come BPO, KPO, IT, ITeS etc. Service industry contributes about 52% to India's GDP growth. Now if that is going to get hurt then it will also hurt India's overall growth but very slightly. India is not going to face a major impact due to US recession. People may say that there is going to be a huge job loss due to recession. and will cite the example of TCS firing about 500 employees but these were employees who didn't perform and for cost cutting one have to reduce Non performing asset and that exactly what has been done. There is no threat to the skilled people. According to NASSCOM India will have a shortage of about 5 million skilled people in IT/ITeS. So there are lots of opportunities.

Apart from this India's travel, tourism and power industry is going to grow at a better rate. This is again a good sign. India has a huge population so a huge consumer base so we don't have to always depend on US for our growth. India's GDP is expected to grow at the rate of 8.5-8.9 % which is again way above the growth rate of US and only second highest in the world after China.

This recession gives us opportunity to be innovative and to think out of box so that the US directly don't affect our robust growth. Due to increasing Rupee exporters are having a hard time but it has been noted that our exporters are not that efficient and in past they got the benefit of depreciating rupee.

So now its time to be innovative and more effective and increase the over all efficiency and go for systematic cost cutting to balance the rupee effect. Infact there are lots of scope for improvement. In West Africa goods at departmental stores are sold at the rate 5 times than Indian price and Indian goods are not exported to several countries in West Africa. Its an excellent opportunity for our exporters.

Conclusion

Over the past couple of months, fears of a slowdown in the United States of America have increased. The impact of the sub prime crisis along with a slowdown in mortgages has led to a significant lowering of growth estimates. Since the United States dominates the global economy, any slowdown there would have an impact on most of the global economic variables.

For India, it could mean a further appreciation in the rupee vis-vis the US dollar and a darkening of business outlook for sectors dependent on US companies. The overall impact of a US slowdown on India would, however, be minimal as the factors driving growth here are more local in nature. Unlike the rest of Asia, India is a strong domestic demand story, so any slowing in the US is likely to have a more muted impact on India. Strong growth in domestic consumption and significant spending on infrastructure are the two pillars of India's growth story. No sector has a dominant influence on earnings growth and risks to our estimate are limited. Corporate India is also learning to master the art of efficient capital management, reduction in costs and delivery of value-added services to sustain profit margins. Further, interest rates are expected to be stable primarily due to control over inflation and proactive measures undertaken by the RBI.

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