Abstract

Coupling of manufacturing sector to global trade and financial cycle is less appreciated in India until very recently. It was generally believed that due to relatively low levels of external exposure, the economy remains decoupled from external events. This paper examined possible transmission lines through which global trading and financial shocks could spill over to growth in India. It argues that the global events manifested over Indian economy systematically in terms of lost growth since the outbreak of the gulf crisis in 1990, which aggravated further with the increase in openness since mid-1990s. The impact of various crises is quickly visible over the manufacturing GDP through manufacturing export that constitutes over 65 per cent of total merchandise export in India. Rest of the GDP is relatively slow to respond as compared to the manufacturing GDP. The shocks also transmit through lower injection of foreign liquidity impacting stock prices and availability of finance from bank and non-bank sources. The empirical framework followed in the study involves examining the tentative cyclical correspondence of a number of domestic and global indicators to assess openness in India apart from giving an episode wise account of the growth around major global events since 1990. In addition, attempts are made to decompose variance of output to global shocks. The paper concludes that the foreign liquidity and trade channel is strong in India not purely from standard trade openness perspective as merchandise trade to GDP ratio is relatively low in India as compared with other emerging economies. In fact, manufacturing exports to value of production is no more than 13 per cent in India. The importance possibly derives from the fact that the country exports labour intensive merchandise by smaller manufacturing units that share around 34-39 per cent of industrial output, exports and employment. Thus, initial exports loss and lower access to credit gradually turn out to be a sizeable shock to output through employment loss and domestic demand. Monetary policy plays a limited role to counter global shock as RBI has to balance the inflationary pressure with simultaneous slowdown of capital inflows. Even an extremely accommodative monetary policy