THE MYTHS AND REALITIES VIS-À-VIS THE FINANCIAL CRISIS IN THE U.S. ECONOMY

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During the last quarter of the year 2011, the U.S economy went through the second phase of the financial crisis that emerged in summer 2007, with a revival till the end of winter 2009. Researchers have concluded that the first phase crisis was all due to the sub-prime lending which resulted in increased risk for the banks by the event of more default borrowers. Moreover, the U.S. Economy, one of the biggest economies, in the world, cannot be said that it took some days/months to flog the pillars of success of such a strong economy. With the support of the Federal Reserve and Government Policies focused towards remedying prices, however, the U.S Economy revived itself but yet something was ignored which then led to the currently ongoing financial crisis. The paper has examined the unemployment rate, productivity, and the GDP growth rate of the U.S. Economy for the period Jan 2001 to July 2011, with a view of examining the base of the Financial Crisis and to find whether the crisis emerged at once or it was sowed and that it has been emerging much before it was diagnosed.

Key words: Financial Crisis, Unemployment Rate, Productivity, Employment Cost Index, GDP Growth Rate.

THEORITICAL ASPECTS

Recession is said to be a slowdown in the economic activities of a nation over a sustained period of time or a business cycle contraction. The most common way to identify a recession in an economy is the two successive quarterly declines in its GDP. Global recession refers to the global economic slowdown over a sustained period of time. It can also be said that if the major part of the world suffers recession, it leads to the global recession. According to the International Monetary Fund, a global recession is when the global economic growth is less than 3%. By this measure, four periods since 1985 qualify: 1990–1993, 1998, 2001–2002 and 2008–2009. One of the longest depressions in the 20th

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century was noticed from August 1929 to September 1939 which is termed as the Great Depression. Since then the globe has experienced several economic slow-downs. But the most shocking was the financial crisis of mid-2007 which ruined the economies of the U.S. and the U.K. and swallowed the 158-year old Lehman Bros, the fourth largest investment bank in the world. The strongest of American, Europian and Japanese companies tackled the problem of liquidity and credit. Although India was wriggled in the crisis but its cautious approach towards reforms has saved it from the possible disastrous implications. The economy of the United States is well known to everyone by its dominancy and progressiveness. It is one of the pivotal economies in the world which has its dominance over the economies of the whole world. A fraction variation in the economic balance of the United States leads to the shuddering of the other big economies in the world. All this is because of the globalized era which had made all the economies dependent over each other. The financial crisis which rose in the early 2007 and ended in 2009 was a good example of this interdependency. We observed that how the major economies were affected by the crisis arising in the economies of the US and the UK; the Indian economy not being an exception. In 1984, the crisis in the US economy was called the savings and loans crisis, while the 2007 crisis was called the sub-prime financial crisis. Whatever be the kind of crisis, the outcomes are quite similar. The interdependency of the world economies had outburst the crisis as a major type of risk which calls for its awareness allover. A financial crisis has its way thru a long time ago. The economies like the US and the UK can never face financial crisis in a day or two; there has been some kind of sedition a long time in the past.

OBJECTIVES, SCOPE AND METHODOLOGY

The global financial crisis has been a burning topic and a number of authors have given their views about its occurrence and the do's and do not's. A number of suggestions still lie behind with regard to the security of the economy in case some major crisis re-occurs. After going through some major views by Indian as well as foreign authors, I have tried to justify the period of the financial crisis by examining the major economic indicators of the US economy. Some major impacts of the crisis have also been listed. The main objective of this paper is to examine the base of the Financial Crisis and to the find whether the crisis emerged at once or it was sowed and that it has been emerging much before it was diagnosed. For this purpose a data of last ten years from January 2001 to July 2011 has been examined. The data consists of the three major economic indicators of the US economy. They are the unemployment rate, productivity, and the GDP growth rate of the U.S. Economy.

QUANTITATIVE ANALYSIS

a. The Unemployment Rate

The unemployment rate is one of the most important indicators of the economy. An increase in unemployment rate implies that the economy is deteriorating while a decrease signifies that the economy is moving upward. We can see the unemployment rate in the United States since January 2001 in Table1. The least rate of unemployment was 4.2 in the month of January and February 2001 while the maximum unemployment rate was 10 in the month of October 2009. It is noticed that the unemployment rate started increasing since the year 2007 and since then the average unemployment rate has been 5.8, 9.3, 9.6, and 9.0 in the year 2008, 2009, 2010 and 2011 respectively. It is also noticed that the unemployment rate of the US has been in a recovering state since July, 2003 and the worst condition started when the unemployment rate carried an upward bounce since June 2007. Although the average unemployment rate was the same in the year 2006 and 2007, the upward bounce can be seen in the mid-2007.

Table 1: Unemployment Rate in the US Economy for the period 2001-2011

Year	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec	Avg
2001	4.2	4.2	4.3	4.4	4.3	4.5	4.6	4.9	5.0	5.3	5.5	5.7	4.7
2002	5.7	5.7	5.7	5.9	5.8	5.8	5.8	5.7	5.7	5.7	5.9	6.0	5.8
2003	5.8	5.9	5.9	6.0	6.1	6.3	6.2	6.1	6.1	6.0	5.8	5.7	6.0
2004	5.7	5.6	5.8	5.6	5.6	5.6	5.5	5.4	5.4	5.5	5.4	5.4	5.5
2005	5.3	5.4	5.2	5.2	5.1	5.0	5.0	4.9	5.0	5.0	5.0	4.9	5.1
2006	4.7	4.8	4.7	4.7	4.6	4.6	4.7	4.7	4.5	4.4	4.5	4.4	4.6
2007	4.6	4.5	4.4	4.5	4.4	4.6	4.7	4.6	4.7	4.7	4.7	5.0	4.6
2008	5.0	4.9	5.1	5.0	5.4	5.6	5.8	6.1	6.1	6.5	6.8	7.3	5.8
2009	7.8	8.3	8.7	8.9	9.4	9.5	9.5	9.6	9.8	10.0	9.9	9.9	9.3
2010	9.7	9.8	9.8	9.9	9.6	9.4	9.5	9.6	9.5	9.5	9.8	9.4	9.6
2011	9.1	9.0	8.9	9.0	9.0	9.1	9.1	9.1	9.0	8.9	8.7	8.5	9.0

Source: U.S. Bureau of Economic Analysis

An easy view of the status of the unemployment rate in the US economy can be viewed in Figure1. The unemployment rate was about to become stable at 4.4 during October 2006 to May 2007 when it was hit by the financial crisis which led the economy fade over. It established a height of 10 in just a year from 6.1 in September 2008.

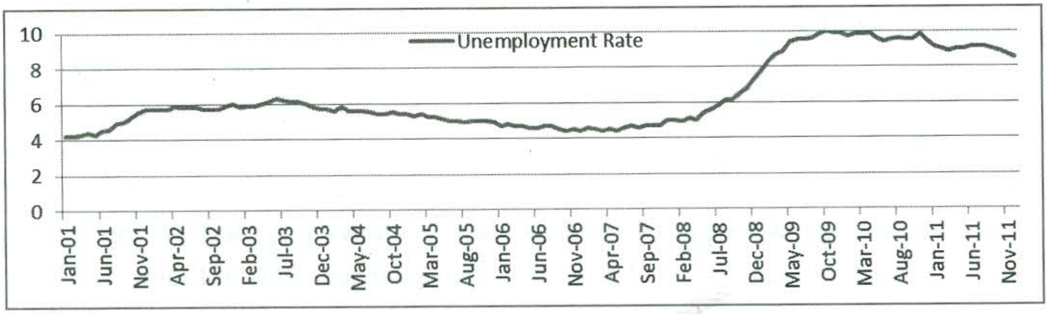

Figure 1: Unemployment Rate in the US Economy since January 2001

The graph of the unemployment has been steeper during the end of the financial crisis and it is still away from its actual direction which is required. However, the study of the unemployment rate reflects that the US economy has been in a good state before the financial crisis evolved.

b. The Productivity

Productivity is one of the most important determinants of the economic status of any country. Productivity here means the labour productivity; i.e., output per hour. An increase in the productivity will lead to the economic development while the decline tends to the economic imbalances. Table2 depicts the annual productivity in the US economy and it can be seen that it has been worsening since the year 2003. It has been continuosly decreasing from 4.6 in the year 2002 to 3.7 in 2003, 2.6 in 2004, 1.6 in 2004, 0.9 in 2006, 1.5 in 2007, and the least 0.6 in 2008. It has been growing since then.

Table 2: Annual productivity of the US Economy for the period 2001-2010

Year	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010
Productivity	2.9	4.6	3.7	2.6	1.6	0.9	1.5	0.6	2.3	4.1

Source: U.S. Bureau of Labor Statistics

Figure 2 reflects the quarterly productivity of the US economy since 2001. It can be seen that there has been major ups and downs in every quarter. This volatility states that the labour productivity has been poor from a time much before the financial crisis was diagnosed by the economist. The downfall in labour productivity initiated in mid-2003 and carried on till the end of the first quarter of the year 2009.

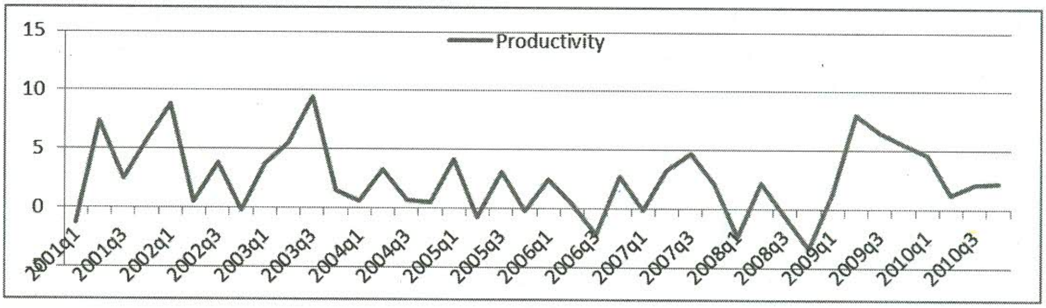

Figure2: Quarterly labor productivity of the US Economy since 2001

Although the worst labour productivity has been experienced during the crisis period, it has not been satisfactory even before that. It can be inferred that the financial crisis although diagnosed in early 2007 but the US economy has been under-performing much before this financial crisis. The under-utilization of labour has been one of the reasons behind the deteriorating performance of the US economy.

c. The GDP Growth Rate

The GDP growth rate is another important indicator of the economy. An increase shows that the economy is growing while the decline hints towards the downfall of the economy. Table3 below depicts the per quarter GDP growth rate of the US economy since 2001. It is seen that for the first quarter of 2001 it was 1.4 while it went up to 5.5 in the second quarter falling back to pathetic 0.2 in the third quarter. The period from the third quarter of 2001 to the third quarter of 2003 has been an overall a good period.

Table 3: GDP Growth Rate of the US Economy for the period 2001-2011

Period	GDP*	GDP**	Period	GDP*	GDP**	Period	GDP*	GDP**
2001q1	1.4	-1.3	2004q3	6.0	3.0	2008q1	0.6	-1.8
2001q2	5.5	2.7	2004q4	6.4	3.3	2008q2	4.0	1.3
2001q3	0.2	-1.1	2005q1	8.1	4.2	2008q3	-0.6	-3.7
2001q4	2.7	1.4	2005q2	4.5	1.8	2008q4	-8.4	-8.9
2002q1	4.9	3.5	2005q3	7.5	3.2	2009q1	-5.2	-6.7
2002q2	4.0	2.1	2005q4	5.5	2.1	2009q2	-1.1	-0.7
2002q3	3.8	2.0	2006q1	8.3	5.1	2009q3	1.9	1.7
2002q4	2.5	0.1	2006q2	5.2	1.6	2009q4	4.9	3.8
2003q1	4.5	1.7	2006q3	3.1	0.1	2010q1	5.5	3.9
2003q2	4.6	3.4	2006q4	4.6	2.7	2010q2	5.4	3.8
2003q3	9.1	6.7	2007q1	5.2	0.5	2010q3	3.9	2.5
2003q4	5.8	3.7	2007q2	6.5	3.6	2010q4	4.2	2.3
2004q1	6.3	2.7	2007q3	4.3	3.0	2011q1	3.1	0.4
2004q2	6.1	2.6	2007q4	3.6	1.7			

Source: U.S. Bureau of Economic Analysis

GDP*: GDP percent change based on current dollars

GDP**: GDP percent change based on chained 2005 dollars

The negative figures during the four quarters from the third quarter of 2008 to the second quarter of 2009 show the peak of the financial crisis. A graphical representation in figure3 depicts the clear picture of the GDP growth rate during the period of study.

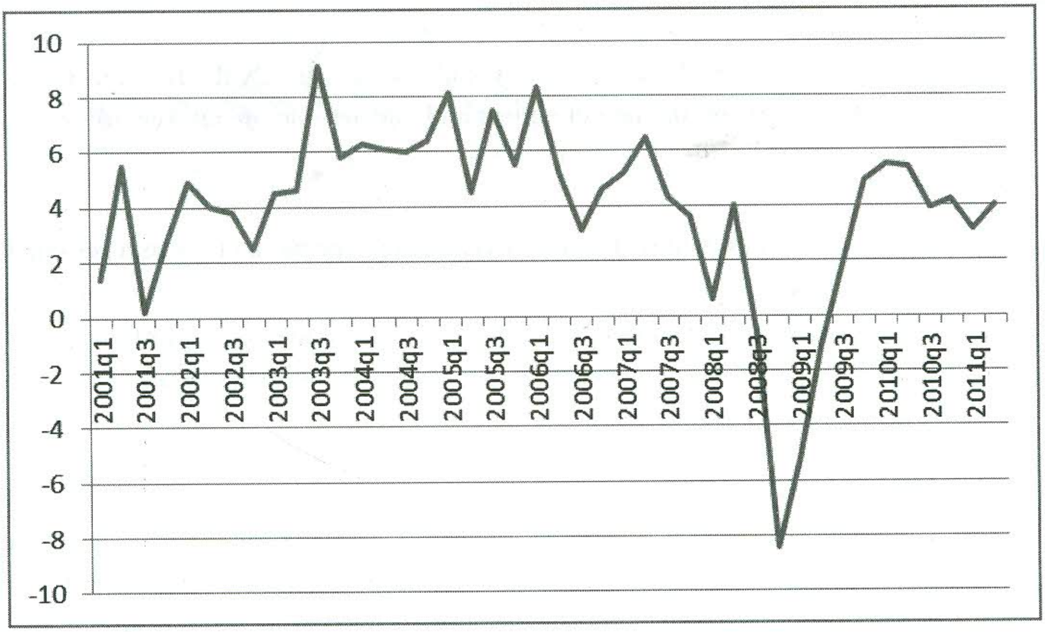

Figure3: Graphical representation of the GDP Growth Rate of the US Economy

The GDP growth rate of the US economy has been much fluctuating since first quarter of the year 2001. An upward move is seen after the third quarter of 2001 to the third quarter of 2003. With passage of time it went on diminishing. It started falling after the first quarter of the year 2006 and deepened to - 8.4 at the end of 2008. Positive figure is seen after the end of the second quarter of the year 2009. Hence, it can be said that the crisis was in its way since 2001 but took a vicious mien in 2006. The global financial crisis was not a sudden occurrence; in fact, it was it was sowed and that it has been emerging much before it was diagnosed.

IMPACTS OF THE CRISIS OVER THE INDIAN ECONOMY

Although the Indian economy has made no contribution in the rising of the financial crisis, it experienced a slowdown during that period. However, with a well-organized banking system, restrictions in the derivatives trading, comfortable foreign exchange reserves and domestic demand driven process of growth, India however limited the extent of the impact of the global financial crisis upon its economy. The major impacts of the crisis can be summed up as follows:

- The growth of the Indian economy declined to 7.3% in 2008, down from 9.3% in 2007.
- The contraction in the economy led to the fall in demand for labour, thus, resulting to large-scale job losses in certain sectors mainly the BPO, KPO, IT, etc. It led to the rise in unemployment and underemployment. According to a sample survey by the Commerce Ministry, 1, 09,513 people lost their jobs between August and October 2008 in export related companies in several sectors mainly textiles, leather, engineering, gems and jewellery, food processing, etc.
- The Indian Stock Market index crashed down from 21000 in January, 2008 to 9000 points by the start of February, 2007 (the start of the Financial Crisis). The IPO sector was significantly affected. It was one of the major financial crises which not only affected the Indian Stock Market but also the world's major stock markets.
- The economy faced the reversal in the Foreign Institutional Investment (FII), External Commercial Borrowings (ECB) and trade credit. The major overflow was noticed in September-October 2008 with the FIIs pulling out a record USD 13.3 billion and a fall in the value of Rupee from Rs.40.36 per USD in March 2008 to Rs.51.23 per USD in March 2009, reflecting 21.2% depreciation during the fiscal 2008-09. The annual average exchange rate during 2008-09 worked out to Rs.45.99 per USD compared to Rs.40.26 per USD in 2007-08 which was the biggest annual loss for the Rupee since 1991 crisis.
- The overall Balance of Payments situation remained resilient in 2008-09 despite signs of strain in the capital and current accounts, due to the global crisis. During the first three quarters of 2008-09 (April-December 2008), the current account deficit was USD 36.5 billion against USD 15.5 billion for the corresponding period in 2007-08. The capital account balance declined significantly to USD 16.09 billion in 2008-09 as compared to USD 82.68 billion for the corresponding period in 2007-08. As at end-March 2009 the foreign exchange reserves stood at USD 252 billion.
- The export growth declined to 3.6% in 2008-09 as compared to the 28.9% in 2007-08 and 22.6% in 2006-07. For the first time in 7-years, the exports then declined in October 2008 resulting a negative growth of -16.16% between Octobers-March 2008-09.

CONCLUSIONS AND SUGGESTIONS

The global financial crisis was experienced not only by the US and the UK economy but due to the globalized transactions it had its deep impacts over major part of the globe; India not being an exception. However, it was noticed that India was able to face the crisis period more conscientiously. Although the stock market figures were crushed it was somehow recovered in a very short span of time of about just one and a half year. Discussing about the depth of the financial crisis, it can be said that the crisis was a past borne issue and it has been neglected for a long time before. Lacerate financial policies of the US led to this disaster come a way. However, with the support of the Federal Reserve and Government Policies focused towards remedying prices, the U.S Economy revived itself but yet something was ignored which then led to the currently ongoing financial crisis. It has been already seen with the help of the major economic indicators that the US Economy was crisis laden much before the diagnosed period of mid-2007. The study of the unemployment rate reflects that the US economy has been in a good state before the financial crisis evolved but the other two indicators had a different story to tell. The study of the productivity inferred that although the worst labour productivity has been experienced during the crisis period, it has not been satisfactory even before that and the financial crisis although diagnosed in early 2007 but the US economy has been under-performing much before this financial crisis. The under-utilization of labour has been one of the reasons behind the deteriorating performance of the US economy. The GDP growth rate with time has been declining and experienced negativity even. It is found that the GDP growth rate shows that the US economy was under performing much before its diagnosis. Towards home, it can be said that an economy must have a strong clutch over its quantitative as well as qualitative performance at all the time so that its major imbalances are traced before much goes wrong. The US economy led crisis is a good example for others to learn from it. Even the banking sector needs to be aware about the loopholes which may endanger the economic performance. The fear of the crisis always remains the same and we need to be more conscious about the uncertainties which the crisis may deliver.

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