

NEXT IAS

**DAILY EDITORIAL
ANALYSIS**

TOPIC

**GLOBAL ECONOMIC RISKS AND
INDIA'S RESILIENCE**

www.nextias.com

GLOBAL ECONOMIC RISKS AND INDIA'S RESILIENCE

Context

- Recently, the Reserve Bank of India (RBI) Governor flagged that **geo-economic fragmentation (GEF)** driven by tariffs, trade restrictions, and industrial policies is not only reshaping global supply chains but also disrupting the free movement of capital and fragmenting financial flows globally.

About the Geo-Economic Fragmentation

- GEF refers to a **policy-driven reversal of global economic integration**, guided by strategic, security, and geopolitical considerations rather than purely economic ones. It is defined as a **multidimensional process that reverses the channels through which countries engage economically** including trade, migration, capital flows, and technology diffusion.
- Unlike organic de-globalisation caused by market forces, GEF is **state-engineered**, the result of **deliberate policy choices such as tariffs, export controls, industrial subsidies, and sanctions**.

Implications of Geo-Economic Fragmentation

- **Financial Market Instability:** These could trigger systemic crises similar to shadow banking risks seen in 2008.
 - ♦ **Asset Price Bubbles:** Elevated valuations in equity markets, especially **technology stocks**, pose correction risks; potential for **global contagion effects** across markets.
 - ♦ **Rise of Private Credit Markets:** Rapid expansion outside traditional banking systems; limited regulation and transparency; and strong interlinkages with formal financial institutions.
- **Macroeconomic Vulnerabilities:** IMF Fiscal Monitor warns of long-term fiscal sustainability challenges.
 - ♦ **Rising Public Debt:** Post-pandemic fiscal expansion has led to high sovereign debt levels; and delayed fiscal consolidation.
 - ♦ **Geopolitical Tensions:** Conflicts and strategic rivalries increasing **defence expenditure**; and crowding out developmental spending.
- **External Sector Pressures:**
 - ♦ **Global Concerns:** Volatile energy prices; trade imbalances; and currency fluctuations.
 - ♦ **Disrupted Supply Chains:** Shift from cost-efficiency to security-oriented production (China+1 strategy).
 - ♦ **Fragmented Financial Flows:** Reduced cross-border capital mobility and regionalization of finance.
- **Capital Flow Volatility:** Fluctuations in **Foreign Direct Investment (FDI)** and portfolio flows. Market corrections may reduce capital outflows, and improve net capital position.
 - ♦ Increasing greenfield investments in emerging economies like India.
- **Growth Slowdown Risks:** **Global trends of growth** are slowing growth in advanced economies; and tight monetary policies to control inflation.
 - ♦ **India's growth** is strong but moderating 8.2% average (2021–25); and gradual stabilization around 6.5–7%.
- **Financial Market Development Challenges:** **Key issues** are limited depth in the government securities market, concentration in derivatives markets, underdeveloped credit derivatives, and limited retail participation in forex markets.
- **Artificial Intelligence:** It **risks** uncertain business model sustainability; uneven technological diffusion; job displacement and skill mismatch.

India's Resilience Amid Geo-Economic Fragmentation

- Government data highlights resilience due to diversified trade and services exports.
 - ♦ **Forex Reserves:** Comfortable (approx 11 months import cover)
 - ♦ **Current Account Deficit (CAD):** Within manageable levels
 - ♦ **Trade Agreements:** Cushion external shocks

- **Capital Flows and Investment Trends:** Strong **FDI inflows**, especially in finance, and technology; increase in **greenfield investments**.
- **India's Growth Performance:** Average growth (2021–25) was around **8.2%**; and **6.9%** (2026–27 projection).
 - ♦ **Key drivers** are strong domestic consumption, public capital expenditure, and crowding-in of private investment.

Policy Responses and Way Forward

- **Global Level:** Strengthening multilateral cooperation (IMF, WTO reforms); and managing fragmentation through dialogue.
- **India's Strategy:** Maintaining macroeconomic stability; enhancing ease of doing business; promoting inclusive growth; and strengthening regulatory frameworks.
- **RBI's Role:** Ensuring financial stability; monitoring systemic risks; and deploying timely policy interventions.
- **Financial Market Development:** There is a need for better depth across maturities in **government securities market**, diversification for better hedging **derivatives market**, wider access and fairness **forex market**; and need for wider access and fairness, and underdeveloped and underutilized **credit derivatives**.
 - ♦ Banks and primary dealers act as market-makers; and have privileged access to liquidity. There is a need to enhance global presence; and improve market efficiency; and ensure ethical conduct.

Source: IE

Daily Mains Practice Question

- [Q] The global economy is increasingly characterized by geo-economic fragmentation, financial volatility, and technological disruptions. Comment. How has India demonstrated resilience in the face of these challenges?

