Global Finance and Economic Crisis, Impact on Indian Economy

MODULE 1 & 2

BALASUBRAMANIAN PG

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IMPACT OF GLOBAL FINANCIAL CRISIS ON INDIAN ECONOMY

Unraveling the repercussions of the global financial crisis on the Indian economy, exploring the interplay between the financial sector, exports, and exchange rates, elucidating the influence these factors had on the overall economic landscape.

01

Transmission channels: Financial sector, Exports, Exchange rates

02

Indian banking sector had limited exposure to sub-prime crisis

03

Exports account for 22% of GDP, with a significant multiplier effect on economic activity

04

Import content in Indian exports is relatively lower compared to other economies

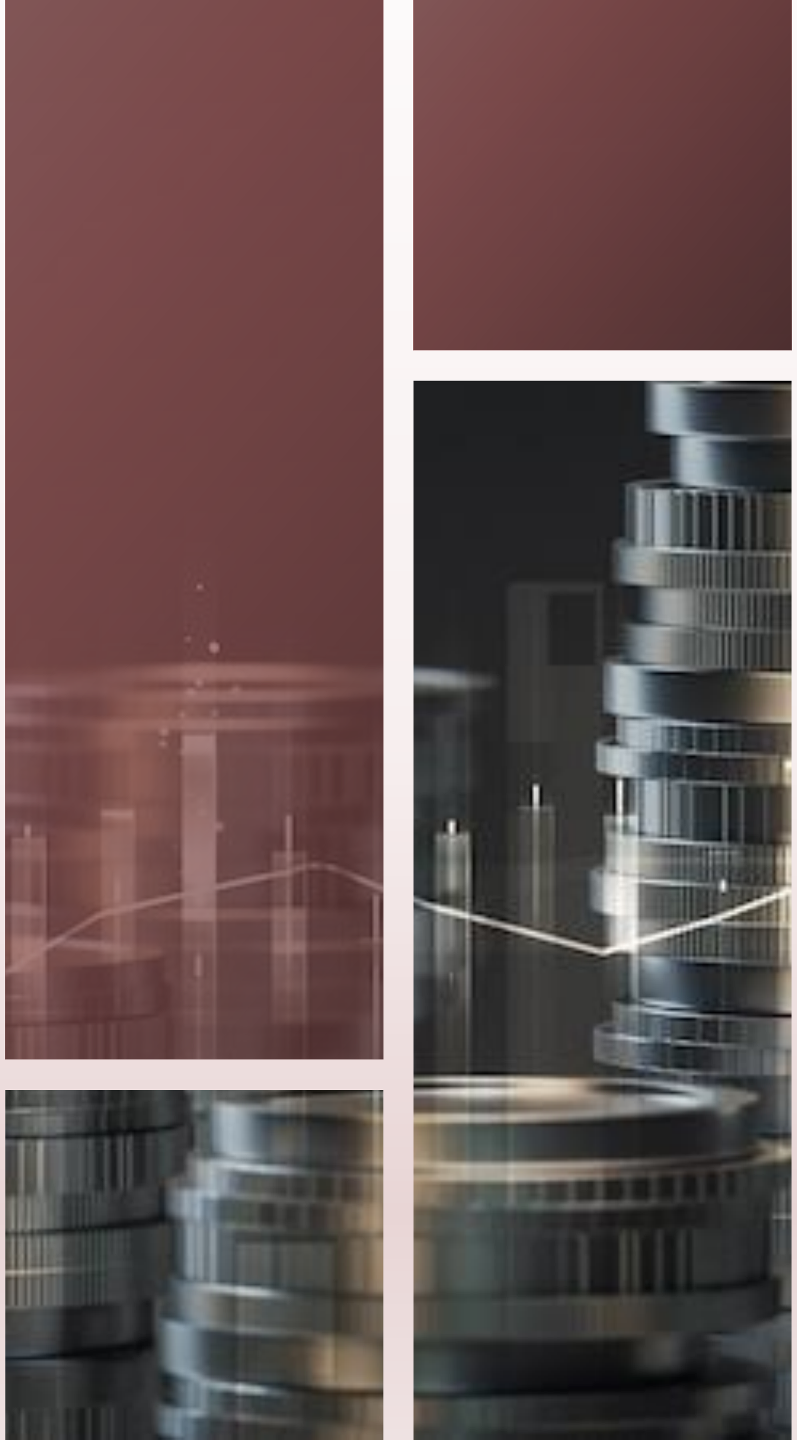
IMPACT ON FINANCIAL SECTOR

Assessing the robustness of the Indian banking sector amidst the global financial crisis, revealing its limited exposure to the sub-prime crisis and how this shielded the financial sector from severe repercussions.

WHO WE ARE

Indian banking sector was not overly exposed to sub-prime crisis

Limited direct impact on the financial sector in India



IMPACT ON EXPORTS

Delving into the ramifications of declining exports, which constitute a significant chunk of India's GDP, unraveling the ripple effects on GDP growth rates, industries, and employment.

Exports of goods and services account for 22% of GDP

Export slump can bring down GDP growth rate

Multiplier effect of exports on economic activity is significant

IMPACT ON EXCHANGE RATES

Impact on competitiveness of Indian exporters

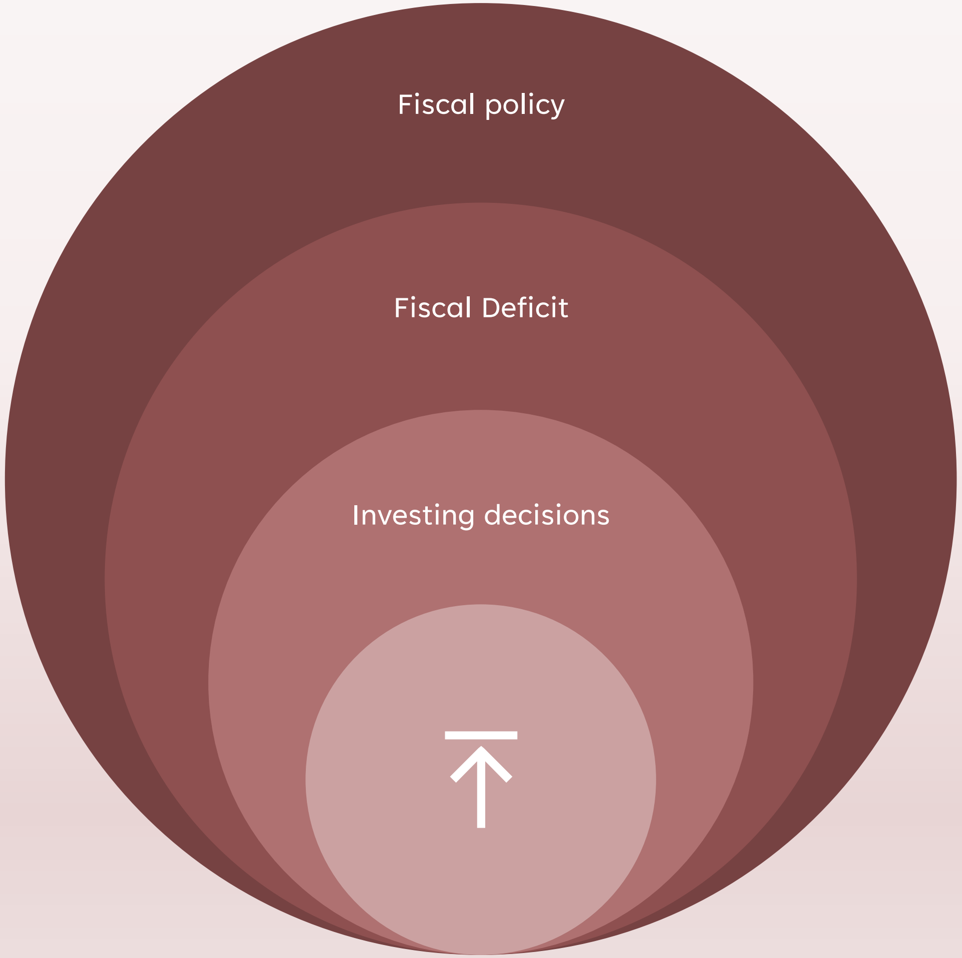
Indian Rupee came under pressure during the crisis

Exchange rate volatility affected the Indian economy

Depreciation of Rupee can make imports costlier

POLICY RESPONSE

Remove entry barriers to attract corporate investments and stimulate growth



- Limited room for further fiscal policy action due to high fiscal deficit
- Increasing fiscal deficit to GDP ratio risks credit rating downgrade and loss of business confidence
- Focus on improving investment climate for domestic and foreign investors

POLICY MEASURES

Navigating the intricate policy landscape in the face of limited fiscal space, spotlighting the imperative to enhance the investment climate, dismantle barriers to corporate investments, and fortify public goods, services, and physical infrastructure.

Improve investment climate: Ease of doing business, regulatory transparency

Remove entry barriers: Attract private investment, foster economic growth

Enhance delivery of public goods and services: Healthcare, education, infrastructure

Expand physical infrastructure capacities: Transportation, energy, communication networks

Improve rural connectivity: Bridge urban-rural divide, promote inclusive growth

Objective 6

IMMEDIATE IMPACT ON INDIAN ECONOMY

Unveiling an arsenal of policy measures aimed at invigorating economic revival, including fostering an investment-friendly climate, enticing domestic and foreign investors, bolstering public service delivery, expanding physical infrastructure, and fostering rural connectivity for inclusive growth

?

Increased challenges in the economy emerged

01. Initially appeared insulated from global financial crisis

02. Reserve Bank of India raising interest rates to control growth and inflation

03. Collapse of Lehman Brothers had immediate impact

GLOBAL ECONOMIC DOWNTURN

Slowdown in global economic activity affected Indian exports

IMF forecasted global recession with negative growth for world GDP

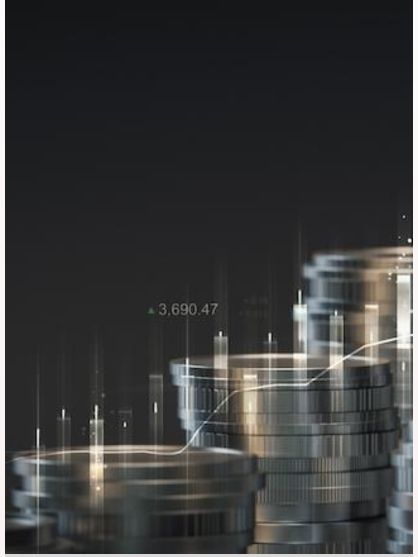
WTO predicted significant decline in world trade

Major exporters experienced sharp decline in exports (Germany, Japan, China)

Unveiling the initial insulation of the Indian economy, swiftly overshadowed by the reverberations of the Lehman Brothers collapse, unearthing the ensuing challenges that emerged on the economic horizon.

CONSEQUENCES AND DOWNSIDE SCENARIOS

Pioneering an understanding of the global economic downturn, as predicted by the IMF and WTO, exploring the ramifications on major exporting economies such as Germany, Japan, and China.



Risk of US economy experiencing prolonged recovery (Japan-like "L" shaped recovery)

Widespread unemployment and social stress in major exporting economies

Economic challenges and risks persist in the global economic landscape

PROTECTIONISM AND PROLONGED RECESSION

Rise of protectionist sentiments in many economies

Our Mission

Escalation of protectionism could lead to prolonged recession

Our Vision

Heightened risks and challenges in the global economic landscape

Need for cooperation and policy measures to mitigate protectionism's impact

Our Values

IMPACT OF GLOBAL CRISIS ON INDIAN ECONOMY

Commercial credit from foreign banks decreased, replaced by domestic banks

01

Transmission channels: Financial sector, Exports, Exchange rates

02

Indian banking sector not heavily exposed to sub-prime crisis

03

Equity markets experienced significant decline in index and market capitalization

FINANCIAL SECTOR IMPACT

The financial sector witnessed a sharp decline in equity markets and market capitalization, along with reduced commercial credit and outflow of foreign portfolio investments, leading to higher interest costs and rupee depreciation.

Equity markets declined by nearly 60% since January 2008

Market capitalization decreased by USD1.3 trillion

Foreign portfolio investors withdrew USD12 billion between September and December 2008

Commercial credit decreased, leading to higher interest costs and rupee depreciation

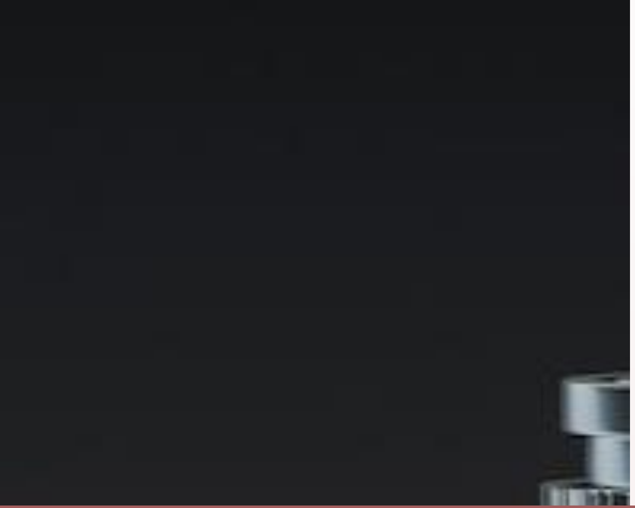
Slowdown on cash flow in economy

EXPORT IMPACT

Indian exports declined, particularly in gems and jewelry sector

- Job losses of over 300,000 workers in the sector
- Other export-oriented sectors affected: garments, textiles, leather, handicrafts, auto components
- 21% decline in exports in February 2009, steepest fall in two decades

MULTIPLIER EFFECT AND IMPORT CONTENT




Slump in exports reduces GDP growth rate


- Exports account for about 22% of Indian GDP
- Exports have a significant multiplier effect on economic activity
- Import content in Indian exports is lower compared to Chinese exports

EXCHANGE RATE IMPACT

The Indian Rupee faced pressure due to outflows of portfolio investments, leading to a 25% depreciation in its exchange rate. This nullified some benefits of declining oil and gas prices and increased the cost of commercial borrowings, affecting GDP growth rate.

Rupee under pressure with outflow of portfolio investments

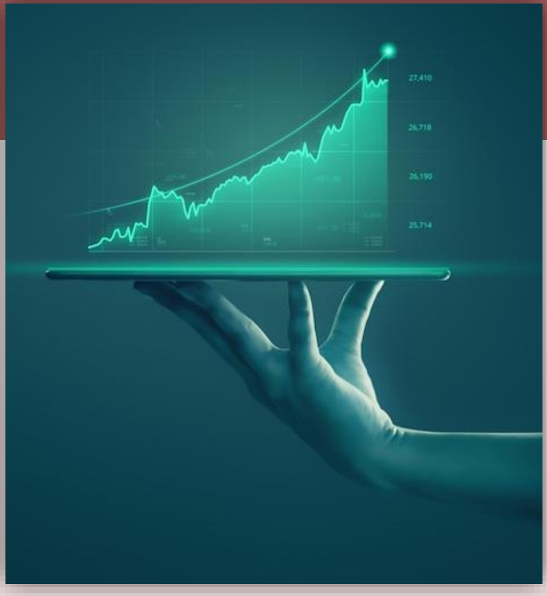
25% depreciation in Rupee's exchange rate

Partially nullifies benefits of declining oil and gas prices

Increases cost of commercial borrowings, affects GDP growth rate

POLICY RESPONSE: RBI

The Reserve Bank of India (RBI) took swift action to manage the crisis, infusing liquidity, lowering interest rates, and implementing measures to discourage overnight fund parking, aimed at stabilizing the financial sector and mitigating the crisis's negative impact.



RBI infused additional liquidity of USD80 billion by cutting CRR and lowering SLR

Expansionary preference signaled by reducing repo rate from 9% to 5%

Reverse repo rate brought down to 3.5% to discourage overnight fund parking — 76%

Quick policy response to manage negative impact of global crisis — 84%

2019

2020

2021

2022

POLICY RESPONSE: FISCAL STIMULI

Three fiscal stimuli announced between November 2008 and February 2009

- Amount to about 1.3% of GDP
- Additional fiscal measures announced in 2008-09 Budget benefiting farmers and rural sector
- Measures include farm loan waivers, rural employment guarantee scheme, rural infrastructure development, and increased subsidies

2019

2020

2021

2022

OVERALL IMPACT MANAGEMENT

Quick policy response by RBI and Central government

- Infusion of liquidity, interest rate cuts, fiscal stimuli
- Measures aimed at stabilizing financial sector, stimulating economic activity
- Mitigating impact on employment, rural sector, and overall GDP growth

2019

2020

2021

2022

CHALLENGES AND OUTLOOK

Continued challenges in global economic landscape

- Need for sustained policy measures to support recovery and growth
- Monitor exchange rate stability and external vulnerabilities
- Promote investment, exports, and domestic consumption for robust economic performance

2019

2020

2021

2022

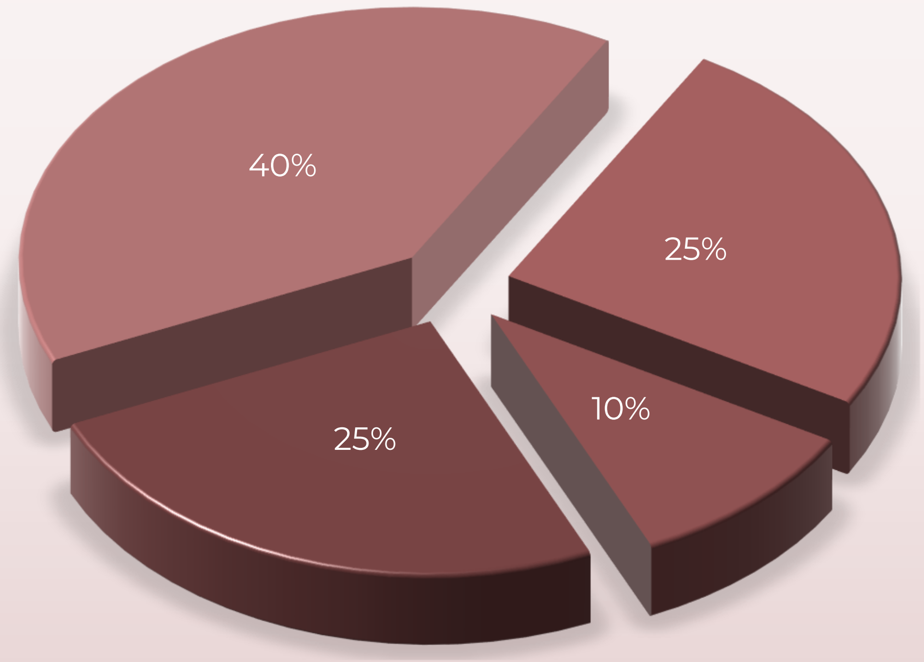
LESSONS LEARNED

Importance of diversifying export markets and reducing dependence on specific sectors

- Strengthening financial sector resilience and risk management
- Enhancing policy coordination and cooperation at the global level
- Continual focus on inclusive growth and development measures

EMPLOYMENT ELASTICITIES IN INDIAN ECONOMY

Employment elasticity measures the ability of an economy to generate employment opportunities relative to its growth process



Derived employment elasticities based on NSS data (1999-2000 to 2004-05):

Agriculture, forestry, and fishing: 1.52
Manufacturing: 0.34

Construction: 0.88
Trade, hotels, and restaurants: 0.59
Transport, storage, and communications: 0.27

Finance, insurance, real estate, and business services: 0.94
Total employment: 0.48

IMPACT OF MONETARY TIGHTENING ON GDP GROWTH

Prior to the external shock, India's GDP growth was already slowing due to monetary tightening measures. The decline in GDP growth resulted in a significant reduction in job creation, with millions of potential jobs not being realized.

45%

GDP growth had already slowed before the external shock due to monetary tightening

70%

Decline in growth to 5.3% results in the creation of 12.7 million jobs

80%

Q2 of 2008-09 registered 7.6% growth, implying the creation of 18.2 million jobs

55%

5.5 million jobs that would have been created will no longer be realized

SECTOR-WISE EMPLOYMENT IMPACT

Agriculture

Agriculture: Marginal decline in Q3, 2.7% growth in Q2 would have created 10.3 million jobs

Manufacturing

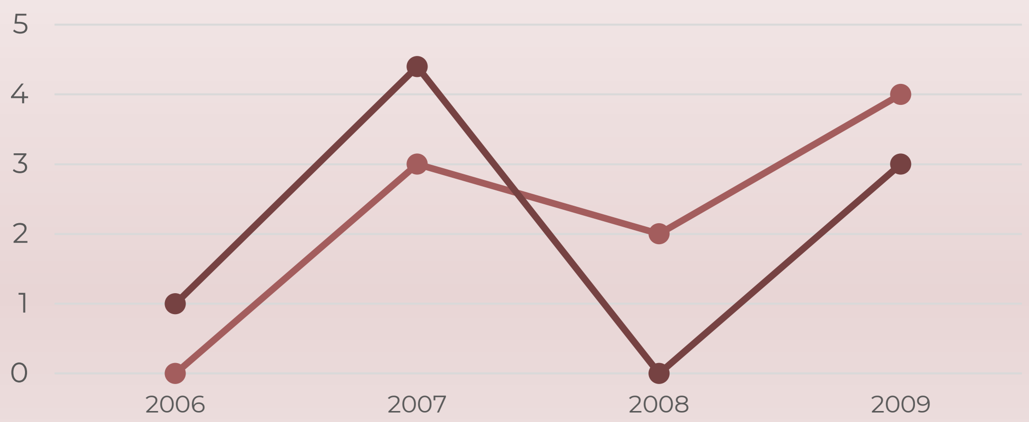
Manufacturing: 2.2% decline in Q3, 5% increase in Q2 would have created 800,000 jobs

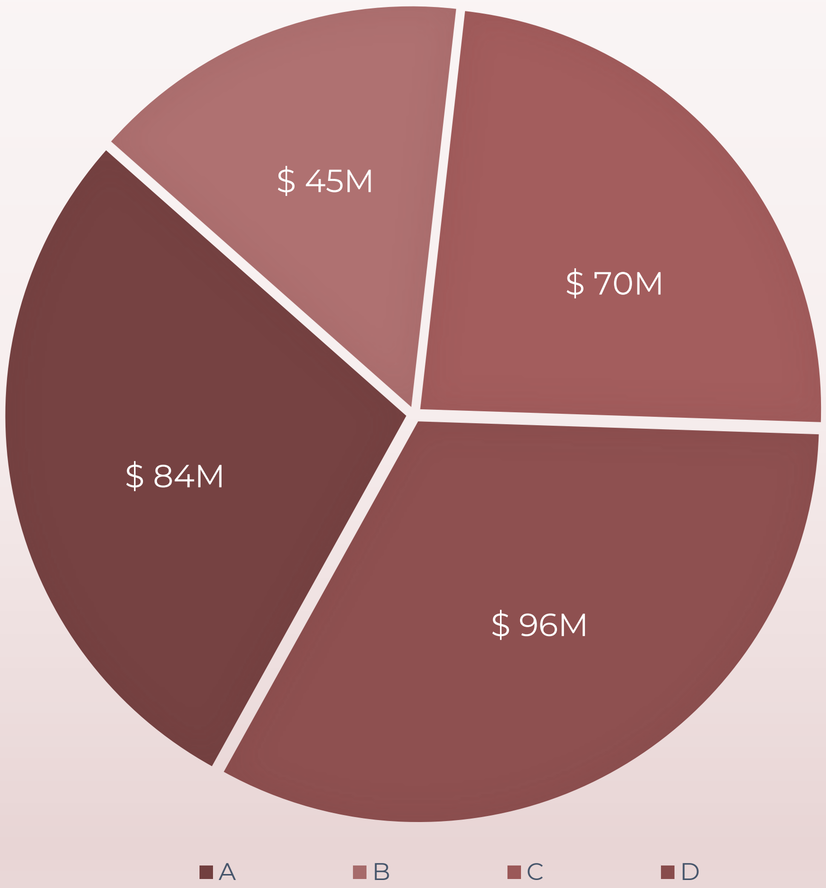
Construction

Construction: Growth declined from 9.7% in Q2 to 6.7% in Q3, suggesting 500,000 fewer job creations

Tourism

Trade, hotels, transport, and communication: Possible job loss of 1.3 million





DIFFERENTIATING EXISTING JOBS LOSS AND EMPLOYMENT GROWTH

The focus has primarily been on the loss of existing jobs due to the economic slowdown. The 11th Five-Year Plan emphasized incremental employment growth, particularly in the unorganized sector, during the period from 2000 to 2005.

Strengths

Focus has primarily been on the loss of existing jobs due to the slowdown

S

FOCUS

The 11th Five-Year Plan highlights incremental employment growth of 46.72 million from 2000 to 2005

F

SWOT ANALYSIS

Significant employment creation has occurred in various sectors since the early 1990s reforms, with agriculture, manufacturing, trade, and community services being major contributors. These sectors have played a vital role in generating employment opportunities in the Indian economy.

O

Opportunities

Most of the employment growth occurred in the unorganized sector
Financial, insurance, real estate, and business services: 3.12 million jobs
Community, social, and personal services: 4.59 million jobs

T

Threats

Significant employment creation since the early 1990s reforms:
Agriculture: 8.84 million jobs
Manufacturing: 8.64 million jobs
Construction: 6.44 million jobs
Trade, hotels, and restaurants: 10.70 million jobs
Transport, storage, and communications: 4.04 million jobs

IMPACT ON KEY EMPLOYMENT-INTENSIVE SECTORS

EMPLOYMENT INTENSIVE SECTORS

Sectors such as manufacturing, construction, trade, and transportation play a crucial role in employment generation. The slowdown in these sectors significantly affects overall job growth and has implications for employment opportunities and livelihoods.

01 Manufacturing, construction, trade, hotels, and restaurants,

02 Slowdown in these sectors significantly affects employment growth

03 Transport, storage, and communications are major employment generators

04 Employment opportunities and livelihoods are impacted by the growth slowdown

IMPLICATIONS AND WAY FORWARD

Need for targeted policy interventions to revive employment-intensive sectors

Promoting investment, entrepreneurship, and skill development in key sectors

Enhancing productivity and competitiveness to stimulate job creation

Balancing economic growth with inclusive development and employment generation

REGIONAL VARIATIONS IN GROWTH PICK-UP

The growth pick-up during the 10th Five-Year Plan varied among Indian states, with notable improvements observed in states such as Andhra Pradesh, Bihar, Goa, Gujarat, Haryana, Karnataka, Madhya Pradesh, Maharashtra, Punjab, Rajasthan, Tamil Nadu, Uttar Pradesh, and West Bengal. However, other states did not experience significant increases in their growth rates.

- Growth pick-up in the 10th Five-Year Plan (2002-2007) varied among Indian states
- Notable growth improvement in Andhra Pradesh, Bihar, Goa, Gujarat, Haryana,
- Karnataka, Madhya Pradesh, Maharashtra, Punjab, Rajasthan, Tamil Nadu, Uttar Pradesh, and West Bengal

JOB LOSSES AND EXPORT CONCENTRATION

The Federation of Indian Export Organizations (FIEO) survey suggests job losses of 10 million

Around one million jobs may have been lost based on a survey by the labor and commerce ministries

Job losses observed in sectors like gems and jewelry, garments, engineering goods, chemicals, leather, and handicrafts

Comparatively, China experienced an estimated 20 million job losses due to its higher export orientation

GEOGRAPHICAL CONCENTRATION OF EXPORT GROWTH

Export growth in India is not evenly distributed across the country but rather concentrated in specific clusters. Examples include Surat (diamonds), Panipat (blankets), Tirupur (hosiery), Agra (leather), Ludhiana (woolen garments), Jaipur (hand-printed textiles), Pune (food processing), Ahmedabad (pharmaceuticals), Ambur (leather), Bangalore (machine tools), and Chennai (leather).

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Job Losses in Specific Sectors and Locations

Construction workers in the Gulf experienced job losses totaling 20,000

Job Losses in Specific Sectors and Locations

Engineering job losses spread across India, while gems and jewelry losses concentrated in Gujarat (Surat, Ahmedabad)

Garments losses mainly located in Ludhiana

IMPORTANCE OF SMALL-SCALE SECTOR IN EXPORTS

The small-scale sector (unorganized or informal sector) plays a crucial role in India's exports, accounting for approximately 40-45% of the total. However, this sector lacks protective labor legislation, including social security provisions, and only a small portion of the workforce is covered by social security.

40-45% of India's exports come from the small-scale sector (informal sector).

Lack of protective labor legislation and social security provisions in the informal sector.

Only 40 million out of the 500 million workforce have social security coverage.

Informal sector plays a significant role in India's export performance.

Policy focus needed to address labor issues and improve social security measures for informal sector workers.

MIGRANT WORKERS AND INTER-STATE MIGRATION

Many workers who lost their jobs are migrants from other states. Inter-state migration has been happening for years due to economic disparities among states and imbalances in labor supply and demand. Notable states with migrants moving to other states for work include Bihar, Uttar Pradesh, West Bengal, and Odisha, with destinations such as Karnataka, Andhra Pradesh, Tamil Nadu, Maharashtra, and Gujarat. The migrants typically work in the export sector, primarily in semi-skilled and unskilled roles.

Job losses primarily affected migrant workers from other states.

Inter-state migration driven by economic disparities and labor supply-demand imbalances.

Bihar, Uttar Pradesh, West Bengal, and Odisha are major migrant-sending states.

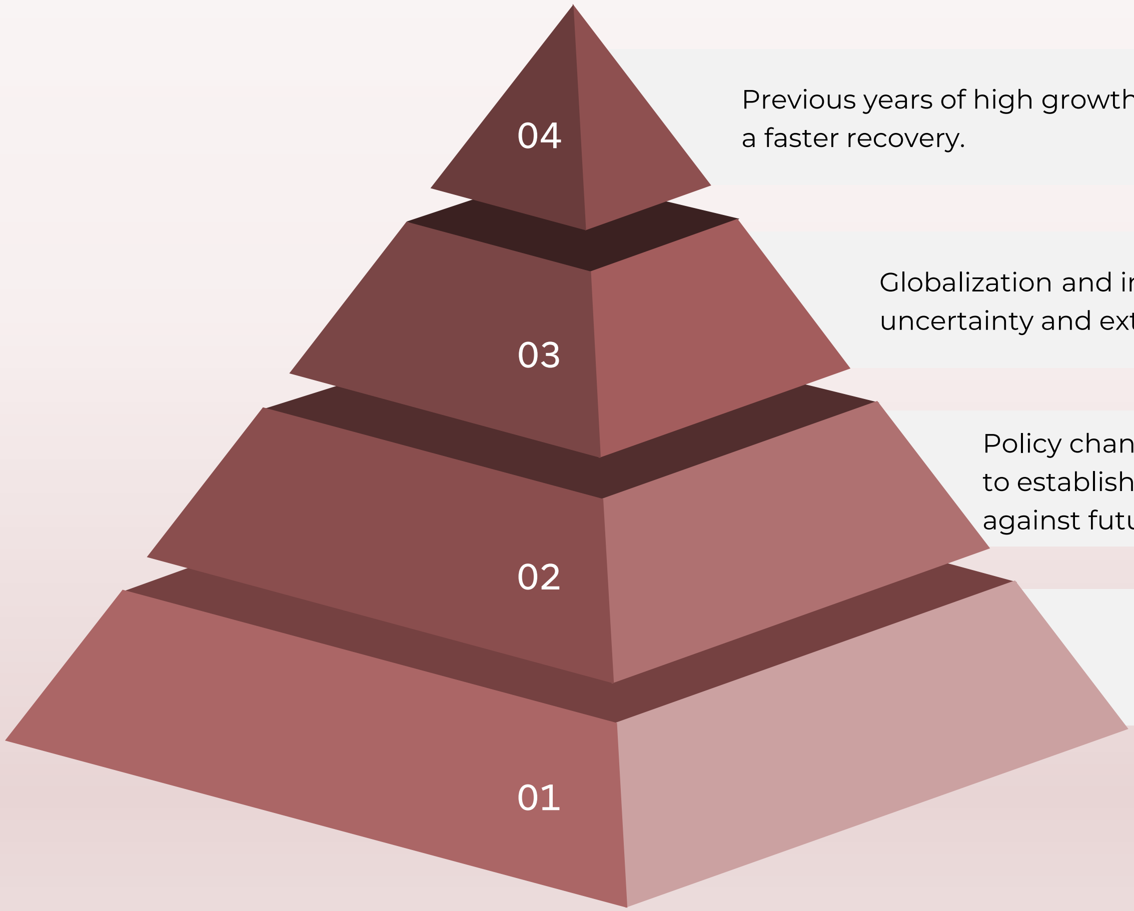
Migrants move to states like Karnataka, Andhra Pradesh, Tamil Nadu, Maharashtra, and Gujarat.

Migrants often work in the semi-skilled and unskilled labor segments of the export sector.

Migration patterns highlight the need for policies that ensure the welfare and protection of migrant workers.

INDIA'S GROWTH DOWNTURN AND POLICY LESSONS

India's growth downturn is less severe compared to other countries and falls short of a recession.



Previous years of high growth provide a foundation for a faster recovery.

Globalization and integration expose the economy to uncertainty and external shocks.

Policy changes should be implemented to establish necessary insurance cushions against future downturns.

Focus on proactive measures to mitigate risks and ensure sustained economic growth.

IMPORTANCE OF LEARNING FROM GROWTH DECLINES

Lessons must be learned from a decline in growth from 8.5% to 5.5% rather than from 8.5% to zero percent.

Policy reforms and individual preparations are essential for better resilience to future downturns.

Strengthening economic and social safety nets to protect against adverse effects of growth slowdowns.

The present episode emphasizes the need for proactive measures in the face of uncertainties.

Promoting flexibility and adaptability in policies to navigate changing global economic dynamics.

IMPACT OF FINANCIAL CRISIS

Global recession, collapsed institutions, disrupted credit markets, stock market decline, government interventions for stability and recovery.

Economic Recession

Companies faced reduced demand, resulting in layoffs, lower consumer spending, and a slowdown in investment and production.

Financial Institution Failures

The crisis exposed weaknesses in the financial sector, leading to the collapse or near-collapse of several major banks and financial institutions. This created a severe credit crunch

Stock Market Decline

Stock markets experienced sharp declines, eroding trillions of dollars in market value. Investor confidence plummeted as uncertainties and risks escalated

Government Interventions and Bailouts

Governments worldwide implemented various measures to stabilize the financial system and prevent a complete economic collapse. These measures included injecting capital into struggling banks, implementing stimulus packages to boost demand, and enacting regulatory reforms to prevent future crises. Government interventions aimed to restore stability, restore confidence, and kickstart economic recovery.

GLOBAL IMPACT

North America

The 2008 financial crisis had a significant impact on North America, particularly the United States and Canada. The crisis originated in the U.S. housing market, leading to a collapse in housing prices and a subsequent banking crisis

75% 25%

South America

The impact of the 2008 financial crisis on South America varied across countries. Countries with strong economic ties to the United States, such as Brazil and Mexico, faced significant challenges due to reduced demand for their exports and declining commodity prices

35% 65%

Europe

Europe was heavily affected by the 2008 financial crisis, with several countries facing severe economic challenges. The crisis exposed vulnerabilities in the European banking system, particularly in countries like Greece, Spain, Ireland, and Portugal, leading to a sovereign debt crisis in the Eurozone

12% 88%

Africa

The impact of the 2008 financial crisis on Africa was relatively less severe compared to other regions. Many African countries were not directly exposed to the complex financial instruments that triggered the crisis

55% 45%

Asia

The 2008 financial crisis had a significant impact on Asia, although the region demonstrated resilience compared to other parts of the world. Countries like Japan, South Korea, and Taiwan, heavily reliant on exports, experienced a sharp decline in demand as global trade contracted

36% 64%

Australia

The 2008 financial crisis had a noticeable impact on Australia, but the country managed to avoid a recession. Australia's strong regulatory framework and prudent banking practices helped mitigate the effects of the crisis

90% 10%

GLOBAL IMPACT

North America

This resulted in a severe recession in the United States, with a sharp decline in economic growth, widespread job losses, and a significant increase in foreclosures and bankruptcies.

Bail outs and closures — 60%

South America

Many countries in the region experienced a slowdown in economic growth, increased unemployment, and a decline in foreign investment. However, some countries with more diversified economies, like Chile and Peru, were able to weather the crisis better due to their prudent economic policies.

Impact on production — 75%

Europe

These countries experienced deep recessions, high unemployment rates, and the need for financial assistance from international institutions

Economic Slowdown — 40%

Africa

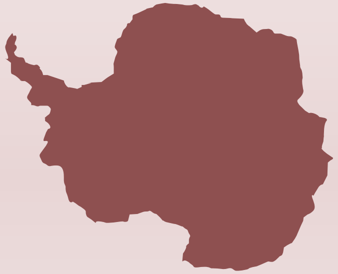
The continent did face indirect effects through reduced global demand for commodities and declining foreign investment

Decline in export — 30%

Asia

Asian financial markets were affected by capital outflows and volatility, leading to monetary policy adjustments and increased regional cooperation in financial stability.

Slow in growth — 50%



Australia

The Australian government implemented stimulus measures to support the economy, including infrastructure spending and cash transfers to households.

Infused Liquidty — 55%

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