



Global Finance and Economic Crisis, Impact on Indian
Economy

MODULE 3 & 4

BALASUBRAMANIAN
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GLOBAL IMPACT

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



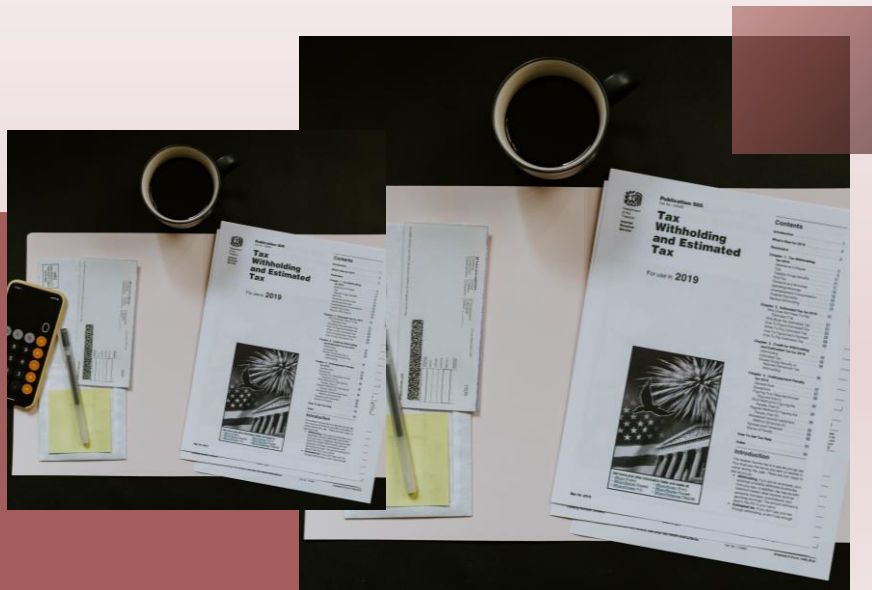
Indian Rupee came under pressure during the crisis



Exchange rate volatility affected the Indian economy

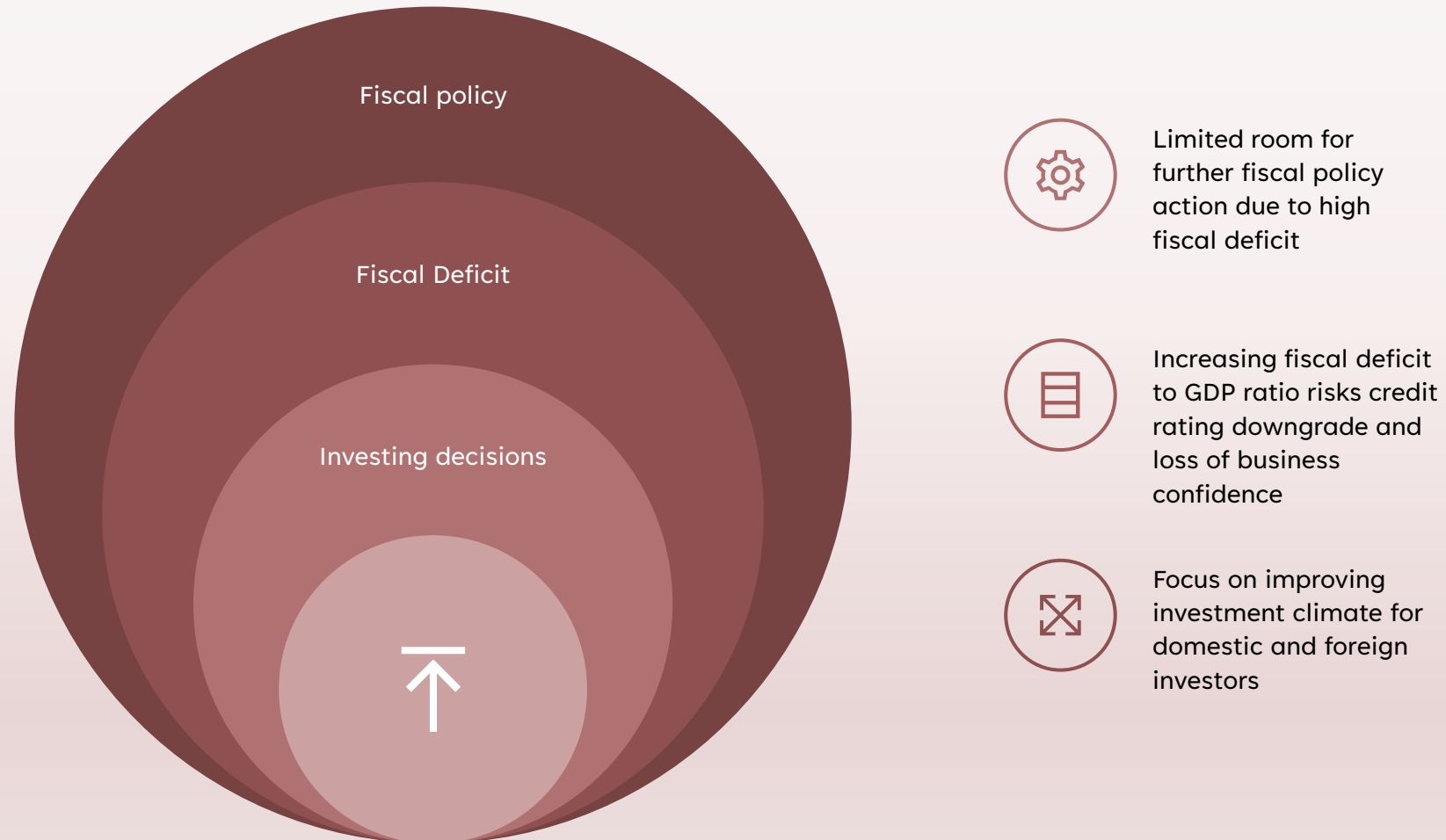


Depreciation of Rupee can make imports costlier



POLICY RESPONSE

Remove entry barriers to attract corporate investments and stimulate growth



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.

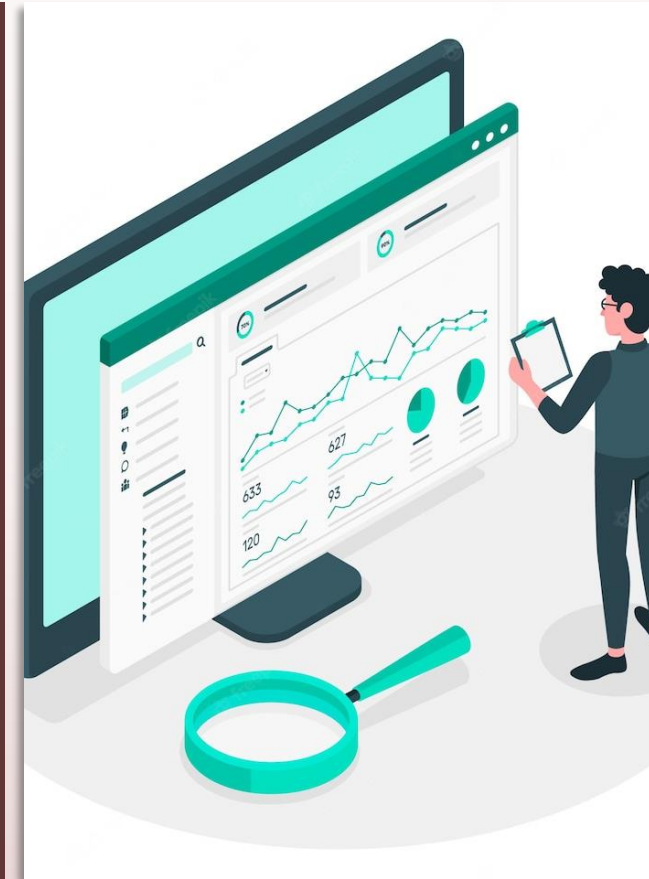
Initially appeared insulated from global financial crisis

02.

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

03.

Collapse of Lehman Brothers had immediate impact



GLOBAL ECONOMIC DOWNTURN

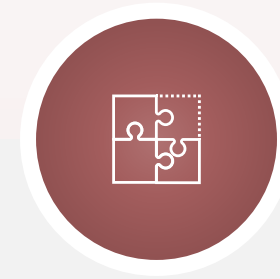
Slowdown in global economic activity affected Indian exports



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.



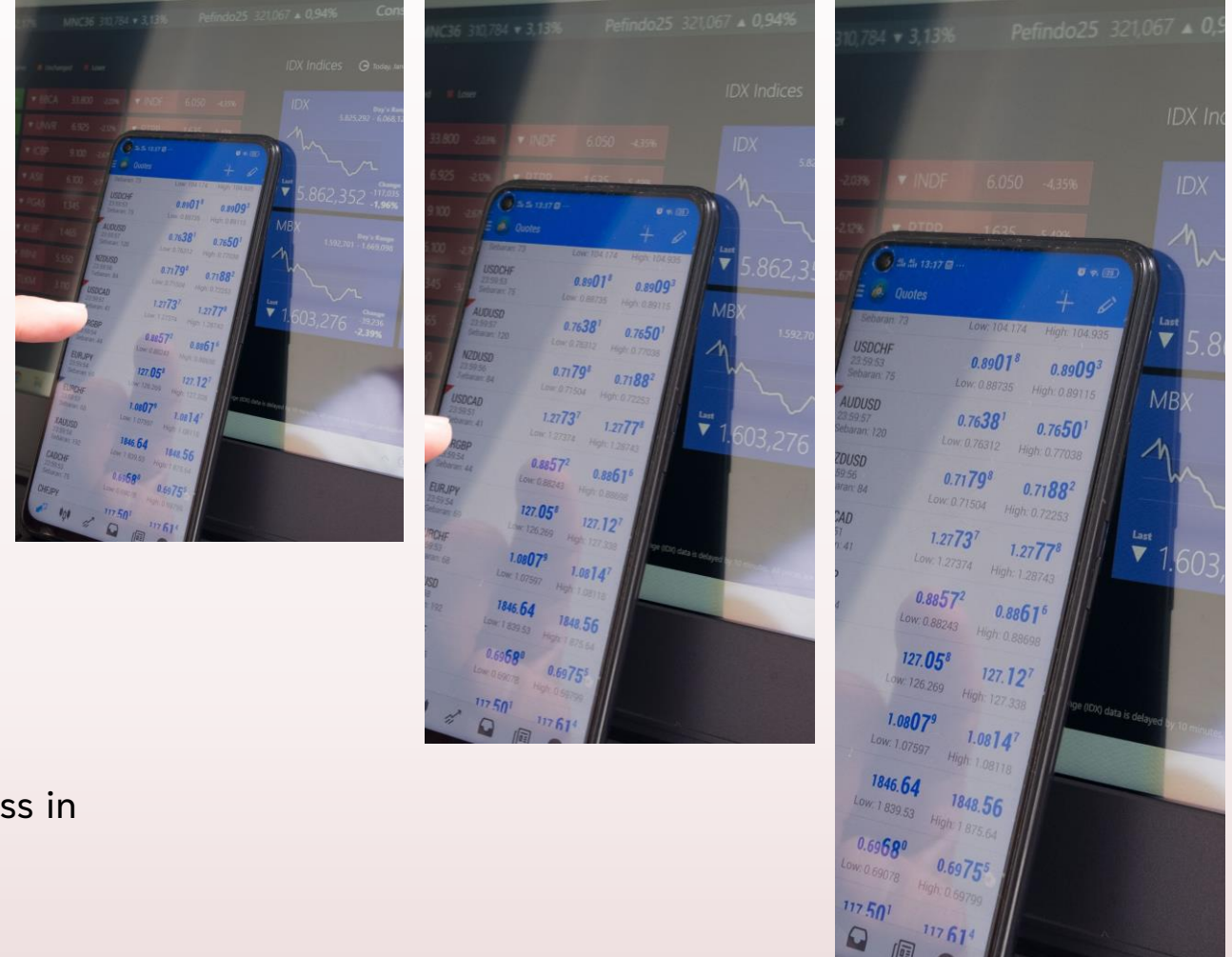
Risk of US economy experiencing prolonged recovery (Japan-like "L" shaped recovery)



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



Why

Escalation of protectionism could lead to
prolonged recession



Phase 2

Heightened risks and challenges in the global
economic landscape
Need for cooperation and policy measures to
mitigate protectionism's impact



End game



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



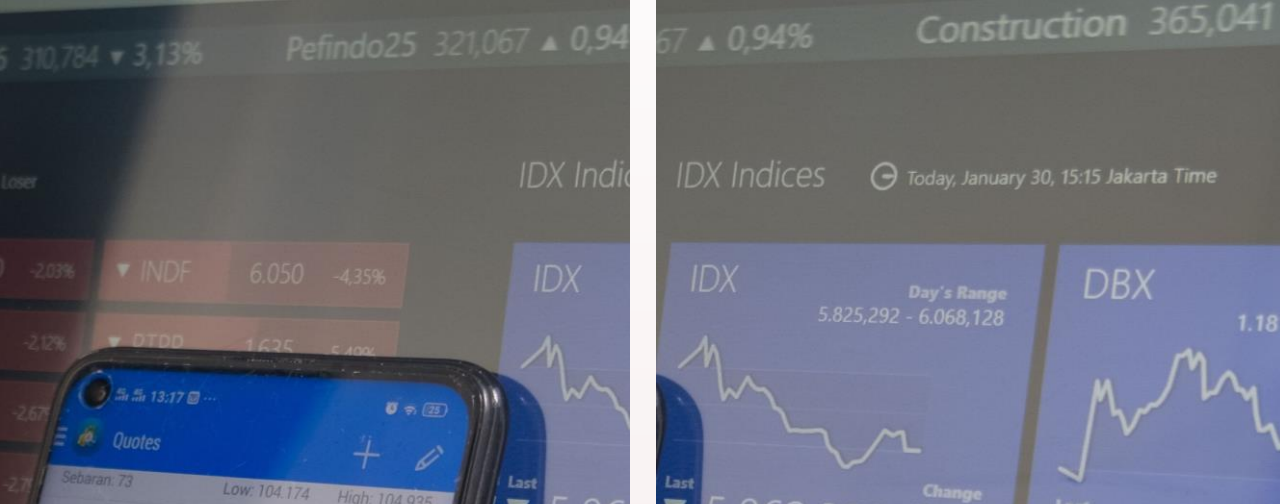
Slowdown on cash flow in economy

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



Exports account for about 22% of Indian GDP



Exports have a significant multiplier effect on economic activity

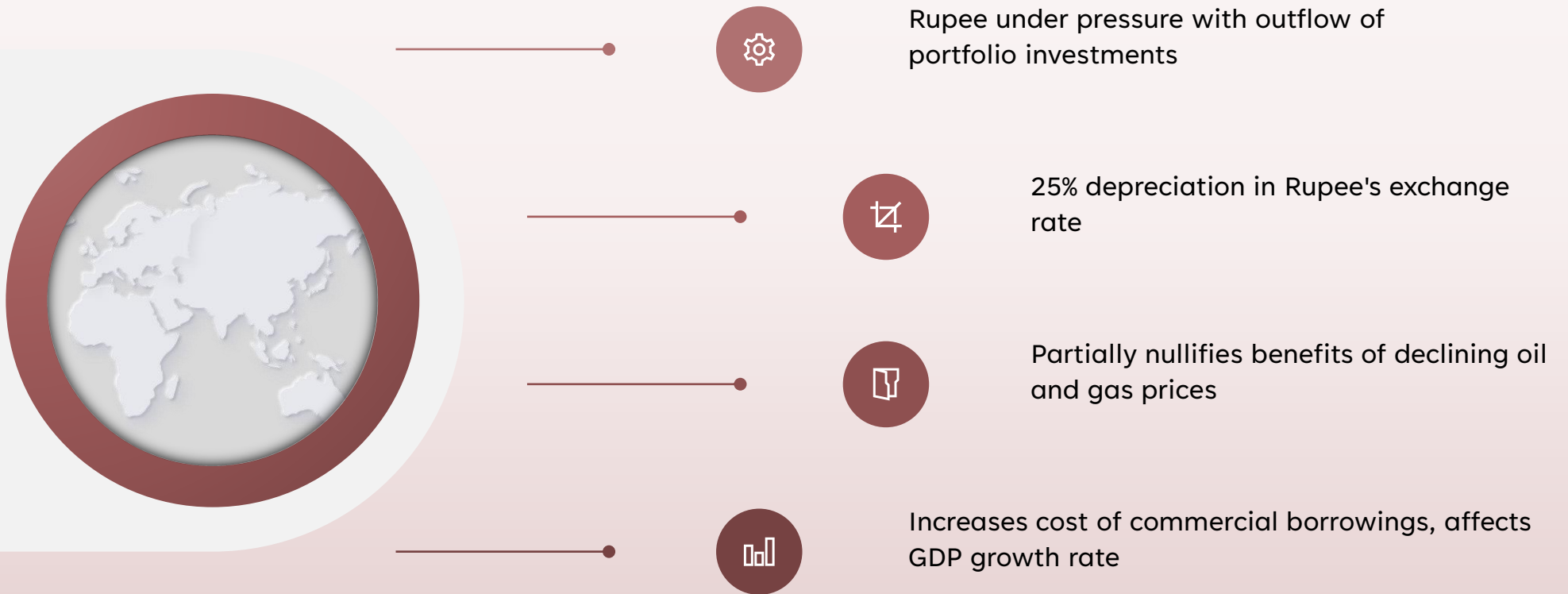


Import content in Indian exports is lower compared to Chinese exports



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.



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.



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



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

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



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

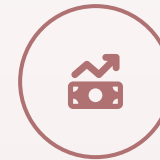
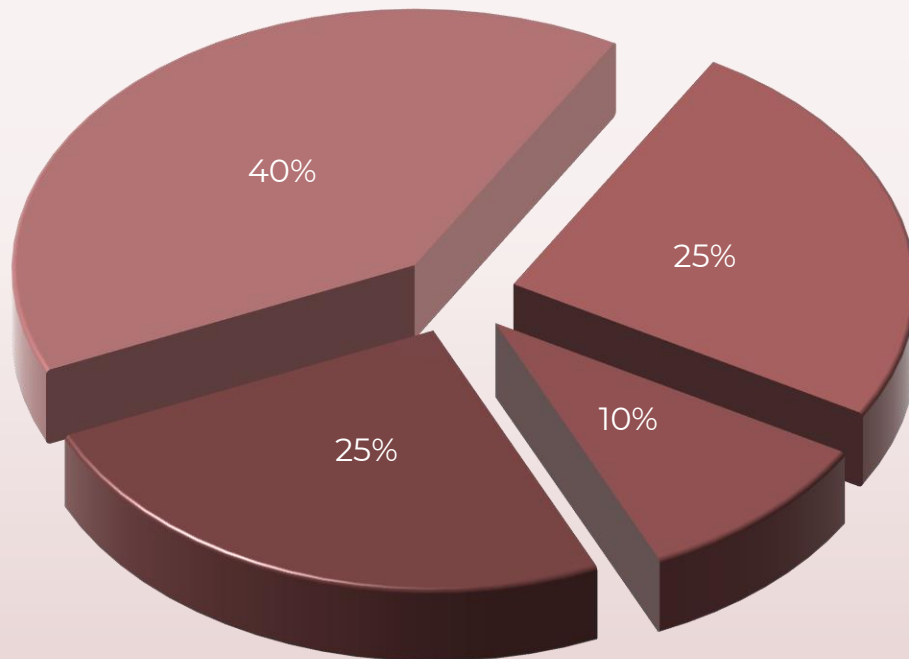
LESSONS LEARNED

Importance of diversifying export markets and reducing dependence on specific sectors

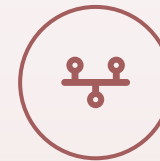
- Strengthening financial sector resilience and risk management
- Enhancing policy coordination and cooperation at the global level
- Continual focus on inclusive growth and development measures

EMPLOYMENT ELASTICITIES IN INDIAN ECONOMY

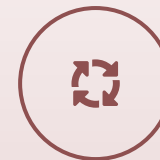
Employment elasticity measures the ability of an economy to generate employment opportunities relative to its growth process



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.



SECTOR-WISE EMPLOYMENT IMPACT

Agriculture

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

Manufacturing

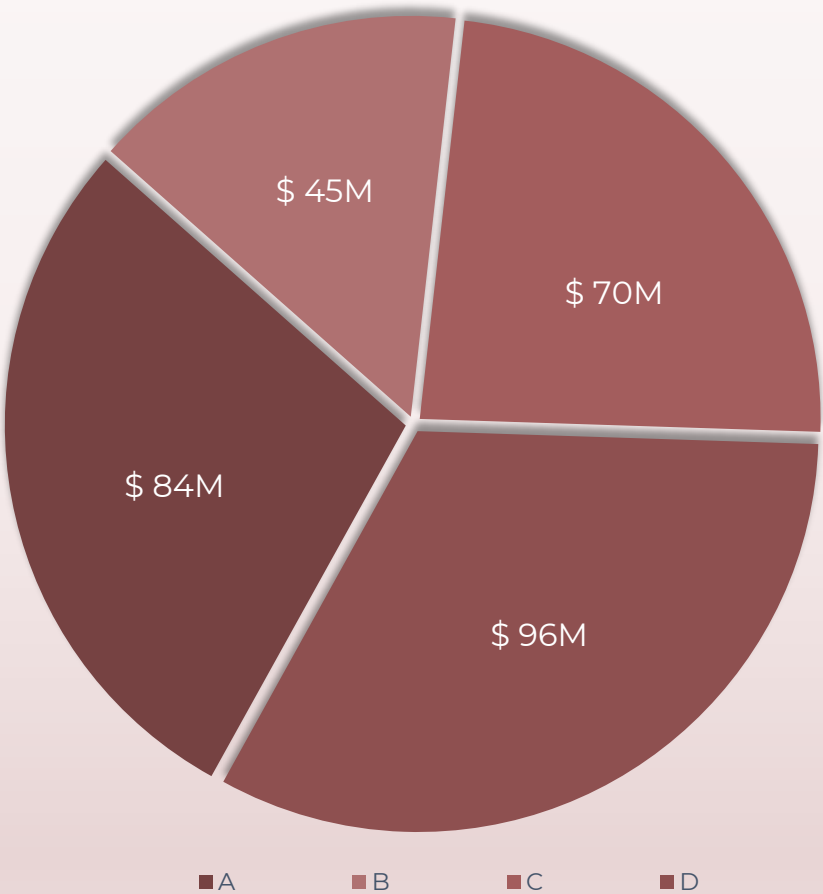
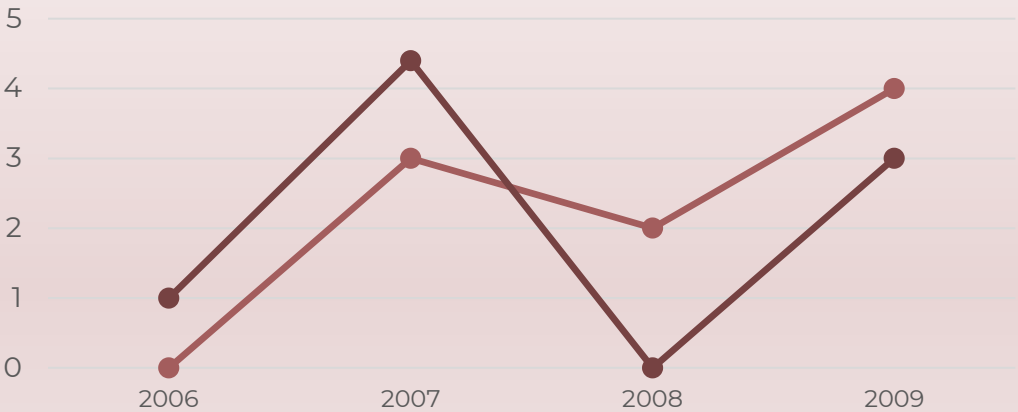
Manufacturing: 2.2% decline in Q3, 5% increase in Q2 would have created 800,000 jobs

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



DIFFERENTIATING EXISTING JOBS LOSS AND EMPLOYMENT GROWTH

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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Jaipur (hand-printed textiles), Pune (food processing), Ahmedabad (pharmaceuticals), Ambur (leather), Bangalore (machine tools), and Chennai (leather)

Job Losses in Specific Sectors and Locations

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



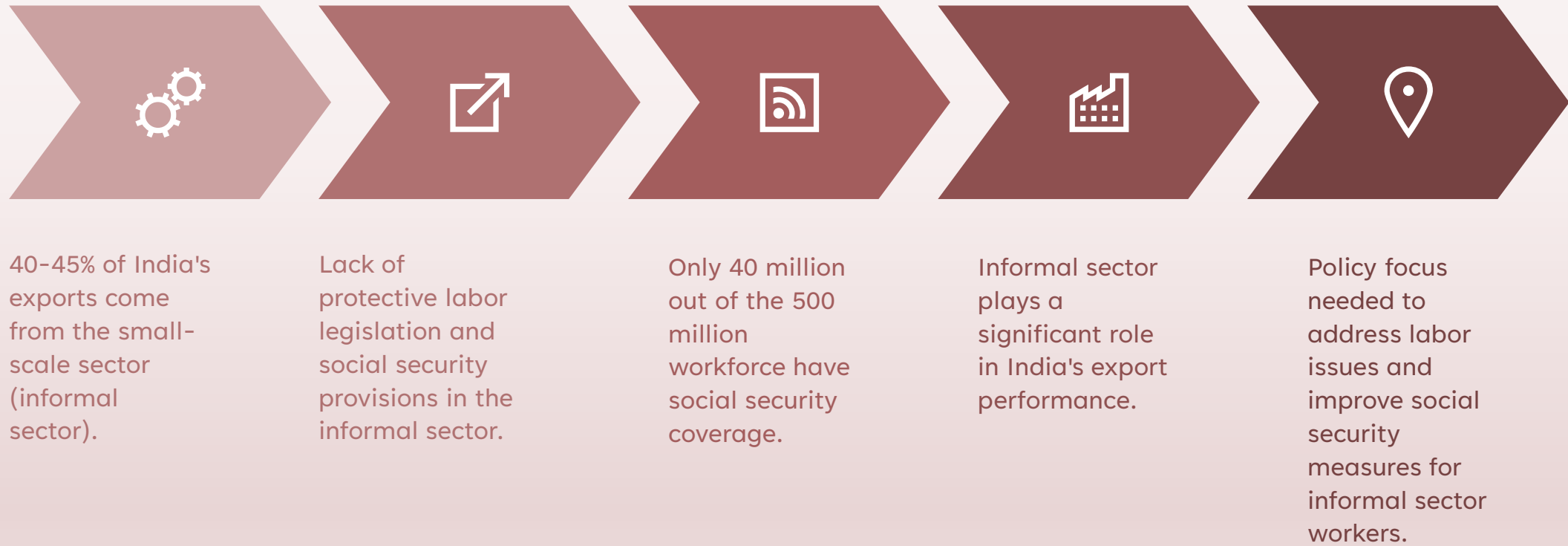
Job Losses in Specific Sectors and Locations

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.



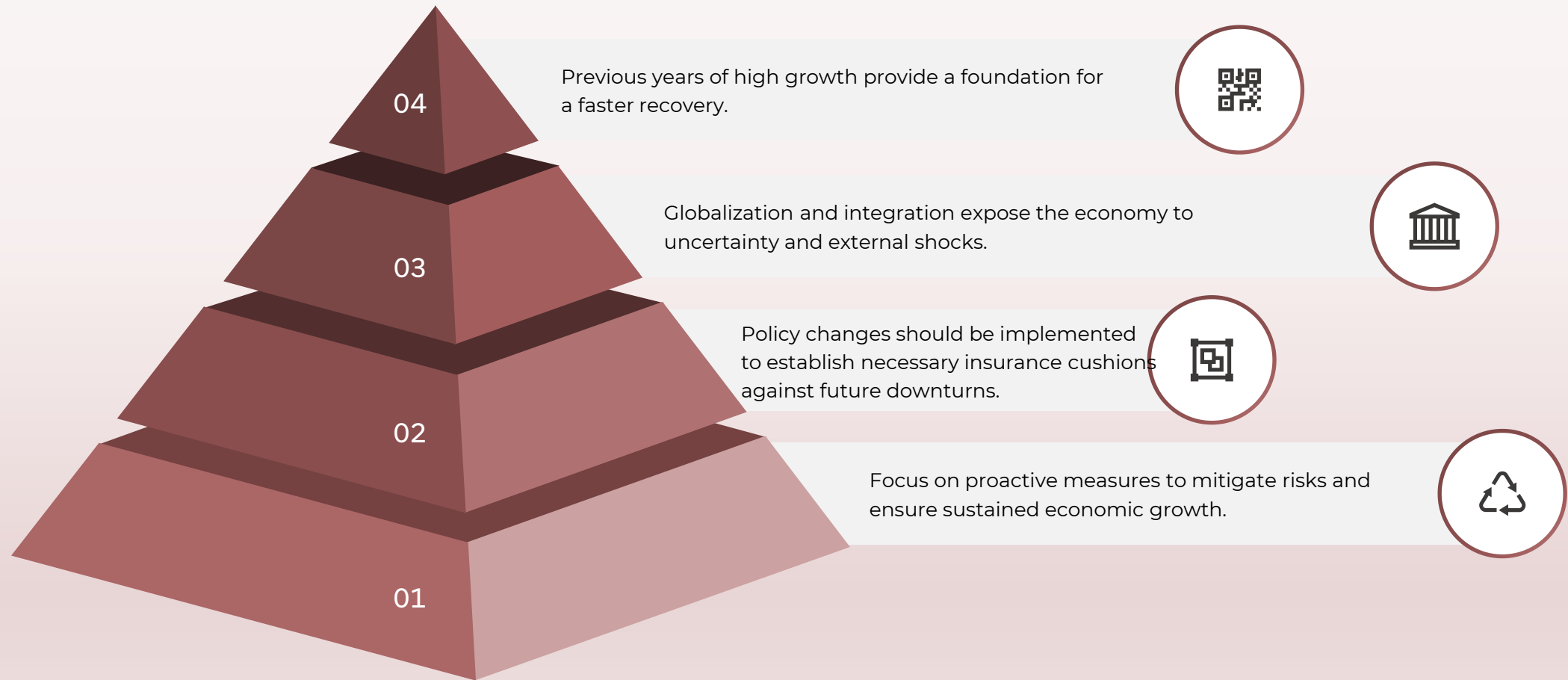
MIGRANT WORKERS AND INTER-STATE MIGRATION

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.



INDIA'S GROWTH DOWNTURN AND POLICY LESSONS

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



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.



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



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



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



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



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



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



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



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.

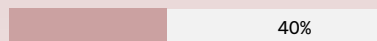
Impact on production



Europe

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

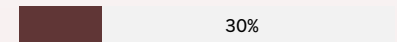
Economic Slowdown



Africa

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

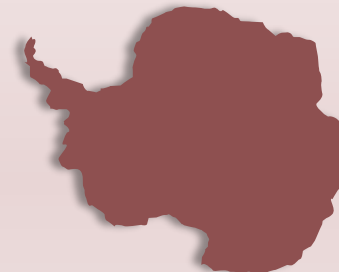
Decline in export



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



Australia

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

Infused Liquidity





THANK YOU



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