INTERNATIONAL MONETARY FUND

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INDIA

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2023 ARTICLE IV CONSULTATION—PRESS RELEASE; STAFF REPORT; AND STATEMENT BY THE EXECUTIVE DIRECTOR FOR INDIA

Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. In the context of the 2023 Article IV consultation with India, the following documents have been released and are included in this package:

- A **Press Release** summarizing the views of the Executive Board as expressed during its November 20, 2023 consideration of the staff report that concluded the Article IV consultation with India.
- The **Staff Report** prepared by a staff team of the IMF for the Executive Board's consideration on November 20, 2023, following discussions that ended on September 21, 2023, with the officials of India on economic developments and policies. Based on information available at the time of these discussions, the staff report was completed on November 3, 2023.
- An **Informational Annex** prepared by the IMF staff.
- A **Statement by the Executive Director** for India.

The IMF's transparency policy allows for the deletion of market-sensitive information and premature disclosure of the authorities' policy intentions in published staff reports and other documents.

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PRESS RELEASE

PR23/458

IMF Executive Board Concludes 2023 Article IV Consultation with India

FOR IMMEDIATE RELEASE

Washington, DC – November 20, 2023: The Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation[1] with India.

India's economy showed robust growth over the past year. Headline inflation has, on average, moderated although it remains volatile. Employment has surpassed the pre pandemic level and, while the informal sector continues to dominate, formalization has progressed. The financial sector has been resilient—strongest in several years—and largely unaffected by global financial stress in early 2023. The current account deficit in FY2022/23 widened as the post-pandemic recovery of domestic demand and transitory external shocks outweighed the impact of robust services exports and proactive diversification of critical oil imports. While the budget deficit has eased, public debt remains elevated and fiscal buffers need to be rebuilt. Globally, India's 2023 G20 presidency has demonstrated the country's important role in advancing multilateral policy priorities.

Growth is expected to remain strong, supported by macroeconomic and financial stability. Real GDP is projected to grow at 6.3 percent in FY2023/24 and FY2024/25. Headline inflation is expected to gradually decline to the target although it remains volatile due to food price shocks. The current account deficit is expected to improve to 1.8 percent of GDP in FY2023/24 as a result of resilient services exports and, to a lesser extent, lower oil import costs. Going forward, the country's foundational digital public infrastructure and a strong government infrastructure program will continue to sustain growth. India has potential for even higher growth, with greater contributions from labor and human capital, if comprehensive reforms are implemented.

Risks to the outlook are balanced. A sharp global growth slowdown in the near term would affect India through trade and financial channels. Further global supply disruptions could cause recurrent commodity price volatility, increasing fiscal pressures for India. Domestically, weather shocks could reignite inflationary pressures and prompt further food export restrictions. On the upside, stronger than expected consumer demand and private investment would raise growth. Further liberalization of foreign investment could increase India's role in global value chains, boosting exports. Implementation of labor market reforms could raise employment and growth.

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[1] Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. A staff team visits the country, collects economic and financial information, and discusses with officials the country's economic developments and policies. On return to headquarters, the staff prepares a report, which forms the basis for discussion by the Executive Board.

Executive Board Assessment[2]

Executive Directors broadly agreed with the thrust of the staff appraisal. They commended the Indian authorities for their prudent macroeconomic policies and reforms that resulted in the economy's strong economic performance, resilience, and financial stability, while also facing continued global headwinds. Noting that India is one of the fastest growing economies globally, Directors called for continued appropriate policies to sustain economic stability and for further progress in key structural reforms to unleash India's significant potential.

Directors welcomed the authorities' near-term fiscal policy, which focuses on accelerating capital spending while tightening the fiscal stance. While acknowledging that India's debt composition helps mitigate debt sustainability risks, Directors recommended ambitious medium-term consolidation efforts given elevated public debt levels and contingent liability risks. In that context, improving revenue mobilization and spending efficiency would allow for continued improvements in digital and physical infrastructure and targeted social support. Directors also encouraged the authorities to put in place a sound medium-term fiscal framework to promote transparency and accountability and align policies with India's development goals.

Directors commended the Reserve Bank of India's (RBI) proactive monetary policy actions and strong commitment to price stability. They agreed that the current neutral monetary policy stance, anchored on a data dependent approach, is appropriate and should gradually bring inflation back to target. Directors agreed that exchange rate flexibility should remain the first line of defense in absorbing external shocks, with foreign exchange interventions limited to addressing disorderly market conditions. Regarding staff's recent reclassification of India's de facto exchange rate regime for the period December 2022 to October 2023, many Directors noted the divergence of authorities' views with that of staff and encouraged continued staff engagement on this issue, with a few Directors encouraging staff and the authorities to resolve these differences. A few Directors explicitly supported the authorities' view that exchange rate stability reflects improvements in India's external position and that foreign exchange interventions have been used to avoid excessive volatility not warranted by fundamentals.

Directors welcomed that the financial sector remains stable and resilient, as reflected in sustained growth in bank credit, low levels of non-performing assets, and adequate capital and liquidity buffers. While acknowledging declining systemic financial risks, Directors broadly called for continued supervision and the use of prudential tools to preserve financial stability and manage emerging vulnerabilities, including rapid growth in unsecured personal loans. They advised further strengthening of regulatory and supervisory standards and encouraged public banks to continue building capital buffers.

Directors noted that continuing with comprehensive structural reforms can help further leverage India's favorable demographics and encouraged the authorities to promote job-rich, inclusive, and greener growth. They emphasized that improving labor market functioning, increasing female labor force participation, and making progress on health, education, land, and agricultural reforms remain critical to sustaining strong and inclusive growth. Directors

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[2] At the conclusion of the discussion, the Managing Director, as Chairman of the Board, summarizes the views of Executive Directors, and this summary is transmitted to the country's authorities. An explanation of any qualifiers used in summing up can be found here: http://www.IMF.org/external/np/sec/misc/qualifiers.htm.

also agreed that strengthening governance and the regulatory framework would foster transparency and safeguard public accountability further. Continued progress on designing and implementing climate policies is also critical to meet the authorities' net zero emissions target date.

Directors acknowledged the authorities' continued efforts to foster new bilateral trade agreements and India's strong leadership during the 2023 G20 Presidency. They broadly stressed that recent restrictive trade policies should be phased out and encouraged further liberalizing the FDI regime and improving the investment climate.

Table 1. India: Selected Social and Economic Indicators, 2019/20-2024/25 1/

	2019/20	2020/21	2021/22	2022/23	2023/24	2024/25
				Est.	Projections	
Growth (in percent)						
Real GDP (at market prices)	3.9	-5.8	9.1	7.2	6.3	6.3
Prices (percent change, period average)						
Consumer prices - Combined	4.8	6.2	5.5	6.7	5.4	4.6
Saving and investment (percent of GDP)						
Gross saving 2/	29.2	29.7	30.0	29.1	29.9	30.0
Gross investment 2/	30.1	28.8	31.2	31.0	31.7	31.9
Fiscal position (percent of GDP) 3/						
Central government overall balance	-4.8	-8.6	-6.8	-6.5	-6.0	-5.8
General government overall balance	-7.7	-12.9	-9.6	-9.2	-8.8	-8.5
General government debt 4/	75.0	88.5	83.8	81.0	82.0	82.4
Cyclically adjusted balance (% of potential GDP)	-7.6	-9.1	-8.7	-9.3	-8.8	-8.5
Cyclically adjusted primary balance (% of potential GDP)	-2.9	-3.8	-3.6	-4.1	-3.4	-2.8
Money and credit (y/y percent change, end-period)						
Broad money	8.9	12.2	8.8	9.0	10.8	7.8
Domestic Credit	8.3	9.5	9.0	13.1	12.9	9.8
Financial indicators (percent, end-period)						
91-day treasury bill yield (end-period)	4.2	3.3	3.8	6.9	…	…
10-year government bond yield (end-period)	6.1	6.2	6.8	7.3	…	…
Stock market (y/y percent change, end-period)	-23.8	68.0	18.3	0.7	…	…
External trade (on balance of payments basis)						
Merchandise exports (in billions of U.S. dollars)	320.4	296.3	429.2	456.1	436.1	460.6
(Annual percent change)	-5.0	-7.5	44.8	6.3	-4.4	5.6
Merchandise imports (in billions of U.S. dollars)	477.9	398.5	618.6	721.4	701.1	751.7
(Annual percent change)	-7.6	-16.6	55.3	16.6	-2.8	7.2
Terms of trade (G&S, annual percent change)	2.1	2.0	-8.1	-2.8	3.1	0.3
Balance of payments (in billions of U.S. dollars)						
Current account balance	-24.6	24.0	-38.7	-67.0	-65.5	-73.0
(In percent of GDP)	-0.9	0.9	-1.2	-2.0	-1.8	-1.8
Foreign direct investment, net ("-" signifies inflow)	-43.0	-44.0	-38.6	-28.0	-32.8	-44.4
Portfolio investment, net (equity and debt, "-" = inflow)	-1.4	-36.1	16.8	5.2	-30.6	-33.9
Overall balance ("+" signifies balance of payments surplus)	59.5	87.3	47.5	-9.1	40.8	54.7
External indicators						
Gross reserves (in billions of U.S. dollars, end-period)	477.8	577.0	607.3	578.4	619.2	673.9
(In months of next year's imports (goods and services))	11.1	9.0	8.1	7.8	7.7	7.9
External debt (in billions of U.S. dollars, end-period)	558.4	573.4	619.1	624.3	681.1	748.3
External debt (percent of GDP, end-period)	19.7	21.5	19.7	18.4	18.7	18.5
Of which: Short-term debt	8.3	9.5	8.5	8.1	8.1	8.1
Ratio of gross reserves to short-term debt (end-period)	2.0	2.3	2.3	2.1	2.1	2.1
Real effective exchange rate (annual avg. percent change)	3.1	-0.8	0.3	-0.4	…	…
Memorandum item (in percent of GDP)						
Fiscal balance under authorities' definition	-4.6	-9.2	-6.8	-6.4	-5.9	-5.6

Sources: Data provided by the Indian authorities; Haver Analytics; CEIC Data Company Ltd; Bloomberg L.P.; World Bank, World Development Indicators; and IMF staff estimates and projections.
1/ Data are for April–March fiscal years.
2/ Differs from official data, calculated with gross investment and current account. Gross investment includes errors and omissions.
3/ Divestment and license auction proceeds treated as below-the-line financing.
4/ Includes combined domestic liabilities of the center and the states, and external debt at year-end exchange rates.

INTERNATIONAL MONETARY FUND

INDIA

STAFF REPORT FOR THE 2023 ARTICLE IV CONSULTATION

November 3, 2023

KEY ISSUES

Context. India is on track to be one of the fastest growing major economies in the world this year, underpinned by prudent macroeconomic policies. Nonetheless, the economy is facing global headwinds, including a global growth slowdown in an increasingly fragmented world.

Policy recommendations. Policy priorities should focus on replenishing fiscal buffers, securing price stability, maintaining financial stability, and accelerating inclusive growth through comprehensive structural reforms while preserving debt sustainability.

- **Fiscal policy to ensure medium-term sustainability while boosting inclusive growth**. Elevated public debt calls for ambitious medium-term consolidation, while continuing to prioritize capital spending. This should be complemented with a sound medium-term fiscal framework to promote transparency and accountability and align policies with India's development goals. Sovereign debt risks are moderate and are mitigated by the composition of debt.

- **Monetary policy to achieve price stability**. The RBI's monetary policy tightening was effective in addressing inflation. Going forward, a data-dependent approach should continue given high uncertainty surrounding the outlook. Clearly communicated monetary policy can help guide market expectations. Greater exchange rate flexibility would help absorb external shocks, with intervention limited to addressing disorderly market conditions.

- **Financial sector policy to continue to promote resilience**. Systemic financial risks have declined but continued vigilant supervision is warranted to manage emerging vulnerabilities, including rapid growth in unsecured personal loans. Policies to facilitate the exit of non-viable firms, enhance the regulatory and supervisory framework, and encourage public banks to continue building capital buffers remain priorities. Ongoing efforts to further strengthen bank governance, deepen capital markets, and expand MSMEs' access to credit should help support medium-term growth.

- **Structural policies to invigorate inclusive and green growth**. To reap the benefits of demographic tailwinds, structural policy should focus on promoting high quality job-rich growth, underpinned by comprehensive reform in areas of education, health, land, agriculture, and labor markets, including measures to boost female labor force participation. Continuing investment in infrastructure, strengthening governance, and enhancing a sound business environment are critical. Expeditiously removing recently introduced trade restrictions would support growth and improve global food supply. Finally, concerted efforts on climate policies are instrumental to achieve India's ambitious climate goals.

Approved By

Anne-Marie Gulde-Wolf (APD) and Anna Ilyina (SPR)

Discussions took place in New Delhi, Mumbai, and Chennai during September 6 - 21, 2023. The team comprised N. Choueiri (Head), C. Alonso, M. MacDonald, D. Prihardini, N. Suphaphiphat (all APD), P. Schneider (MCM), M. Gorbanyov (SPR) and L. Breuer (Senior Resident Representative). S. Mohapatra and G. Dang assisted the mission. K. Subramanian and S. Hansda (all OED) attended some mission meetings. The mission met with Finance Secretary T.V. Somanathan, Economic Affairs Secretary A. Seth, Chief Economic Advisor A. Nageswaran, Reserve Bank of India (RBI) Deputy Governors M. D. Patra and T. R. Sankar, SEBI Chairman M. P. Buch and other senior government and RBI officials, along with representatives from the private sector. M. Conde Panesso, S. Y. Lee and F. Li (APD) assisted in the preparation of this report.

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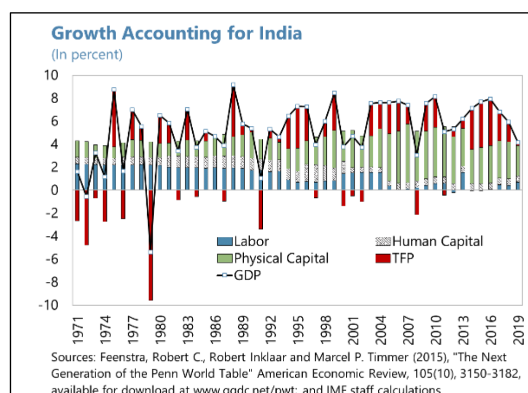
CONTEXT

1. India has been among the fastest growing economies in the world. India's economy has rebounded strongly from the pandemic to become an important driver of global growth. After surging during FY2022/23, headline inflation has, on average, moderated although it remains volatile. Employment has surpassed the pre-pandemic level and the informal sector continues to dominate while formalization has progressed. The financial sector has been resilient, largely unaffected by global financial stress in early 2023. While the budget deficit has eased, public debt remains elevated and fiscal buffers need to be rebuilt. Globally, India's 2023 G20 presidency has demonstrated the country's important role in advancing multilateral policy priorities. On the political front, general elections are expected in April 2024. Macroeconomic policies have been partly in line with past IMF staff advice (Annex I).

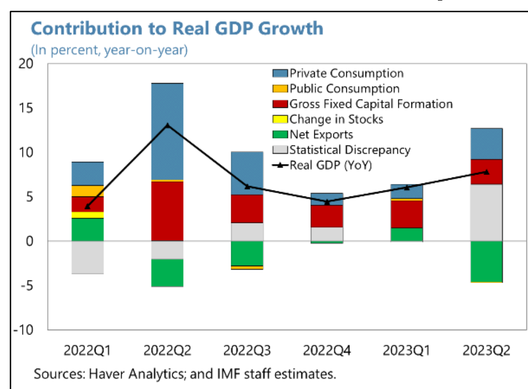
2. India's favorable demographics could significantly add to growth if accompanied by wide-ranging structural reforms. India has potential to experience higher growth contributed by additional labor and human capital if comprehensive reforms are implemented (see the structural reforms section). Furthermore, the country's foundational digital public infrastructure has significant potential to raise total factor productivity by fostering innovation and competition, accelerating financial inclusion, and boosting public sector efficiency.[1] Finally, the government's investment program should raise potential growth through capital accumulation.



Sources: Feenstra, Robert C., Robert Inklaar and Marcel P. Timmer (2015), "The Next Generation of the Penn World Table" American Economic Review, 105(10), 3150-3182, available for download at www.ggdc.net/pwt; and IMF staff calculations.

CONTINUED BROAD-BASED GROWTH

3. Growth has been strong, supported by robust domestic demand and service exports. GDP growth reached 7.2 percent in FY2022/23, moderating from 9.1 percent in FY2021/22. Growth has been supported by robust consumption stemming from pent-up demand of households and strong investment, with historically high levels of public capital expenditure. Strong global demand for outsourcing induced by the pandemic pushed up service export growth to a decade high in FY2022/23, raising net exports. Services exports lost some momentum in early FY2023/24, largely reflecting



Sources: Haver Analytics; and IMF staff estimates.

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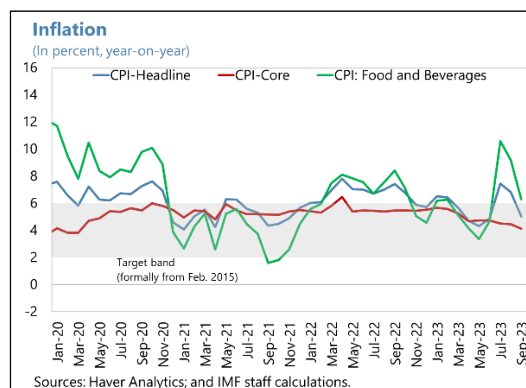
[1] Alonso, C., T. Bhojwani, E. Hanedar, D. Prihardini, G. Uña, and K. Zhabska. 2023. "Stacking up the Benefits: Lessons from India's Digital Journey." *IMF Working Paper* 2023/078.

demand slowdown in partner countries, but GDP growth remained strong at 7.8 percent in FY2023/24Q1, supported by robust domestic demand.

4. Inflation has moderated after a brief surge in the summer driven by vegetable prices. After peaking in mid-2022, headline inflation returned to the RBI's tolerance band of 4±2 percent between March and June 2023. However, a 202-percent year-on-year increase in tomato prices in July 2023, together with increases in other food prices, pushed headline inflation up to 7.4 percent in that month, highlighting the vulnerability of the disinflation process to exogenous shocks (Box 1). The shock began moderating since August and in September, headline inflation declined sharply to 5 percent, within the RBI's tolerance band. Only 36 percent of the CPI basket experienced increases greater than 6 percent in September. Core inflation declined to 4.5 percent. Wholesale prices have been declining since April 2023.



5. Employment is rising, with significant contribution by informal workers and recovery in real wages. According to the Periodic Labour Force Survey (PLFS), the labor force participation rate (LFPR) increased to 54.6 percent in AY2022/23, primarily driven by own-account, casual, and unpaid family workers, while the unemployment rate declined to 5.1 percent.[2] By sector, employment in agriculture and construction has increased the most since AY2017/18, with services picking up more recently. Real wages also recovered from the pandemic-driven decline, which was larger for self-employed workers. Nominal wages for regular workers have broadly kept up with inflation since AY2017/18, whereas wages for casual workers have enjoyed gains in real terms.

Box 1. Inflation Dynamics in India

India's recent inflation dynamics have not followed the same pattern as in other countries.[1] Inflation in India increased in late 2019, driven by higher prices of vegetables after adverse weather shocks. It came up above the RBI's tolerance band (4±2 percent) in December and remained above 6 percent for most of 2020. Elsewhere, inflation generally did not increase until mid-2021, when economies began to emerge from pandemic lockdowns and supply chains came under pressure. India however did not experience a large increase in the inflation rate when most economies suffered from elevated commodity prices in 2022, reflecting extensive government interventions (e.g., restrictions on wheat, sugar, and rice exports, removal of tax on import of lentils, reversal of earlier increases in excise duties on petrol and diesel). Notably, India's pick-up in inflation was also different, even when limiting the sample to emerging economies and, among those, to emerging economies practicing inflation targeting.

[2] Based on PLFS Current Weekly Status, which is most closely aligned with the ILO's recommended measure. AY2022/23 refers to the period from July 2022 to June 2023.

Box 1. Inflation Dynamics in India (concluded)

The increase in core inflation in India was also particular.[2] Core inflation in India picked up significantly earlier than elsewhere, reaching close to 6 percent as early as October 2020. Core inflation remained elevated, oscillating around 6 percent, until a sharp decline began in March 2023. The increase in core inflation was first led by transportation, and then by clothing. It likely reflected exchange rate depreciation, increase in fuel excise duties in 2020, and pass-through of higher food prices.

The RBI appropriately targets headline CPI inflation, while remaining vigilant over core inflation, which is also important.[3] While conventional wisdom suggests that central banks should concentrate on core inflation and disregard transitory changes in fuel and food inflation, that approach does not seem appropriate for India. First, core inflation components represent just 47 percent of the CPI basket, much lower than in other emerging market peers practicing inflation targeting. Second, food price increases could spill over into higher core inflation, especially if they are persistent. Granger causality tests provide evidence of bidirectional Granger causality between food and core inflation rates in India, perhaps mediated by household inflation expectations. Third, it is easier to communicate monetary policy based on headline inflation, rather than core inflation. At the same time, given that food inflation remains very volatile in India, achieving the RBI's headline inflation target sustainably requires having core inflation hovering around 4 percent and allowing the tolerance bands to handle food price shocks. As a consequence, this could require the RBI to tighten monetary policy in the case of sizable and persistent exogenous weather shocks to avoid de-anchoring of inflation expectations and transmission to core inflation. Government administrative interventions to mitigate food price pressures can be appropriate on a temporary basis to address major emergencies. However, they negatively impact global food markets and should be removed expeditiously, also to allow market forces to provide adequate incentives to economic agents.

p-values for Granger Causality Tests

Lags	(1) Core Causes Food	(2) Food Causes Core	(3) Core Causes Expectations	(4) Food Causes Expectations
1	0.17	0.14	0.15	0.00
2	0.56	0.24	0.30	0.02
3	0.01	0.05	0.21	0.05
4	0.01	0.03	0.59	0.17
5	0.18	0.25	0.09	0.00
6	0.15	0.39	0.02	0.01
7	0.43	0.46	0.07	0.00
8	0.84	0.07	0.00	0.00

Notes: The table reports p-values for Granger causality tests between core and food inflation (columns 1 and 2), and among core inflation, food inflation, and inflation expectations (columns 3 and 4) in India for different lags (from 1 to 8), taking energy and exchange rates as exogenous variables. Cells shaded in darker tones of green reflect that the null hypothesis of no causation can be rejected with greater confidence.
Quarterly inflation data between the first quarter of 2012 and the first quarter of 2023 is used. Results control for a small sample size.

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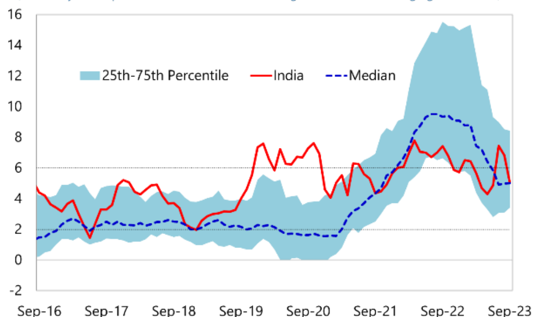
[1] India's CPI basket is based on the 2011/12 household expenditure survey. Given India's economic transformation since then, a revision of the CPI basket would be important to ensure the index reflects current consumption patterns.

[2] India's core inflation excludes food and fuel and lighting.

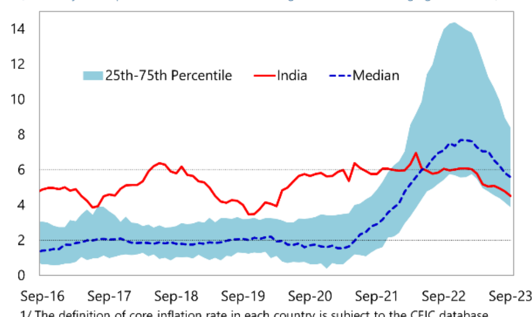
[3] The determination of the target follows the recommendations of the Report of the Expert Committee to Revise and Strengthen the Monetary Policy Framework. https://rbidocs.rbi.org.in/rdocs/PublicationReport/Pdfs/ECOMRF210114_F.pdf.

Figure 1. Inflation Dynamics in India

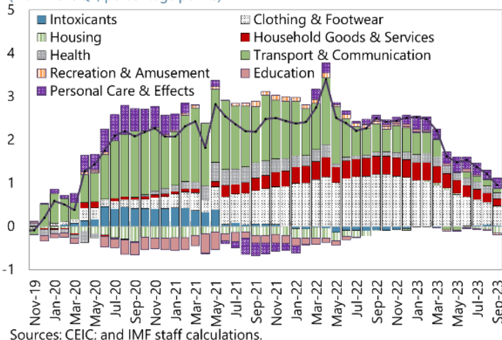
India's inflation was high at the onset of the pandemic, but increased by much less than elsewhere in 2021-2022.



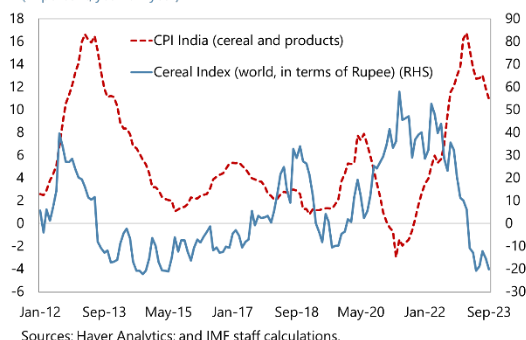
Core inflation in India rose earlier than elsewhere...



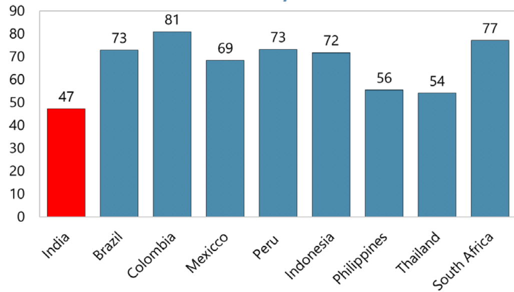
.... and it was driven by transport and clothing.



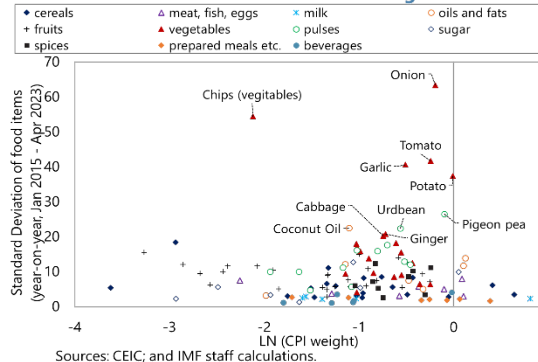
CPI food inflation in India does not track global commodity prices closely.



Core represents a small share of the CPI basket in India.



India's inflation is subject to large shock in food items.

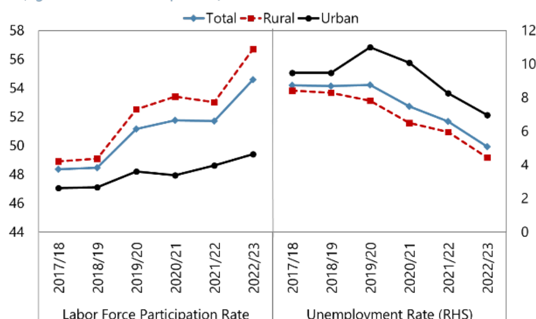


Source: Haver, CEIC, country authorities, and IMF staff estimates.

Figure 2. Labor Market Developments

Labor market indicators continue to improve, surpassing the pre-pandemic levels.

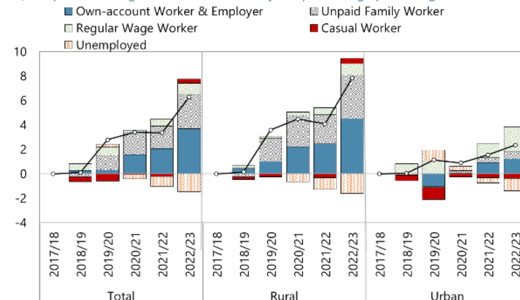
Headline Labor Market Indicators in India
(Aged 15 and above, in percent)



Sources: PLFS; and IMF staff estimates.

The large increase in the LFPR is driven by self-employed (own-account and family workers) in rural areas.

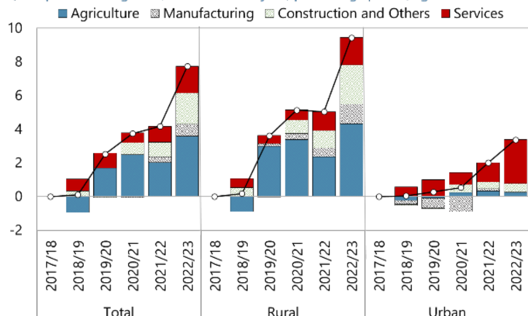
Cumulative Change in LFPR by Employment Status
(Comparison using 2017/18 as the base year, percentage points, aged 15 and above)



Sources: PLFS; and IMF staff estimates.
Note: Breakdown excludes self-employed who did not work during the reference week.

Employment has risen the most in agriculture and construction in rural areas.

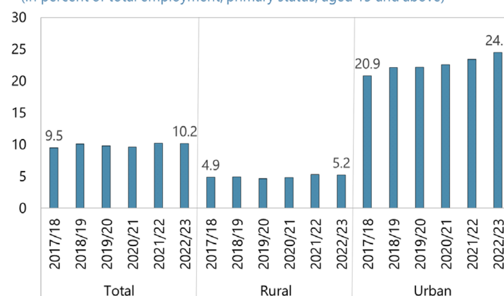
Cumulative Change in Employment Rate by Sector
(Comparison using 2017/18 as the base year, percentage points, aged 15 and above)



Sources: PLFS; and IMF staff estimates.

Employment formalization is improving but remains low.

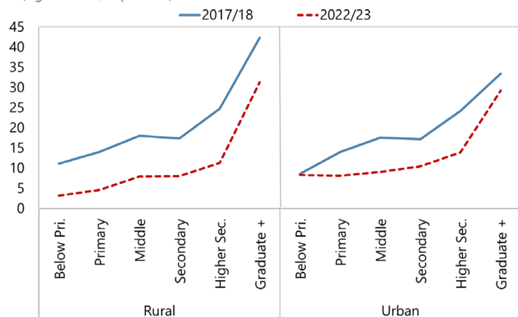
Formal Employment
(In percent of total employment, primary status, aged 15 and above)



Sources: PLFS; and IMF staff estimates.
Note: Formal employment defined based on eligibility for social security benefits.

Youth unemployment remains high for the most educated but has declined significantly.

Youth Unemployment Rate by Education Level
(Aged 15-29, in percent)



Sources: PLFS; and IMF staff estimates.

Wages have recovered in real terms, with significant gains for casual workers.

Real Wages
(2017/18=100)

Sources: Haver Analytics; PLFS; and IMF staff calculations.

6. **Financial conditions remained supportive of the economy, with credit growth reaching the highest level since 2013**. Between September 2022 and August 2023, bank credit growth averaged 15.6 percent y/y, while lending by nonbank financial companies (NBFCs) accelerated to 16.1 percent y/y in March 2023. Both banks and NBFCs have seen rapid lending growth to personal borrowers. While bank credit to services has also been strong, credit to the industrial sector has been low and lending to micro, small and medium enterprises (MSMEs) has normalized after a surge in 2021-2022, partly reflecting expiration of support measures and base effects. However, strong loan inquiries from MSMEs suggest demand remains high. Domestic corporate bond issuance has increased since late 2022 in the face of subdued USD issuance abroad. Domestic equity indices have reached new highs after an uneven start to the year, gaining about 10 percent as of end-September. Increased participation by domestic investors has supported equity markets in recent years, and despite modest net selling by individual retail investors in FY2023/24, monthly inflows to Systematic Investment Plans have increased 37 percent since January 2022 to INR158 bn ($1.9 bn) in August 2023, providing a more durable source of funding.

7. **India's external position in FY2022/23 was moderately stronger than that implied by medium-term fundamentals and desirable policies (Annex II)**. In FY2022/23, the current account deficit (CAD) widened to 2 percent of GDP, from 1.2 percent of GDP in the previous FY. The post-pandemic recovery of domestic demand and transitory external shocks, including a surge in commodity prices after Russia's invasion of Ukraine, outweighed the impact of robust services exports and proactive diversification of critical oil imports.[3] According to the EBA model, the cyclically-adjusted CAD stood at 0.9 percent of GDP in FY2022/23, 1.5 percentage points below its estimated long-term norm of 2.3 percent of GDP. Net FDI inflows declined to 0.8 percent of GDP in FY2022/23, covering almost half of the CAD. India's net international investment position improved marginally to about -11 percent of GDP at end-March 2023, as valuation changes and a base effect of rapid nominal GDP growth offset the CAD's contribution.

8. **Over the past year, the rupee's exchange rate moved within a narrow range.** At the same time, India's FX reserves, which had declined significantly in the context of Russia's war in Ukraine and US monetary policy tightening, recovered since end-October 2022.[4] As of end-September 2023, FX reserves stood at US$587 billion, covering more than 7 months of prospective imports.

9. **India has introduced trade restrictions recently**. Restrictions on wheat, sugar, and rice exports introduced by the authorities in 2022 in response to domestic food security concerns have remained in place through 2023. Moreover, during July-August 2023, the authorities widened the

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[3] India benefitted from discounted oil imports from Russia. According to data collected by *Kpler* and *Vortexa,* the share of India's oil imports from Russia increased from about 1 percent in 2021 to more than 40 percent in mid-2023.

[4] In 2022-23, about 2/3 of the decline in reserves was due to valuation changes arising from an appreciating US dollar and higher US bond yields reflecting US monetary policy tightening.

rice export restrictions amid domestic harvest concerns. Import regulations for laptops, tablets, and personal computers were announced in August 2023.

ROBUST OUTLOOK WITH BALANCED RISKS

10. Growth is projected to remain strong on the back of robust investment. As pent-up demand from the pandemic wanes and monetary policy pass-through to the real economy proceeds, consumption growth is expected to soften.[5] This, together with lower external demand will lead to softer growth. Nevertheless, a robust public capex agenda, which will support India's wide-ranging infrastructure needs, is expected to boost growth while crowding-in private investment.[6,7] As a result, growth is expected at 6.3 percent in both FY2023/24 and FY2024/25. The output gap is estimated to remain broadly closed.

11. Inflation is expected to decline gradually over the next two years. The recent increase in inflation driven by vegetable prices is expected to be temporary. Overall, inflation is projected to decline to 5.4 percent in FY2023/24 (from 6.7 percent in FY2022/23) before gradually converging to the RBI's 4-percent target over the medium term. Core inflation is projected to ease to 4.7 percent in FY2023/24 from 6.1 percent in the previous year and to also converge gradually to 4 percent over the medium term. These dynamics reflect the impact of past monetary policy tightening as well as the easing of global commodity prices.

12. The current account is projected to improve this year but will revert to its norm over the medium term. The CAD is expected to narrow to 1.8 percent of GDP in FY2023/24, reflecting lower oil import costs and resilient services exports. Subsequently, the CAD is expected to widen and converge to its long-term norm of around 2.3 percent of GDP, on the back of robust imports induced by strong investment and normalization of services exports.

13. India's medium-term growth outlook would be significantly enhanced by implementing broad-ranging reforms. Despite widespread global uncertainty, India is expected to grow above 6 percent over the next five years driven by continued strong investment, still-growing private consumption, and digitalization-driven productivity gains. Potential growth has been revised up to 6.3 percent, reflecting primarily larger-than-expected capital spending and higher employment.[8] Should productivity-enhancing reforms (see structural reforms section) be implemented, they would create additional jobs necessary to meet the needs of India's growing

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[5] The RBI's estimated lagged impact of monetary policy on output is about 4-6 quarters.

[6] India's infrastructure investment gap is estimated at 4.1 percent of GDP (ADB, 2017). More recently, India's urban infrastructure needs alone are estimated at 1.2 percent of GDP annually over 2022-2036 (World Bank, 2022).

[7] Evidence has shown that in India, public-capital accumulation is complementary to private-sector investment (Bahal, G., M. Raissi, and V. Tulin, 2015, "Crowding-Out or Crowding-In? Public and Private Investment in India" *IMF Working Paper 15/264*).

[8] Other studies estimate potential growth between 7.1 to 7.7 percent (Subramanian, 2023, mimeo).

population. This, along with reforms to raise female LFP, would boost potential growth. Under the baseline, the output gap is expected to remain broadly closed throughout the medium term.

14. Risks to the outlook are balanced. Important risks include (Annex III).

- **External risks**. Global and idiosyncratic risks could cause a synchronized growth slowdown, with adverse spillovers through trade and financial channels and market fragmentation. Further global supply disruptions—e.g., due to conflicts or natural disasters—could cause recurrent commodity price volatility, increasing fiscal pressures for India and prompting economic instability. Broader and deeper conflict(s) and weakened international cooperation may lead to a more rapid reconfiguration of the global economy with knock-on effects on India.

- **Domestic risks**. Pressure to address cost of living increases may lead to fiscal slippages or under-execution of government capex to meet the budgeted fiscal deficit, which could slow growth. Weather shocks could weigh on agricultural output and raise food prices, reigniting inflationary pressures. Rapid and persistent growth of personal loans could lead to financial sector stress in a future downturn. Uncertainty related to upcoming elections could negatively impact investment.

- **Available policy buffers and relevant structural policies should be used if downside risks materialize**. Action would be needed to contain the negative economic impact which could include a significant growth slowdown with rising inflation. The available fiscal space would need to be drawn upon to provide targeted economic support to the vulnerable, while standing ready to tighten monetary policy should inflationary pressures from supply shocks appear to become entrenched.

- **Upside risks**. Stronger-than-expected consumer demand and private investment would raise growth. Further liberalization of foreign investment could increase India's role in global value chains, boosting exports. Implementation of labor market reforms could raise employment and growth. Broad-based structural reforms would lift potential growth over the medium term. Lower-than-expected commodity prices can lower inflation, which would boost household purchasing power and lower business input costs, thereby supporting consumption and investment.

15. The authorities were more optimistic than staff on the economic outlook. They projected growth at 6.5 percent in FY2023/24, driven by domestic factors—capital spending resulting from government spending on infrastructure with widening crowding in of private capital expenditure in related areas and robust consumption. The authorities noted that the recent upticks in inflation appear temporary and they expect inflation to moderate, averaging 4.5 percent in FY2024/25. Over the medium term, the authorities expect growth to remain robust and above staff's projections, with potential growth around 7-8 percent. The authorities expect that weakening FDI trends will be temporary. They emphasized that global interest in investing in India, supported in part by the PLI schemes in key sectors, is expected to boost domestic manufacturing, exports, and employment. The RBI pointed out that staff's external sector assessment only relied on the EBA-CA

methodology, while a net foreign assets approach would be preferable and would show that the economy was aligned with fundamentals. That said, RBI's own analysis delivers an equilibrium CA estimate of -2.5 percent of GDP, very close to the EBA result.

16. The authorities assessed risks to be balanced. The authorities noted that rising international oil prices and a slowdown in China, which could dampen global growth, are the main external risks. They highlighted that adverse weather shocks—which would hurt agriculture output and put pressure on prices—are the only notable domestic risk and did not see any elections-related economic uncertainty.

FISCAL POLICY: REBUILDING BUFFERS

17. The fiscal deficit narrowed in FY2022/23 as measures introduced to mitigate cost of living pressures were offset by expenditure compression in other areas and buoyant revenues.

- **The central government deficit declined to 6.5 percent of GDP, meeting the budgeted target**. The war in Ukraine and corresponding pressure on commodity prices prompted the government to announce additional measures to mitigate cost of living increases, outside of the budget cycle. These additional expenditures (estimated at 1.2 percent of GDP) were offset by revenue outperformance, driven by strong economic growth and buoyant goods and services tax (GST) revenue amid continued efforts to improve tax compliance, particularly through digitalization.

India: Summary Central Government Fiscal Developments

(In percent of GDP)

	FY 2021/22	FY 2022/23			FY2023/24	
	Est.	Budget	Revised Est.	Proj.	Budget	Proj.
Total Revenues	**9.4**	**8.7**	**8.9**	**8.9**	**8.9**	**8.9**
Net tax revenues	7.7	7.5	7.8	7.7	7.8	7.6
Non-tax revenues	1.7	1.2	1.1	1.2	1.1	1.3
Total Expenditure	**16.2**	**15.2**	**15.4**	**15.4**	**15.0**	**14.9**
Revenue expenditure 1/	13.7	12.3	12.7	12.7	11.6	11.6
Food Subsidy	1.2	0.8	1.1	1.1	0.7	0.7
Fertilizer Subsidy	0.7	0.4	0.8	0.9	0.6	0.6
Capital expenditure	2.5	2.9	2.7	2.7	3.3	3.3
Central Government (CG) Fiscal Deficit	**6.8**	**6.6**	**6.5**	**6.5**	**6.1**	**6.0**
Memo Items						
Nominal GDP (Rs billions)	234,710	259,562	273,078	272,407	301,751	300,983
CG Fiscal Deficit (authorities' definition) 2/	**6.8**	**6.4**	**6.4**	**6.4**	**5.9**	**5.9**
General Government Fiscal Deficit	9.6	10.8	9.4	9.2	9.1	8.8
State Government Fiscal Deficit	2.8	4.2	2.9	2.8	3.1	2.8
General Government Debt (% of GDP) 3/	83.8	…	…	81.0	…	82.0

Notes: 1/ Starting in FY2020/21, includes food subsidies covered by the Food Corporation of India (FCI).
For FY2020/21, excludes retroactive payment to FCI for previous years' food subsidy bill.
2/ Includes asset sales in receipts, and excludes certain non-tax revenue items. Includes the retroactive payment to Food corporation of India for previous years' food subsidy bill.
3/ For FY2021/22 reflects the additional SDR allocation of about 0.6 percent of GDP.

- **The state governments' combined deficit declined to 2.8 percent of GDP, below the medium-term deficit target of 3 percent**. Strong growth in state tax revenue and interest-free loans from the center allowed states to expand capital expenditure at a robust pace while still meeting deficit targets. In FY2022/23, eight states met the benchmarks set by the central government for reform of electricity distribution companies and were provided additional borrowing space.[9] In comparison, 12 states were able to meet the benchmarks in FY2021/22, reflecting tougher reform standards over time.

18. The FY2023/24 central government budget appropriately prioritizes capital spending while tightening the fiscal stance. The fiscal deficit is expected to improve by 0.5 percentage point of GDP, notwithstanding strong growth in capital expenditure.[10] The deficit reduction is expected to be achieved through spending restraint in current expenditure and a reduction in subsidies, reflecting both moderating commodity prices and cessation of temporary measures to ease cost of living pressures. The FY2023/24 Budget also adjusted the personal income tax (PIT) regime to make the preferred broad-based PIT schedule (introduced in parallel with the existing schedule in FY2020/21) more attractive, including through an increase in the tax-free threshold while setting this schedule as the default. Transfer taxes on personal remittances and payments for educational, medical and travel services were introduced in 2020; effective October 2023, the tax rates on personal payments and travel services were raised to discourage underreporting of income by high-net-worth individuals on their tax return. While the income tax law provides for the reimbursement of these taxes, they still give rise to exchange restrictions as they represent an additional burden/cost on making current international payments and transfers.[11] At the state level, the deficit is expected to remain broadly unchanged at 2.8 percent of GDP, as capital expenditure is not expected to reach budgeted levels. India is assessed as having some fiscal space and therefore has some room for expansionary fiscal measures, if needed.

19. Over the medium term, the fiscal deficit is projected to gradually decline while public debt is expected to remain elevated but risks of sovereign stress are moderate (Annex IV). Under the baseline, the central government deficit is projected to be higher than the target of 4.5 percent of GDP by FY2025/26. To reach the target, additional policies will be needed (see ¶21). Public debt is expected to rise to 82.3 percent of GDP by FY2024/25 before falling, leading to substantial gross financing needs (15 percent of GDP in the medium-term). Risk factors are

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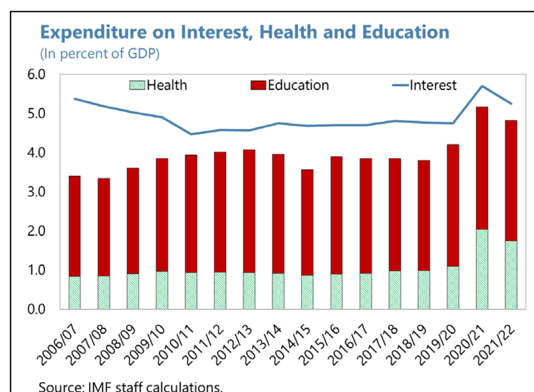
[9] Additional borrowing of up to 0.5 percent of state-level GDP is available each year between FY2021/22 and FY2024/25 for states that implement power sector reforms to improve operational and economic efficiency, including a sustained increase in paid electricity consumption.

[10] The reduction in the public sector borrowing requirement, which includes borrowing by central SOEs, is narrower at 0.4 percent of GDP.

[11] The exchange restrictions arise from: (i) 20 percent tax on personal remittances above the annual INR700,000 threshold; (ii) 0.5 percent tax on remittances, above the annual INR700,000 threshold, for education payments where financed by loan; (iii) 5 percent tax on payments above the annual INR700,000 threshold for education and medical services, and (iv) 5 percent tax on payments for travel services (overseas packages) below the annual threshold of INR700,000 and 20 percent tax thereafter, to the extent that it applies to cross-border payments (i.e. to nonresident seller).

mitigated by the fact that the bulk of public debt is in the form of long-dated, fixed-rate instruments denominated in domestic currency and predominantly held by residents. Demand for government securities remains robust, with bid-cover ratios averaging 2.6 between April and September 2023. Contributions to the National Small Savings Funds have increased, supported by a lift in deposit limits and the introduction of new schemes, providing an alternative funding source to market-based securities. In addition, India continues to benefit from favorable interest-growth differential.

20. An ambitious fiscal consolidation path is needed to replenish buffers and sustainably lower debt, while supporting inclusive growth. Given the shocks that India has experienced historically, and instances of fiscal slippages between 2000 and 2020, the baseline carries the risk that, should similar shocks materialize, debt would exceed 100 percent of GDP in the medium term (see debt fanchart in Figure 6 of Annex IV). Reaching the authorities' deficit target in FY2025/26 and then maintaining further fiscal tightening would rebuild buffers at a faster pace, safeguarding against shocks. This would also reduce the interest burden on the budget (currently at around one third of tax revenue), creating room for expenditure which supports long-term growth, such as on infrastructure, health, and climate change mitigation and adaptation.



21. A proposed consolidation scenario can be achieved through both revenue and expenditure measures.

- **Revenue mobilization**: The GST Council is discussing recommendations on GST rationalization of rates and exemptions. In this context, Staff analysis provides alternative simplification options (text table). Reforms to the GST would raise revenue efficiently, with minimal distortions to growth drivers e.g., investment decisions. Other revenue measures include reversing the fuel excise tax cuts, further broadening the corporate and personal income tax bases, and continued improvements in tax administration.

Additional GST Revenue
(% of GDP)

Reform options:	No Exemption	Exemptions for Food	Existing Exemptions
Current Regime:	0.6%	0.3%	
Uniform Rate (%):			
13	0.7%	0.4%	0.1%
14	1.4%	1.1%	0.7%
15	2.1%	1.7%	1.3%
16	2.8%	2.4%	2.0%

Source: De Mooij and others (2019)

- **Expenditure efficiency**: Achieving further efficiency in expenditure is possible through better targeting of subsidies, greater utilization of the digital infrastructure to deliver social support and, where possible, the use of direct, targeted, cash transfers. For example, the digital ID, combined with land records, can be used to allocate subsidized fertilizer to farmers based on the size of their land; this is being trialed in selected states. The digital infrastructure also supports efforts to make social assistance more resilient and adaptable (to reach e.g., migrants, informal workers, and the urban poor), by improving access to socio-economic data through greater data exchange between various scheme holders; this process is underway with the e-Shram portal (Alonso and other, 2023). The availability of socio-economic data is key to reach intended beneficiaries and targeting is crucial to contain fiscal costs.

Potential Consolidation Scenario

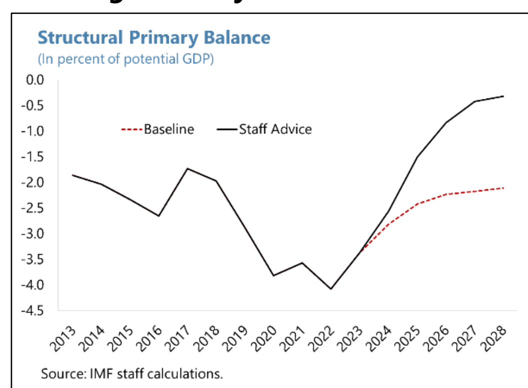
Change between FY2022/23 and FY2027/28 (% of GDP)

	Consolidation	Baseline	Difference
GST	1.1	0.3	0.9
Excise	0.2	-0.2	0.4
Income tax	0.4	0.2	0.2
Subsidies	-1.2	-0.9	-0.3
Capital Expenditure	0.3	0.3	0.0
Cyclically adjusted primary balance	3.7	1.9	1.7

Nb: This is a stylized scenario illustrating possible measures that could underpin faster consolidation

Source: IMF Staff estimates, de Mooij and others (2019)

22. This proposed consolidation scenario is expected to significantly lower the fiscal deficit and put public debt firmly on a downward path. The additional policy measures in this scenario would allow the authorities' deficit target to be reached in FY2025/26, and then continue to narrow the fiscal deficit from FY2026/27 onwards; the general government structural primary deficit is projected at 0.4 percent of GDP in FY2027/28[12]. This implies a general government deficit of 5.7 percent of GDP. Public debt would fall to 74 percent of GDP by FY2028/29, 6 percentage points of GDP lower than the baseline, (with gross financing needs 2.2 percentage points lower, of which 0.4 percentage points due to a reduction in debt servicing), thus creating much needed buffers in an increasingly shock-prone world. Growth is supported by maintaining a high level of capital expenditure, while the smaller financing needs of the government reduces crowding out and creates room for private investment. Alternative consolidation scenarios could include greater spending on health, coupled with higher domestic



Structural Primary Balance
(In percent of potential GDP)
Source: IMF staff calculations.

Outcome in FY2027/28 under Consolidation Scenario

(% of GDP)

Cyclically adjusted primary balance	-0.4
General Government Balance	-5.7
General Government Balance (Authorities' Definition)	-5.6

Source: IMF Staff estimates, de Mooij and others (2019)

[12] This anchor is based on a stochastic model which optimizes the tradeoffs between macroeconomic stabilization (i.e., responding to the output gap) and debt sustainability. See Fournier (2019) and Fournier and Lieberknecht (2020) for model details.

revenue mobilization-India's tax gap is estimated at 5 percent of GDP (De Mooij and others, 2019)-to maintain the proposed deficit path.

23. Risks to the consolidation path include contingent liabilities, such as those from the electricity distribution companies. Distribution companies struggle to remain financially viable amid underpriced electricity, technical losses, and inefficiencies in billing and collection (Chateau and others, 2023). States have absorbed their debt or losses three times in the last twenty years, another rescue package could cost 2.3 percent of GDP, though with large variation across states (Mukherjee and others, 2022)[13]. Other contingent liabilities include government guarantees estimated at 2.2 percent of GDP for the Center and 4.5 percent of GDP for the States. The realization of these contingent liabilities would raise gross financing needs to over 20 percent of GDP and raise debt levels to 88 percent of GDP (Annex IV).

24. The review of the FRBM Act, following its suspension during the pandemic provides an opportunity to revamp India's medium-term fiscal framework (MTFF) to align it with international best practice and incorporate lessons from the pandemic (Annex V).

- **Public financial management (PFM)**: India's central government PFM is sound, with a strong financial compliance basis. This serves as a good springboard to take fiscal planning to the next level (Fouad and others, 2018). Areas of improvement include (i) a stronger link between the MTFF, fiscal objectives and the budget process, (ii) a comprehensive assessment of fiscal risks and mitigation strategies, and (iii) closing data gaps. IMF capacity development efforts are supporting selected Indian states in the development of MTFFs, which have helped states navigate shocks to the economy, including the pandemic (Annex VI).

- **Fiscal rule and medium-term anchor**: Part of the revamped MTFF should be a medium-term anchor and fiscal rule that are consistent with India's development goals, while rebuilding fiscal buffers at an appropriate pace and maintaining flexibility in the face of shocks (Caselli and others, 2022). Given missed fiscal targets in the pre-pandemic period, the new MTFF should incorporate checks and balances to support accountability and assist in building credibility. This can be achieved through institutional reforms and/or through procedural reforms that introduce, inter alia, greater transparency surrounding the fiscal path to enable real-time, ex-ante assessment of the fiscal strategy by the wider public.

- **Fiscal governance**: Providing timely and easy-to-understand information to the public regarding the government's fiscal policy design process would support good governance. Building on recent progress, additional fiscal transparency reforms could include (i) expanding the institutional coverage of fiscal reports to consolidated general government; (ii) releasing sub-national fiscal data in a more timely manner; (iii) transitioning to accrual accounting; (iv) publishing a fiscal strategy ahead of the budget (which would replace the current Macroeconomic Framework Statement and Medium-Term Fiscal Policy Statement); and (v)

[13] The fiscal cost ranges from 0.5 to 5.2 percent of state-level GDP.

improving access to fiscal information, particularly at the state level. In addition, high levels of capital expenditure places greater importance on sound public investment management. Further improving PFM and public procurement, as well as transparency of beneficial ownership of companies that are awarded public contracts and publishing audits of emergency spending, can mitigate governance and corruption vulnerabilities.

25. The authorities remain committed to achieving the central government deficit target of 4.5 percent of GDP by FY2025/26. The adjustment will be implemented approximately evenly over FY2024/25 and FY2025/26. State government deficits are expected to remain below the 3 percent of GDP ceiling, in line with their historical performance.

26. The authorities acknowledged that from FY2026/27, a further reduction in the debt-to-GDP ratio is desirable. They are more sanguine regarding medium-term sovereign risks as staff's baseline assessment does not factor in the targeted consolidation. Broadly, the authorities intend to restrain growth in recurrent expenditure to below nominal GDP growth, while continuing to prioritize infrastructure investment. Buoyancy in tax revenues will be supported by further formalization of the economy and continued efforts in improving and streamlining tax administration. The authorities do not consider a reversal of the fuel excise tax cut to be appropriate when inflation is hovering around the upper range of RBI's tolerance band and remains volatile. Guarantees of the central government have declined over time and the incremental increase in guarantees are capped. A significant proportion of guarantees from the state government are to the electricity sector, hence improving the financial viability of the sector would also mitigate state-level contingent liability risks. States have been provided with budget incentives to reform the electricity sector and important milestones such as electricity tariff revisions have been achieved. As regards recommendations surrounding the MTFF, they believe that their demonstrated commitment to the fiscal deficit target, first announced in the FY2021/22 Budget, achieves the same purpose with regards to credibility and transparency.

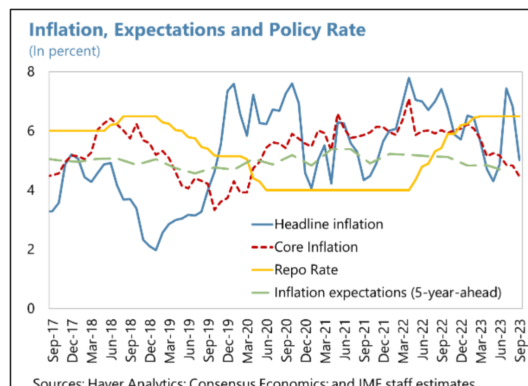
27. The authorities strongly disagreed with staff assessment of exchange restrictions pertaining to taxes on outward remittances. They viewed that such taxes do not in any way limit the availability or use of foreign exchange by resident individuals in India. Moreover, the total amount of tax collected at source is available for full credit or refund when filing an income tax return. Therefore, in their view, the only cost involved is in terms of cash flow and such nominal cost should not amount to an exchange restriction.

MONETARY POLICY: SECURING PRICE STABILITY

28. The RBI appropriately tightened monetary policy to address elevated inflation. Since May 2022, the RBI raised the policy rate by a total of 250 basis points (bps). As inflationary pressures eased and inflation moved within the tolerance band during March-June 2023, notwithstanding some volatility from food price shocks, the RBI kept its policy rate unchanged at 6.5 percent since February 2023, while expressing a strong commitment to guide inflation towards the 4-percent

target. Given moderating inflation and a closed output gap, coupled with well-anchored inflation expectations, the current broadly neutral monetary policy stance is appropriate.[14]

29. Further monetary policy actions should continue to be data dependent and carefully calibrated to safeguard price stability. Given staff projects the output gap to remain closed and inflation to gradually converge to the 4-percent target in the medium term, a broadly neutral monetary stance remains appropriate. Given uncertainty surrounding the inflation outlook, however, the magnitude and timing of a policy rate change should continue to be data-dependent and carefully calibrated to avoid premature easing. Furthermore, the RBI should continue to communicate its monetary policy in a transparent way to help guide market expectations.



Sources: Haver Analytics; Consensus Economics; and IMF staff estimates.

30. Liquidity management should remain nimble to ensure adequate resources are available to productive sectors while preserving financial stability. Surplus interbank liquidity expanded significantly in the first half of FY2023/24, partly reflecting the deposit of INR 2,000 banknotes in banks and RBI's FX purchases.[15] To absorb a surge in surplus liquidity, the RBI conducted variable reverse repo rate auctions alongside the standing deposit facility. In response to the one-off shock of the INR2000 banknotes withdrawal, the RBI also implemented in August an incremental cash reserve ratio (ICRR) of 10 percent on the increase in banks' net demand and time liabilities (NDTL) between May 19, 2023, and July 28, 2023 and then unwound the ICRR in a phased manner in September-October. Going forward, managing system liquidity through market-based tools remains the most efficient approach and would help further develop money markets.

31. The use of FXI may be appropriate when the FX market turns shallow, which destabilizes risk premia (Annex VII). The IMF's Integrated Policy Framework (IPF) provides guidelines for when FXI would be appropriate, subject to a country's characteristics, frictions, and types of shocks.[16] For India, the use of FXI could effectively mitigate the fallout from adverse shocks when the FX market becomes shallow.

- In general, India's FX markets have relatively stable UIP premium, high FX turnover and narrow bid-ask spread, suggesting a deep FX market, notwithstanding the presence of FXI. A

[14] The natural real interest rate (r*) is estimated at 1 percent. A projected average inflation rate of 5.4 percent in FY2023/24 and a policy rate of 6.5 percent implies a real interest rate of 1 percent.

[15] On May 19, 2023, the RBI announced that it will withdraw INR 2000 banknotes from circulation.

[16] The IPF frictions comprise shallow FX market, high FX mismatches, and de-anchoring inflation expectations. While India's FX market can become shallow, the country has low FX mismatches and well-anchored inflation expectations. (Annex VII provides additional details).

model-based analysis, which allows for time-variation in FX market depth, favors a mostly deep but occasionally shallow market, including during the GFC and COVID-19 outbreaks.

- Two scenario analyses illustrate when FXI could be beneficial in alleviating the output-inflation policy tradeoffs. Scenario 1 assumes supply-side shocks from global trade fragmentation/a wider geopolitical conflict but there is no risk-off shock. Under a deep FX market and with inflation expectations remaining well-anchored, Scenario 1 shows that exchange rate flexibility can help absorb the shock and there is no additional benefit of FXI to mitigate the output-inflation tradeoffs. Scenario 2 assumes a severe risk-off shock due to global financial market turbulence, inducing a domestic risk premium. Staff's analysis finds that under this scenario, FXI can help limit excessive rupee depreciation and absorb the pressure from monetary policy tightening to contain inflation. This in turn helps soften an adverse impact on domestic demand, thereby reducing the decline in output. Nonetheless, the scope for using FXI relies on its effectiveness in stabilizing the exchange rate. In some cases, having a meaningful impact on the exchange rate may require the use of large amounts of reserves, making FXI costly, and infeasible if reserves are limited.

- The above analysis confirms that, given India's generally deep FX markets, the use of FXI would only be warranted when shocks are strong enough to disrupt market functioning.

32. Greater exchange rate flexibility would help absorb external shocks. Over the past two years, the Rupee-U.S. Dollar had moved significantly, depreciating by about 15 percent between December 2019 and November 2022 (Figure 5, panel 1). Over the past year, improved domestic macroeconomic stability, supported by tightening monetary policy, has helped attract capital inflows. Based on FXI data that the RBI publishes on a monthly basis, the RBI has been using FXI to cushion the impact of external shocks, smooth market volatility, preclude emergence of disorderly market conditions (DMC), and opportunistically replenish its FX reserves. However, during December 2022-October 2023, the Rupee-U.S. Dollar exchange rate moved within a very narrow range, suggesting that FXI likely exceeded levels necessary to address disorderly market conditions. The observed stability of the exchange rate prompted staff to reclassify India's *de facto* exchange rate regime from "floating" to "stabilized arrangement" for that period, while the *de jure* classification remained "floating" (see Informational Annex).[17] FX reserves are assessed at just above 100 percent of the IMF composite reserve adequacy metric for a stabilized exchange rate regime. Going forward, a flexible exchange rate should act as the first line of defense in absorbing external shocks.

33. The pilots of central bank digital currency (CBDC) are in progress. The wholesale and retail CBDC pilots—in place since November and December 2022, respectively—are gradually gaining traction. As of August 2023, the digital rupee has 1.46 million users, including 0.31 million

[17] The reclassification is based on a statistical methodology that is implemented by staff evenhandedly across member countries. The methodology follows a backward-looking statistical approach that relies on past exchange rate movement and historical data. Therefore, this reclassification does not imply statements or views on future or intended policies nor does it imply a policy commitment on the part of the country authorities.

merchants, that carry out between 5,000-10,000 transactions per day. The authorities are aiming for the number of digital rupee transactions to surpass 1 million per day by end-2023 in part through the integration of the digital rupee with the existing unified payments interface (UPI) system. The RBI is also actively engaging with other countries to explore the feasibility of cross-border payments using CBDC, although progress thus far has been incremental, given macroeconomic implications of cross-border CBDC and potential risks. Any adjustments to CFM measures impacting the use of CBDCs in cross-border payments should align with the IMF's Institutional View on CFMs.

34. The authorities reiterated firm commitment to bringing inflation down to the 4 percent target. They reaffirmed their continued focus on withdrawal of accommodation, given upside risks to inflation. They indicated that further monetary policy actions would be carefully calibrated to inflation developments. On liquidity management, the authorities noted that the ICRR was a special measure in response to the specific circumstances of the withdrawal of INR2000 banknotes from circulation—and not part of regular liquidity management operations.

35. There was significant divergence of views on the exchange rate and FXI assessments. The authorities highlighted that FXI is only used to curb excessive exchange rate volatility. The RBI strongly disagreed with staff's assessment that FXI likely exceeded levels necessary to address disorderly market conditions and has contributed to the Rupee-USD moving within a narrow range since December 2022. The RBI strongly believes that such a view is incorrect as, in their view, it uses data selectively. In their view, staff's assessment is short-term and restricted to the last 6-8 months without any rationale for the same, and if a longer-term view of 2-5 years is taken, staff's assessment would fail. In the authorities' view, therefore, staff's reclassification of the de facto exchange rate regime to "stabilized arrangement" is unjustified. They noted that the RBI's FXI comply with the best principles of transparency since FXI data dissemination in the public domain complies with SDDS standards prescribed by the IMF, and that the rupee continues to be a market determined currency, with no explicit/implicit target/band. The authorities also stated that they remain committed to their stance of minimizing volatility for financial stability considerations but without any view on the level for the rupee. Moreover, in their view, the exchange rate's stability in 2023 reflects the strength of macroeconomic fundamentals and improvements in India's external position, particularly significant moderation in the current account deficit (CAD) and revival of capital flows on the back of a comfortable foreign exchange reserves buffer. Overall, they noted that India's macroeconomic stability also imparted stability to the exchange rate. Regarding the IPF analysis, the authorities noted that India has well-anchored inflation expectations, limited FX mismatches, deep FX markets, and rising international investor confidence as reflected in the surge in portfolio flows, external commercial borrowings and rise in non-resident deposits during 2023-24 so far.

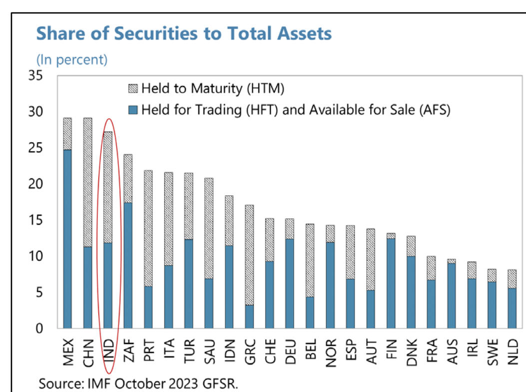
36. The authorities concurred that India's external position remains strong and can withstand near-term shocks. In terms of published data, the current account deficit and the external financing requirement are modest at 1.1 percent of GDP during April-June 2023. Reflecting these factors, they noted an increase in the foreign exchange reserves of US$ 24.4 billion excluding valuation effects, which is a further attestation of the strength of the country's external position. The authorities viewed the current level of FX reserves as comfortable and noted that while there are

costs associated with holding FX reserves, the benefits, including lower risk premia, should also be considered. The authorities were satisfied with the progress in retail and wholesale CBDC pilots, while stating the intention to move cautiously towards full-scale CBDC implementation.

FINANCIAL SECTOR POLICY: PRESERVING STABILITY AND STRENGTHENING REFORM FOR GROWTH

37. Systemic financial risks have declined, bolstered by improved balance sheets and stronger capital buffers across financial institutions. Capital-to-risk-weighted asset ratios have improved across the board, reaching a record high of 17.2 percent for the banking system in March 2023, though public sector banks continue to lag significantly behind their private sector peers. Bank profitability has increased, with return on assets reaching 1.2 percent—the best in a decade—albeit remaining relatively low on a cross-country basis. Net interest margins (and income) have strengthened through the course of the monetary policy cycle, bolstering earnings, although further gains may be challenging as bank funding costs rise and deposit growth has lagged credit growth. Gross nonperforming asset ratios[18] have fallen to multiyear lows at 3.9 percent and 4.3 percent for banks and NBFCs, respectively, with improved provisioning also driving net nonperforming assets to 1 percent among banks. The RBI's stress tests suggest the financial system would be resilient to adverse macro shocks, but that a weaker tail of NBFCs remain vulnerable to liquidity risks, suggesting careful monitoring of lingering vulnerabilities in NBFCs is warranted. More acutely, though not systemically important, urban cooperative banks (UCBs) remain susceptible to credit, market, and liquidity risks.[19]

38. While interest rate risks remain contained in the near term, a relatively high share of bank holdings of government securities could amplify macro-financial risks. Bank holdings of securities are relatively high, largely driven by government bonds at around 22 percent of assets, which partially reflects regulatory constraints. A sudden increase in sovereign risk premia could weigh on balance sheets and bank lending appetite. However, the increase in securities under held to maturity (HTM), aided by RBI regulatory relief[20], has masked the impact of interest rate risks on the income statement during the recent tightening cycle. Moreover, ten-year government bond yields have risen by 145 bps and 88 bps since the beginning of 2021



[18] As of March 2023

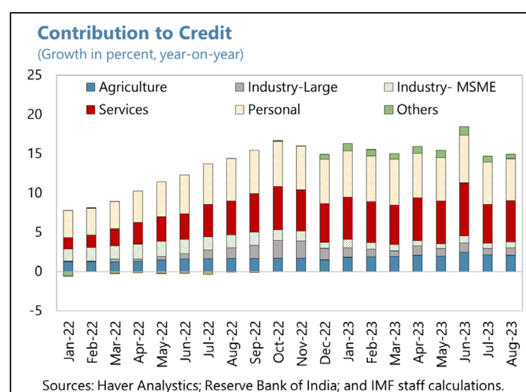
[19] RBI announced the move towards a scale based regulatory framework for UCBs in December 2022.

[20] The measure, introduced in 2021 and later extended, allows banks to hold up to 23 percent of net demand and time liabilities (NDTL) for SLR purposes in held to maturity securities, compared to 19.5 percent previously. HTM securities accounted for 64 percent of securities in March 2023.

and 2022 respectively, approximately one-third the move seen in US Treasury yields. As such, unrealized losses remain modest, accounting for 65 bps of CET1 for the median bank.[21]

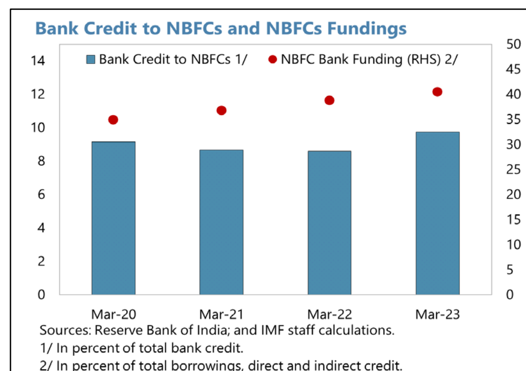
39. Continued nimble and vigilant supervision and the use of prudential tools are needed to preserve financial stability. Moreover, continuing to encourage sound governance and strong prudential norms remain priorities, as supervisors have uncovered occasional lapses by banks in recognizing problem loans.

- **Rapid growth in personal lending**: Personal credit, accounting for 30 percent of total bank credit outstanding in FY2022/23, has continued to outpace total bank credit, averaging close to 20 percent y/y growth from January 2023 to August 2023.[22]. NBFC personal lending also expanded 30 percent y/y in June 2023. The rapid expansion in personal lending, unsecured loans in particular, which have averaged 25.8 percent y/y growth for banks in 2023 through August[23], could stretch debt service capacity and pose balance sheet risks in a future downturn. While nonperforming assets in the segment remain low, early-stage delinquencies are somewhat elevated, particularly for public sector banks. The authorities may consider prudential tools to preempt the buildup of financial sector risks, such as increasing risk weights or introducing new tools such as debt-service-to-income limits, although the latter may take time to implement, while continuing to emphasize prudent underwriting standards.



Sources: Haver Analystics; Reserve Bank of India; and IMF staff calculations.

- **Interconnectedness between banks, NBFCs, and fintech companies**. Increased NBFC-bank linkages can amplify financial stress and adverse spillovers. Bank lending to NBFCs has increased; encouraging a diversified and long-term funding base would contribute to a more resilient financial system. Furthermore, a rapidly developing fintech industry also suggests more indirect and opaque linkages could emerge.[24] While the introduction of a scale-based framework for NBFCs is a significant



Sources: Reserve Bank of India; and IMF staff calculations.
1/ In percent of total bank credit.
2/ In percent of total borrowings, direct and indirect credit.

[21] Dispersion of unrealized losses across banks is high (179 bps for the weakest 5th percentile).

[22] Credit is net the impact of a larger bank-NBFC merger as of July 2023.

[23] Unsecured lending defined as credit card loans and other personal loans, and accounts for close to 10 percent of total bank credit. Total is calculated by aggregating sectoral totals, which accounts for 93 percent of all nonfood credit.

[24] The RBI released a digital lending framework in September 2022, following by clarification on First Loss Default Guarantees in June 2023, which placed a 5 percent cap on default guarantees.

step, addressing lingering data gaps would improve the effectiveness of supervisory efforts and reduce the remaining potential for regulatory arbitrage. Further efforts to monitor and regulate NBFC liquidity risks would be beneficial, in particular beyond the 30-day horizon. Comprehensive systemic risk assessments, would benefit from more in-depth quantitative analysis in the upcoming FSAP. [25]

- **Climate risk**: After releasing a discussion paper in July 2022, the RBI has been gathering feedback to assess the credit, market, liquidity, and operational risks to financial institutions around climate issues. Following the release of the green deposit framework in April 2023, these efforts should continue to facilitate the inclusion of a climate framework into bank stress tests and supervision.

40. Improved financial resilience provides an opportunity to implement structural reforms that would support durable credit growth and solidify recent improvements. Such reforms include:

- **Continuing to strengthen regulatory and supervisory standards**. Pushing forward with implementation of the Expected Credit Loss Framework in line with IFRS9 would incentivize prudent lending practices. In collaboration with the IMF, the RBI is improving its stress testing framework. Further reforms should include development of macro-financial scenarios and network analysis. Renewing efforts to establish a bank resolution framework should be a priority. The authorities should work to enhance the effectiveness of their AML/CFT framework, including by addressing technical compliance gaps in line with the 2017 FSAP recommendations, in particular those related to domestic politically exposed persons and domestic tax evasion (Annex VIII).[26]

- **Facilitating the exit of non-viable firms and promoting asset resolution**. The authorities have taken meaningful steps to build capacity of the National Company Law Tribunals (NCLTs) and improve the functioning of the resolution process. Nonetheless, procedures under the Insolvency and Bankruptcy Code (IBC) have been relatively slow[27], and efficient execution of the bankruptcy process remains critical to the overall success of the law. The authorities should promote alternatives to formal procedures (hybrid, enhanced, and/or out of court), and consider various proposed reforms, such as allowing unincorporated enterprises more access to 'prepack' process.[28] The meaningful impact of the National Asset Reconstruction Company Limited

[25] The FSAP is expected to commence during FY2023/24.

[26] FATF is scheduled to begin a review in November 2023, with the report to be discussed at the FATF Plenary meeting in June 2024. The authorities have expressed interest in regional AML/CFT technical assistance (see Annex VII).

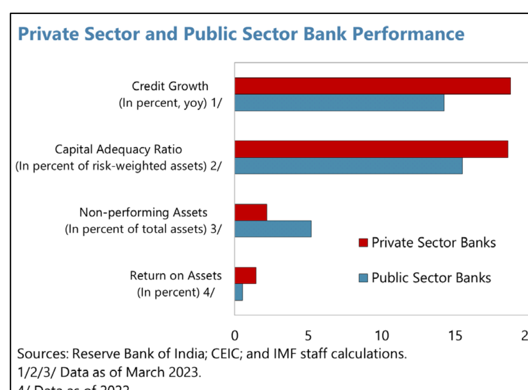
[27] Admission to NCLT takes an average of one year, compared to a benchmark of 14 days, while resolution also takes an additional year, compared to a benchmark of 180-270 days.

[28] Recognizing the need for reform, the Ministry of Corporate Affairs released on January 18, 2023, a draft proposal for amendments to the IBC for public consultation.

(NARCL) also depends on timely implementation; as of mid-September, NARCL has purchased INR 263 billion, compared to INR 2 trillion initially planned.

- **Further deepening capital markets**: India debuted its first sovereign green bonds (INR 160 billion) in early 2023 and additional issuances are expected in the second half of FY2023/24. Continued initiatives to develop the corporate bond market and Environmental, Social, and Governance (ESG) framework would help deepen capital markets and diversify sources of financing for corporates. The newly announced corporate bond backstop[29] has not yet been tested but should help support market functioning during periods of stress. Further reforms to improve bond market efficiency and ease frictions could facilitate higher foreign investment in the domestic market. Finally, recent announcement of inclusion into JPMorgan's Government Bond Index should provide India with access to a wider pool of investors, with expected inflows likely to increase nonresident ownership in India's bond market.

- **Promoting governance**. Active risk management, financial transparency, and effective compliance practices are critical for a competitive and resilient banking system. Public sector bank governance has been improved in recent years through administrative reforms and training. Nonetheless, public sector banks still lag their private sector peers in asset quality, profitability, credit provision, and capital buffers, which underscores the need to maintain a steadfast reform momentum and move forward with privatization efforts in line with the 2017 FSAP recommendations.



- **Financing for MSMEs (Annex IX)**. Ongoing efforts to ease information asymmetries and market frictions, such as the Account Aggregator should help bring more MSMEs into the formal finance sector. Collecting more up to date and comprehensive data on MSMEs is paramount, while streamlining the wide array of state and central government support measures would also be beneficial. Legacy asset quality issues among MSMEs may be hindering credit growth and diminishing risk appetite among certain lenders, reinforcing the necessity of a robust and expeditious asset resolution framework.[30]

41. The authorities highlighted that the financial sector is strong, with robust balance sheets and asset quality across institutions. While recognizing the rapid growth in personal loans, they noted that borrower quality has been relatively good and nonperforming assets are low, and that they will continue to closely monitor developments in the coming year. They indicated that all possible macroprudential measures can be considered, including borrower level measures. They

[29] Corporate Debt Market Development Fund

[30] Transunion SIBIL MSME Pulse data showed that in FY223Q2, delinquency rates among MSMEs had fallen to 3 percent when excluding doubtful, loss and 720 days past due accounts, but as high as 12.5 percent otherwise.

noted the positive impact of digitalization and related initiatives on personal and MSME lending. The authorities highlighted that the implementation of the scale-based regulatory framework has placed large systemic NBFCs under close supervision, while also acknowledging that some data gaps remain among comparatively smaller institutions. They noted that recent efforts have greatly improved governance at public sector banks, adding that this was work in progress. The authorities felt that the resolution timelines under the Insolvency and Bankruptcy Code (IBC) would improve as capacity has continued to increase, and that the IBC has been successful in reforming bankruptcy processes as evidenced by the significant decline in gross NPAs over the past two years.

STRUCTURAL REFORMS: INVIGORATING INCLUSIVE AND SUSTAINABLE GROWTH

A. Creating High Quality Jobs

42. India's economic development largely bypassed a take-off in low-skill, job rich sectors as it shifted from a mainly agrarian to a services-led economy. Existing job opportunities would need to be significantly expanded to absorb India's young and growing workforce and address India's still pressing human development needs. While there are ongoing efforts to improve education and skilling and to create skills jobs, large gaps remain. Indeed, many Indian workers who cannot access high-quality service sector jobs—particularly those with limited education or skills—rely on own-account or unpaid work, primarily in agriculture, construction, and trade. These sectors, which account for over half of the workforce, demonstrate low productivity and value added, and limited catchup to the global productivity frontier. Staff estimate that India will need to create between 145 and 330 million jobs by 2050 to meet its growing population's demand for work (Annex X).[31]

43. Women in particular experience limited access to the labor force and to jobs (Annex XI). Despite improving, gender gaps in the LFPR in India remain high, with female LFPR at 28.6 percent in 2022.[32] The LFPR of women with advanced (tertiary) education is also well below the global average, at 33 percent. Furthermore, 59 percent of employed females are classified as either participating in unpaid activities or self-employed. Supply and demand factors could explain Indian females' low LFPR and high rate of informal work. Supply-side factors include time constraints due to domestic work, lack of relevant skills due to inadequate quality of education, safety concerns, and social norms. From the demand side, limited opportunities (particularly in rural areas), a rise in agriculture mechanization, and gender-biased occupation segregation are among the reasons limiting demand for female workers.

[31] The range stems from different assumptions on labor force participation rates. See Annex IX for details.

[32] Source: PLFS, current weekly status, calendar year basis.

44. An ambitious reform agenda would help create high-quality formal jobs and should be timed carefully. Major streamlining of labor regulations was performed by the central government in 2020, but implementation is still lagging. Furthermore, in many sectors productivity is low and skill sets do not match firms' needs, and thus active labor market policies (ALMP) can increase workers' suitability for hiring and productivity. The authorities' ongoing revamping of the skilling framework and the employee-employer matching tools embedded in the National Career Services Portal hold promise in this regard. The impact of labor market reforms and ALMP, however, depends on the overall business cycle conditions and on complementary reforms to mitigate any adverse effects. For instance, ALMP have large effects during periods of slack, so long as they are explicitly targeting well identified labor market failures. During times of strong growth, as India is currently experiencing, reducing employment protection could have positive effects if it is preceded by the establishment of strong social safety nets and product market reforms, and combined with programs that help workers move across jobs.[33]

45. Policy reforms should also encourage females to shift into paid and productive employment. Reforms in recent years that aim to increase maternity and childcare benefits, ensure gender wage parity, and promotion of work women hostels should help but more effort is needed in several areas. These include, for example, investment in services and infrastructure (e.g., expanding access to childcare, electricity, running water), improving skilling through appropriate education and training, and promoting the development of non-agriculture sectors in rural areas (see Annex XI).

46. There is scope for India to catch up with the global labor productivity frontier and become more integrated in global value chains. India remains behind the global labor productivity frontier in most industries, and the catch-up has been uneven (see Annex X).[34] Agriculture labor productivity was at 2.3 percent of the global technological frontier in 1995 and had risen to only 2.9 percent by 2019. Other sectors, in particular services (business, health, information) have been more dynamic, but remain at less than 20 percent of the global frontier. There is thus room for India to grow by both accelerating the catch-up to the technology frontier across industries, via investment in productivity-enhancing technology and skills training, and by facilitating the flow of workers out of low-value-added jobs (e.g., agriculture and construction) to higher value-added jobs in manufacturing and services, which land and product market reforms in agriculture could help prompt. Such reforms would also help attract FDI and boost export growth, integrating India more deeply into global value chains. Agricultural reforms would also help mitigate food price volatility, increase food security, and support climate change adaptation.

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[33] Duval, Romain and Davide Furceri, 2018 "The effects of labor and product market reforms: The role of macroeconomic conditions and policies." *IMF Economic Review 66(1): 31-69*. *IMF World Economic Outlook,* October 2019, "Reigniting growth in low-income and emerging market economies: What role can structural reforms play?", IMF Staff Discussion Note "Structural Reforms to Accelerate Growth, Ease Policy Trade-Offs, and Support the Green Transition in EMDEs" *Forthcoming*.

[34] Global productivity frontier is defined as the 90th percentile of labor productivity in advanced economies included in the KLEMS databased.

47. High quality provision of health and education would help leverage India's demographics, reduce poverty, and boost long-term growth. Education is critical for supporting labor productivity, innovation, and better quality of employment. India needs to build on its success in boosting education enrollment and achieving gender parity in primary through tertiary school enrollment by improving learning outcomes for all students, which were below their grade level even before the COVID-19 pandemic. Ongoing learning recovery programs should assist in this effort. More generally, policies should ensure that students are receiving quality education that positions them to enter the labor force and find gainful employment, including stemming school dropouts, tracking and measuring learning, and preparing teachers to teach according to students' capabilities. High quality spending on health, another important driver of long-term growth, should also be prioritized given India's still substantial human development needs.

B. Other Growth-Enhancing Reforms

48. Sustained public infrastructure investment and continuous removal of obstacles to private investment would also help boost growth. Ongoing improvements in public physical and digital infrastructure, such as the online National Single Window System for business applications, will help increase private sector productivity. Additionally, efforts to remove bureaucratic inefficiencies (especially at the state level) and further improve the business climate will help spur private sector investment. Market participants are perceiving programs like the Production-Linked Incentive schemes (PLIs) as a signal of the government's intention to work with the private sector to remove barriers to investment.[35] While the program comes at a relatively low cost (totaling 0.72 percent of FY2022/23 GDP over its lifetime), it is projected to create only 2-4 percent of estimated needed jobs.[36] Furthermore, it will be critical to assess the scheme as data become available to ensure it is addressing existing market failures, remains time-bound, and that private sector competition is being fostered. Decriminalizing minor economic offenses could help improve the business climate. Removing disincentives for increasing firm size, as proposed in the Center's labor market codes, would also help boost investment and job creation.

49. Data improvements would help the monitoring of economic and labor market dynamics and policy design. Good progress has been achieved in developing selected sectoral producer price indices, with publication expected in the coming months. Staff also welcomes the authorities' collaboration with the ILO on strengthening the methodology underlying employment statistics. Providing more frequent and timely employment statistics for rural areas would help better understand labor market dynamics. Swift progress on data collection and processing for the ongoing surveys on household expenditure and unincorporated businesses will be critical to improve the quality of national accounts and price statistics. Rebasing GDP would also be an opportunity to improve national accounts statistics and could be complemented by the release of

[35] Production-Linked Incentive (PLI) schemes provide subsidies based on incremental production and investment to participant companies in 14 specific sectors.

[36] The Indian authorities estimate that the PLI schemes could create up to 6 million jobs.

seasonally adjusted quarterly national accounts. Given its importance in the design of all nationally representative surveys, conducting the decennial census, which has been delayed due to the COVID-19 pandemic, remains a priority.

50. Advancing trade liberalization, lifting trade restrictions, and further improving the investment climate would help achieve India's ambitious development objectives.

- The new Foreign Trade Policy (FTP) approved by the authorities in early 2023 sets an ambitious goal of nearly tripling the export of goods and services to US$ 2 trillion by 2030. The FTP introduced various measures for reducing trade transactions costs, including digitization of applications for export-import licenses, promotion of trade settlement in Indian rupees, and provisions for merchanting trade. Building on the successful conclusion of free trade agreements (FTAs) with the United Arab Emirates (UAE) and Australia that became effective in 2022, the authorities are proactively negotiating new trade agreements with other countries including the UK and the EU.

- While pursuing FTAs, however, some export and import restrictions have been tightened since mid-2022. Such restrictions may have wide-ranging cross border spillovers and may contribute to volatility of international food prices, domestic resource misallocation, rent seeking behavior, and potential retaliation by trading partners. Trade restrictions on wheat and rice were introduced by the authorities to ensure food security and contain food price inflation; in this vein, agricultural reforms would provide a more durable solution by raising food productivity and mitigating food price volatility. The authorities introduced an Import Management System for IT equipment such as laptops, tablets, and personal computers to encourage imports from sources viewed as trustworthy and the development of local production of such goods, and to address IT security concerns. However, such requirements—besides carrying administrative cost—will create frictions that would hold back growth in important sectors of India's economy. Developing vibrant and competitive industries would be better supported through implementation of the authorities' structural reform agenda. Staff's advice is to phase out the recently introduced restrictions expeditiously, and work towards reducing India's longstanding high tariff and non-tariff import barriers.[37]

- Further liberalizing the FDI regime and improving the investment climate would help make India more attractive for FDI (Annex XII). Building on the recent amicable resolution of all seven bilateral trade disputes with the U.S., India should continue working actively with other nations to strengthen the WTO by supporting deeper integration and promoting a stable and predictable policy environment, in particular, for services and investment.

[37] See 2022 Article IV Staff Report Appendix VIII.

51. India continues to make good progress on its climate agenda. A recently announced nation-wide Carbon Credit Trading Scheme (CCTS) is welcome.[38] The CCTS will have both a mandatory emissions intensity scheme, with hard to abate sectors notified of their emissions targets, and a voluntary mechanism for other sectors. Implementation of this scheme and various other climate policies (including expanding solar and wind capacity, a gradual increase in subsidies on the use of renewable energy, progress on green hydrogen production, and higher taxes on pollution) and improvements in energy storage are critical in the near term. These will help reduce transition costs, build greater energy security, reduce health effects from pollution, and put India on a realistic pathway towards its 2070 net zero target.[39] Access to financing as well as the global transfer of technology, particularly related to storage, could be a possible way forward for India to meet its climate goals.

52. Continued strengthening of governance, anti-corruption, and the rule of law would reduce corruption risks, support economic progress and financial stability and increase efficiency. More efforts are needed to further enhance transparency, oversight, and accountability in various government processes. The authorities have made important efforts to promote governance, such as the use of digitization. Digital technology has helped reduce leakages, improve efficiency, and tackle corruption vulnerabilities in both government revenue (e.g., faceless tax assessments) and expenditure areas (e.g., the Direct Benefit Transfers). There is scope to strengthen the corporate regulatory framework, and further improve fiscal and financial governance (¶24 and ¶40). Measures to further reduce administrative and regulatory burdens, shorten regulatory approval timelines, and implement single-window clearance more widely would be beneficial; so would continued efforts to strengthen efficiency and integrity of the judiciary system.

53. The authorities recognized that reforms across various sectors are needed to boost growth and employment. They emphasized important ongoing efforts to improve logistics through public capital expenditure, strengthen education and skill development, boost formalization of the economy, and expand social security schemes. The authorities questioned staff's estimate of number of jobs needed, noting that the expansion of remote work and of the gig economy will likely change the nature of work and thus reduce that number. Relatedly on female LFPR, the authorities believe rates are underestimated due to methodological issues that do not capture women doing household work. Despite this, they noted an improvement in female LFPR in recent years and highlighted the various schemes to support women workers, especially in the informal sector.

54. Implementation of the online National Single Window and approval of the Jan Vishwas Act, 2023 to decriminalize minor economic offenses were noted as recent reforms to improve the business climate. The authorities consider PLIs as temporary support programs to

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[38] The Scheme builds on success of the Performance Achieve Trade scheme, which created a market-based mechanism to reduce energy consumption in energy intensive industries.

[39] IMF Country Report No. 2022/386.

help firms achieve economies of scale and compensate for cost disadvantages, while broader structural reforms are implemented over the medium term.

55. On climate, the authorities remain committed to their renewable energy targets, including through the development of green hydrogen, and highlight the critical need for new and diversified storage technologies. They noted that while concerted global efforts are needed to tackle climate change, the carbon budget for EMs should be consistent with both their development needs and their historical contribution to the stock of existing carbon in the atmosphere. The authorities highlighted the commitments and responsibilities of advanced countries under the UNFCCC and Paris Agreement to provide new financial resources and technology transfer to address global climate change. They noted that India would require its due share from both financial and technology support to meet its adaptation and transition needs.

56. The authorities highlighted food and data security as the main reason for recent trade restrictions. They noted that food export restrictions were warranted to address domestic food security concerns raised by uncertain weather patterns and to limit domestic food price increases, and they emphasized the temporary nature of these restrictions. Regarding the Import Management System for laptops, tablets, and personal computers, the authorities noted that this was motivated by encouraging imports from trusted sources, by national information and data security concerns, and by the desire to develop domestic industries. They expect a smooth implementation of this system and do not anticipate a significant disruption in the supply of IT equipment in the short term. They also noted that non-tariff barriers have been raised by many countries, particularly advanced economies, and emphasized the unprecedented dumping of goods by certain countries. In their view, India's tariff structure needs to be seen in the context of trade barriers to global services, removal of which could help realize India's demographic dividend.

STAFF APPRAISAL

57. India's strong economic performance, supported by macroeconomic and financial stability, is expected to continue with balanced risks. India is today one of the fastest growing economies globally, with projected growth at 6.3 percent. Headline inflation is expected to gradually decline towards the target although it has been volatile due to food price shocks. The economy has potential to grow faster and more sustainably if a comprehensive structural reform agenda is implemented. Risks are balanced, with a global growth slowdown and adverse weather shocks most salient on the downside, and more resilient consumption and private investment on the upside.

58. The tightening fiscal stance in FY2023/24 is appropriate, and an ambitious medium-term consolidation plan is needed to rebuild buffers and preserve debt sustainability. A projected improvement in the fiscal deficit, notwithstanding strong push in capital spending in FY2023/24, is welcome. Looking forward, India's elevated public debt calls for additional revenue and expenditure measures, such as further GST and subsidy reforms, while continuing to prioritize public investment and targeted support for the vulnerable. The plans to reform the MTFF present an opportunity to promote transparency and accountability and align policies with India's development goals.

59. Monetary policy should remain data dependent and exchange rate flexibility should act as the main shock absorber. The RBI's monetary policy tightening has been effective in addressing inflation. Given declining inflation and a closed output gap, a broadly neutral monetary stance is appropriate and premature easing of monetary policy should be avoided. A data-dependent approach should continue given high uncertainty surrounding the outlook. The temporary increase in the ICRR was justified given a one-off surge in excess liquidity; market-based liquidity management tools would be preferable during normal circumstances. The external position in FY 2022/23 was moderately stronger than the level implied by medium-term fundamentals and desirable policies. Fiscal consolidation, development of export infrastructure, and negotiation of free trade agreements would facilitate external rebalancing over the medium term. Greater exchange rate flexibility is warranted to help absorb external shocks, with intervention limited to addressing disorderly market conditions. Finally, staff do not recommend the approval of the newly identified and previously existing exchange restrictions at this time.

60. Systemic financial risks have declined, although some emerging vulnerabilities call for careful monitoring, while further reforms would promote continued resilience. The financial sector appears healthy, and its performance is the strongest in several years. Nonetheless, continued vigilant supervision and the use of prudential tools are warranted to preserve stability. Policies to manage the rapid growth in personal loans, continue to strengthen regulatory and supervisory standards, encourage public sector banks to build capital buffers, and further facilitate the exit of nonviable firms should be prioritized. Further reform efforts, including to promote governance of public sector banks, deepen capital markets, and expand MSMEs' access to financing, would support medium-term growth.

61. Advancing comprehensive structural reforms will help leverage India's demographics and boost sustainable and inclusive growth. Promoting high quality job-rich growth should be a priority. This can be done through comprehensive reforms, including measures to improve the labor market and boost female labor force participation, and reforms to health, education, land, and agriculture. Continuing to strengthen governance and the rule of law, and promoting a sound business environment would help foster sustainable growth. Continued progress on designing and implementing climate policies would be instrumental for India to achieve its climate goals. Finally, upgrading statistics and data monitoring would help support timely policy design.

62. India's recent restrictive trade policies should be unwound expeditiously. Agricultural sector reforms would provide a more durable solution to fostering domestic food security. Reducing India's high tariff and non-tariff import barriers, including the recently announced regulation of imports of laptops, tablets, and personal computers, would help boost growth and integration into global value chains. Further liberalizing the FDI regime and improving the investment climate through structural reforms would catalyze foreign and domestic investments and help develop vibrant and competitive industries.

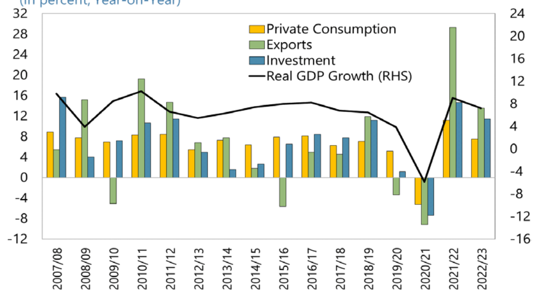
63. It is recommended that the next Article IV consultation take place on the standard 12 months cycle.

Figure 3. Recent Macroeconomic Developments

India recovered strongly from the pandemic…

Demand Components of GDP

(In percent, Year-on-Year)

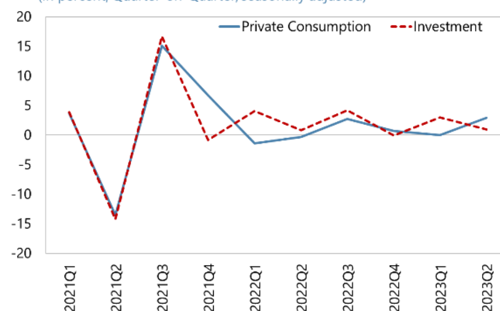


Sources: CEIC; Haver Analytics; and IMF staff calculations.

…partly driven by robust domestic demand.

Private Consumption and Investment Growth

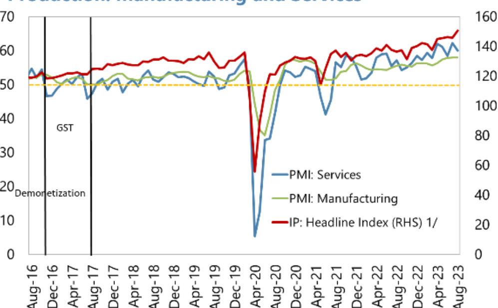
(In percent, Quarter-on-Quarter, seasonally adjusted)



Sources: Haver Analytics; and IMF staff calculations.

Industrial production and PMIs recovered, largely catching up to pre-pandemic levels.

Production: Manufacturing and Services



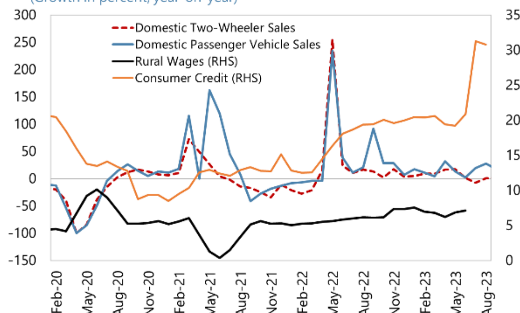
Source: Haver Analytics.

1/ Index, April 2011-March 2012 = 100.

Motor vehicle sales have normalized post-pandemic, as consumer credit surged.

Consumption Indicators

(Growth in percent, year-on-year)

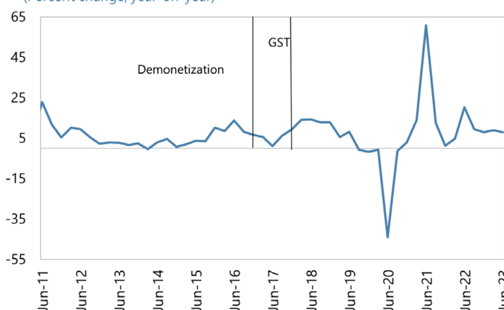


Sources: Haver Analytics; CEIC; and IMF staff calculations.

Investment remains strong, supported by record high capital expenditure.

Real Gross Fixed Capital Formation

(Percent change, year-on-year)

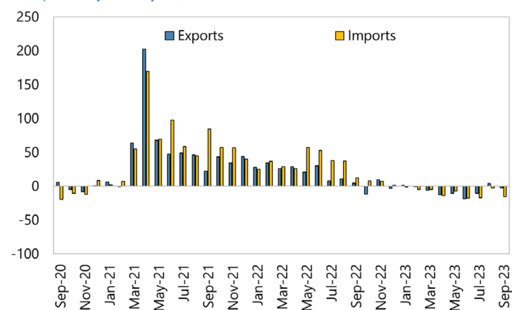


Source: Haver Analytics.

Goods export and import has contracted in recent months.

Merchandise Export and Import Growth

(In percent, year-on-year)

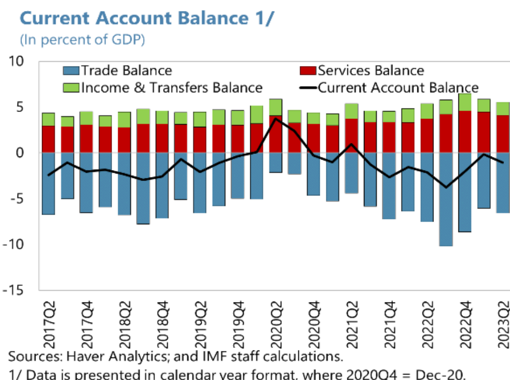


Source: CEIC.

Figure 4. External Sector Developments

The current account balance has improved in recent quarters…

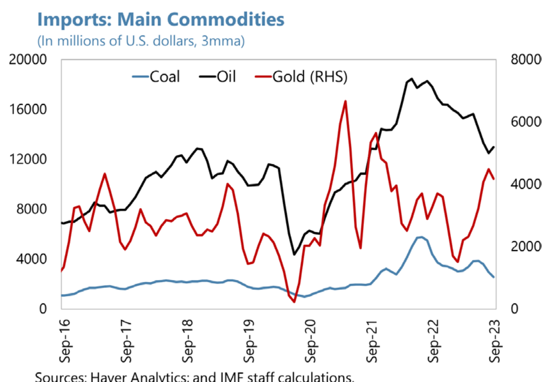
Current Account Balance 1/
(In percent of GDP)



Sources: Haver Analytics; and IMF staff calculations.
1/ Data is presented in calendar year format, where 2020Q4 = Dec-20.

…partly driven by easing global commodity prices.

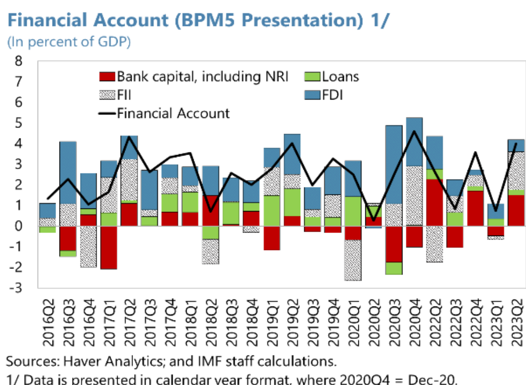
Imports: Main Commodities
(In millions of U.S. dollars, 3mma)



Sources: Haver Analytics; and IMF staff calculations.

The financial account remained in surplus in FY2022/23 and FY2023/24.

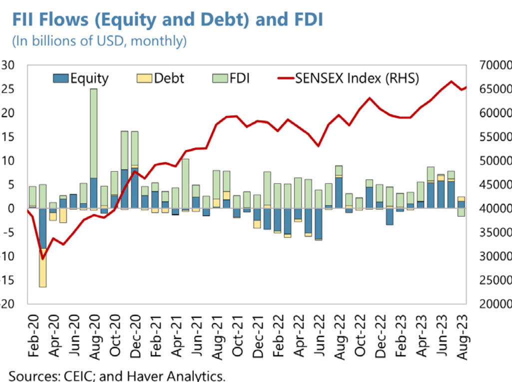
Financial Account (BPM5 Presentation) 1/
(In percent of GDP)



Sources: Haver Analytics; and IMF staff calculations.
1/ Data is presented in calendar year format, where 2020Q4 = Dec-20.

Portfolio investment inflows have resumed.

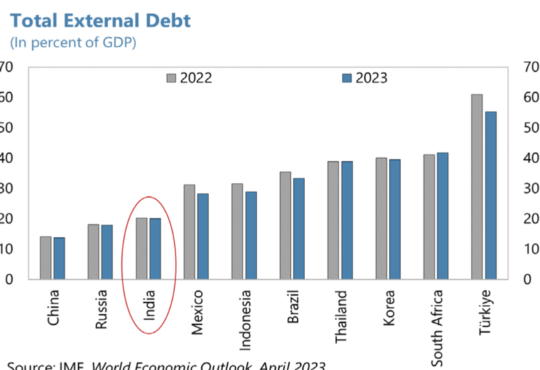
FII Flows (Equity and Debt) and FDI
(In billions of USD, monthly)



Sources: CEIC; and Haver Analytics.

India has low level of external debt compared to peers …

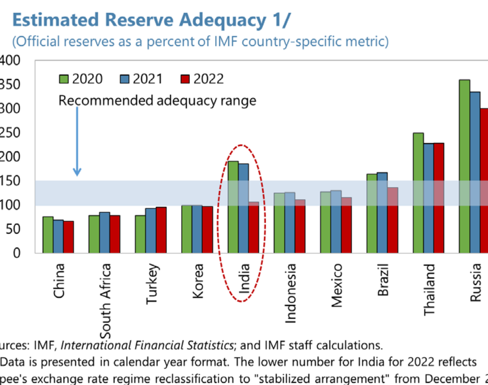
Total External Debt
(In percent of GDP)



Source: IMF, *World Economic Outlook, April 2023*.

…and adequate FX reserves mitigating external vulnerabilities.

Estimated Reserve Adequacy 1/
(Official reserves as a percent of IMF country-specific metric)

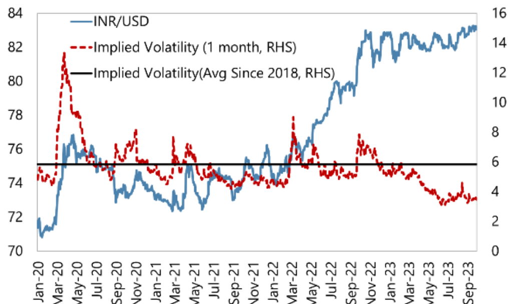


Sources: IMF, *International Financial Statistics*; and IMF staff calculations.
1/ Data is presented in calendar year format. The lower number for India for 2022 reflects Rupee's exchange rate regime reclassification to "stabilized arrangement" from December 2022.

Figure 5. Financial Market Developments

The Indian rupee has traded in a narrow range, as volatility has fallen sharply...

Rupee Exchange Rates and Volatility

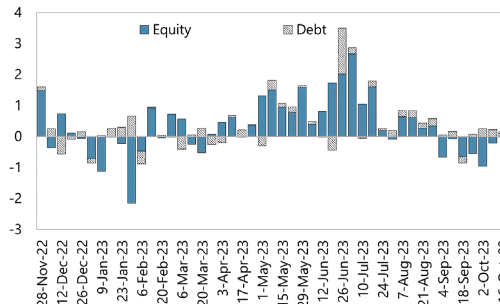


Sources: Bloomberg; and IMF staff calculations.

...while equity inflows have reached [$14 bn] through YTD through September.

Net Portfolio Inflows

(Billions)

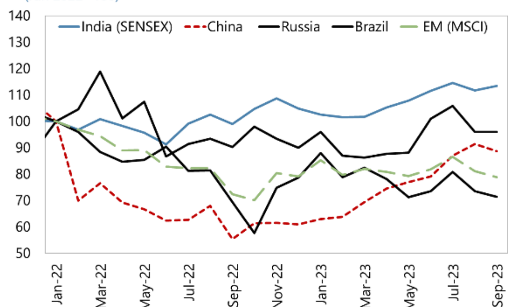


Sources: Haver Analytics; CDSL; and IMF staff calcuations.

Indian equity markets have recently outperformed other emerging markets.

Stock Market Indices

(Jan 2022=100)

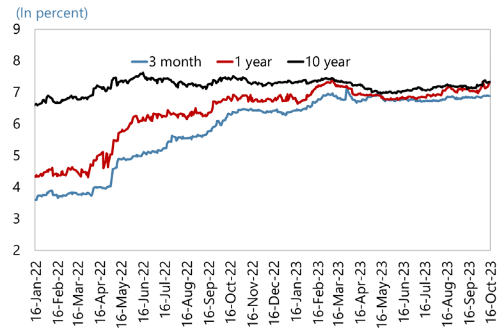


Sources: Thomson Reuters EIKON; and IMF staff calculations.

Bond yields have broadly declined since March 2023, trading in a relatively narrow range.

Government Bond Yields

(In percent)

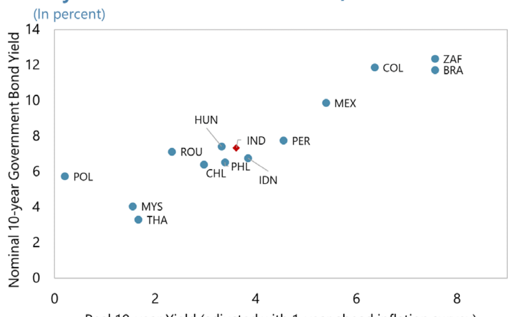


Sources: Thomson Reuters EIKON; and IMF staff calculations.

Real and nominal bond yields are comparable to other emerging markets.

10-year Government Bond Yields 1/

(In percent)



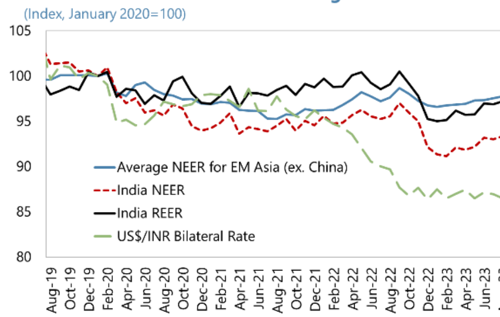
Sources: Bloomberg; and IMF staff calculations.

1/ Data as of October 14, 2023.

The REER and NEER have appreciated in 2023, although remain somewhat below their pre-pandemic levels.

Nominal and Real Effective Exchange Rates

(Index, January 2020=100)

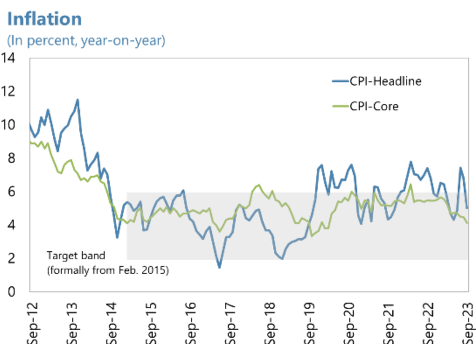


Sources: IMF, *Information Notice System*; Haver Analytics; and IMF staff calculations.

Figure 6. Monetary Sector Developments

Inflation declined in September 2023, as a temporary uptick in vegetable prices eased.

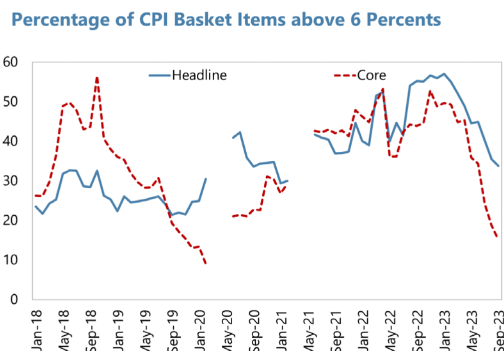
Inflation
(In percent, year-on-year)



Sources: Haver Analytics; and IMF staff calculations.

A broad-based decline in inflation persists.

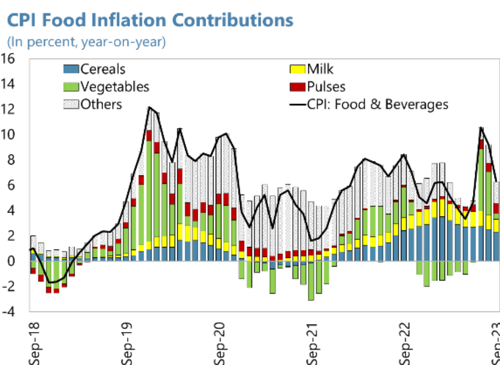
Percentage of CPI Basket Items above 6 Percents



Sources: Haver Analytics; and IMF staff calculations.

Food prices remain very volatile, but vegetable price shocks tend to be short-lived.

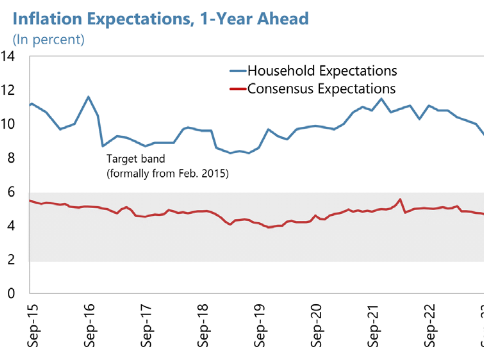
CPI Food Inflation Contributions
(In percent, year-on-year)



Sources: Haver Analytics; and IMF staff calculations.

Household Inflation expectations have declined in recent months, while consensus expectations remained well-anchored.

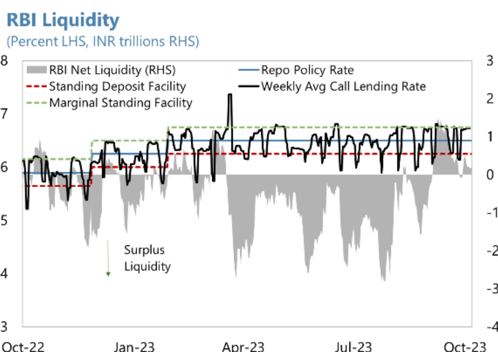
Inflation Expectations, 1-Year Ahead
(In percent)



Sources: Haver Analytics; and Consensus Economics.

The central bank has focused on managing bank liquidity, including temporary ICRR enforcement during September-October to mop up one-off surge in excess liquidity…

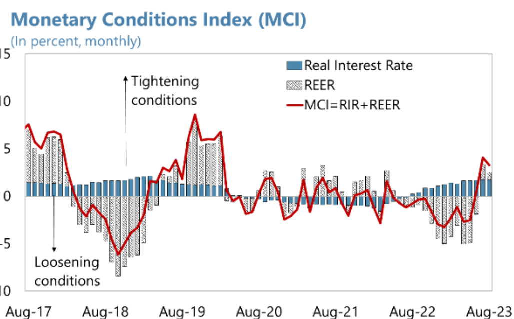
RBI Liquidity
(Percent LHS, INR trillions RHS)



Sources: Bloomberg; and IMF staff calculations.

…resulting in tightening financial conditions

Monetary Conditions Index (MCI)
(In percent, monthly)



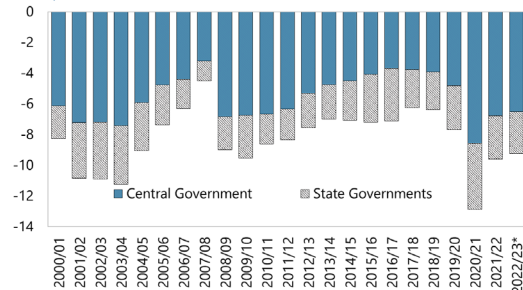
Sources: Haver Analytics; CEIC CDMNext; Consensus Economics; and IMF staff calculations.
Note: Real Interest Rate (RIR) is calculated as a difference between nominal repo rate (end-of-period) and 1-year ahead inflation expectations.

Figure 7. Fiscal Sector Developments

The deficit narrowed slightly in FY2022/23…

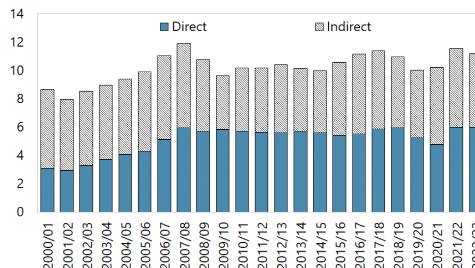
…due to buoyant revenues driven in part by improvements in tax compliance …

Government Balance
(In percent of GDP) 1/



1/ Includes subsidy-related bond issuance.
Sources: Haver Analytics; and IMF staff data.
*IMF staff estimates.

Central Government Revenue
(In percent of GDP)

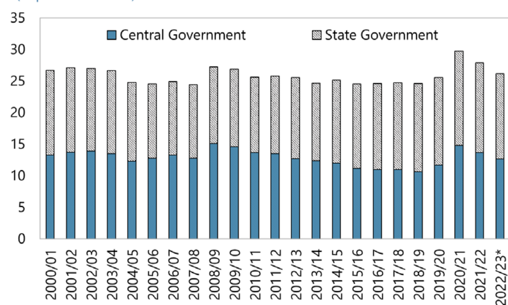


Source: IMF staff data.

… and continued reduction in expenditure from pandemic peaks.

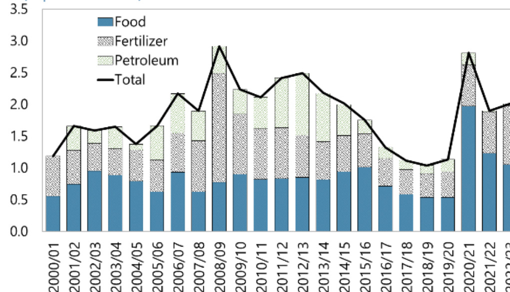
Subsidies remain elevated as measures to address cost of living pressures were introduced…

Government Recurrent Expenditure
(In percent of GDP)



Sources: Ministry of Finance; and IMF staff calculations.
*IMF staff estimates.

Government Subsidies
(In percent of GDP)

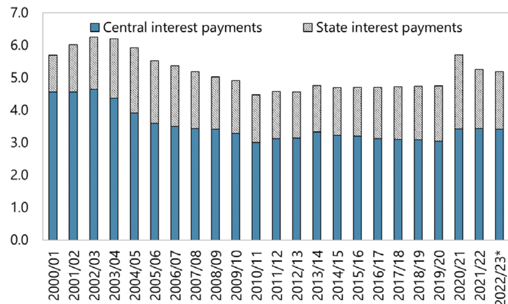


Source: IMF staff data.

…while the jump in interest expenses persists.

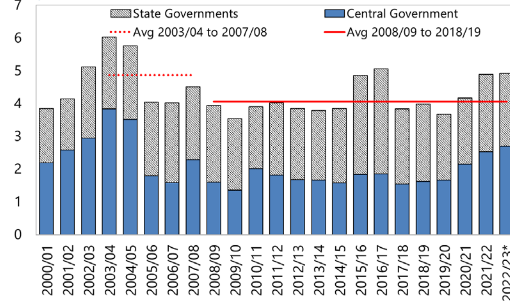
Capital spending continues to exceed its pre-pandemic average.

Interest Payments
(Percent of GDP)



Sources: Ministry of Finance; and IMF staff calculations.
*IMF staff estimates.

Capital Spending
(In percent of GDP)

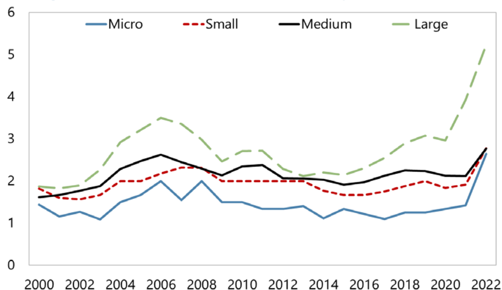


Sources: Haver Analytics; and IMF staff data.
*IMF staff estimates.

Figure 8. Corporate and Banking Sectors

Corporate balance sheets and liquidity have improved....

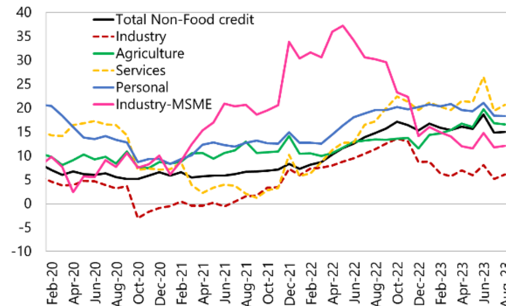
Interest Coverage Ratio
(Earnings before Interest and Taxes (EBIT) to Interest Expenses, median)



Sources: CMIE Prowess; and IMF staff calculations.

...while bank credit growth has averaged near 15% y/y, led by services and personal loans.

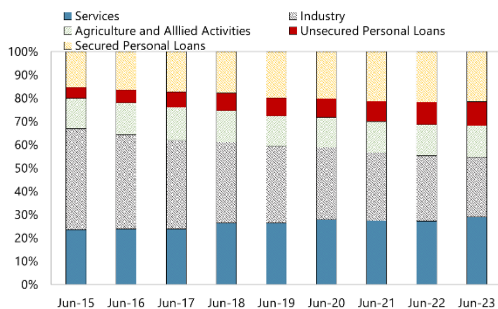
Credit Growth by Sector
(Percent change yoy)



Sources: Reserve Bank of India; and IMF staff calculations.

Personal lending share has expanded, particularly for unsecured loans.

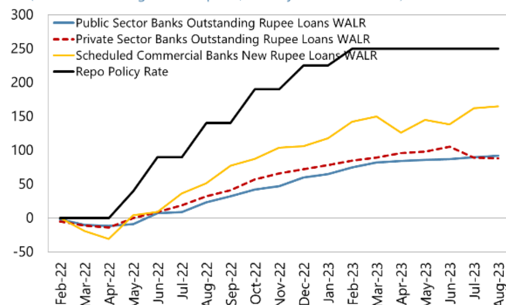
Bank Credit Decomposition



Sources: CEIC; and IMF staff calculations.

Lending rates have slowly moved higher, but still lag the recent tightening cycle.

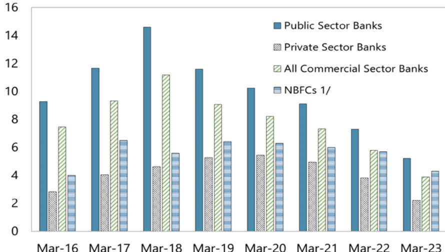
Bank Lending Rates
(Cumulative change in basis point, January 2022 as baseline)



Sources: Haver Analytics; Bloomberg; and IMF staff calucations.

NPAs have continued to decline to multiyear lows...

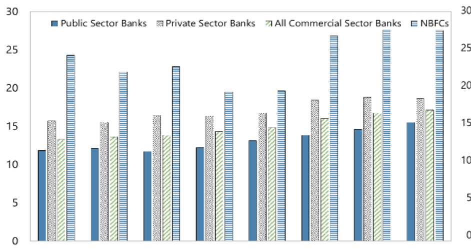
Non-Performing Assets of Financial Institutions
(In percent of total assets)



Source: Reserve Bank of India.
1/ excluding core investment companies

...capital buffers remain high, despite lingering disparity between public and private sector banks.

Capital Adequacy Ratio of Financial Institutions
(Percent of Risk-Weighted Assets)

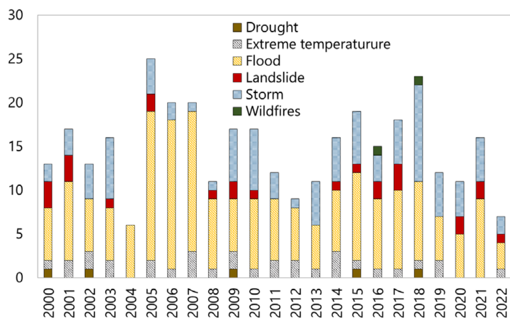


Sources: Reserve Bank of India; and IMF staff calculations.

Figure 9. Climate Developments

India is significantly impacted by climate change....

Climate-related Disaster Frequency

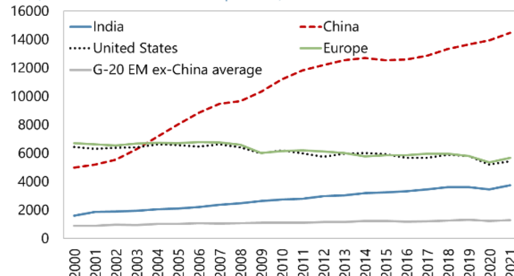


Sources: IMF, *Climate Change Indicators Dashboard*; CRED / UCLouvain, *EM-DAT*.

...and is an increasingly important contributor to global GHGs...

Total Greenhouse Gas Emissions 1/

(Million metric tons of CO2 equivalent)



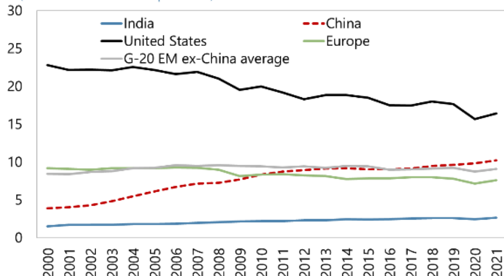
Sources: IMF, *Climate Change Indicators Dashboard*; UNFCCC; EDGARv7.0; EU; FAO; and IMF staff calculations.

1/ Including land-use, land-use change and forestry.

...but remains one of the lowest emitters on a per-capita basis.

Total Greenhouse Gas Emissions Per Capita 1/

(Metric tons of CO2 equivalent)



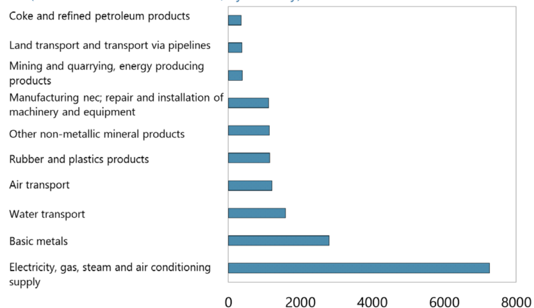
Sources: IMF, *Climate Change Indicators Dashboard*; UN; IMF, *World Economic Outlook, July 2023*; and IMF staff calculations.

1/ Including land-use, land-use change and forestry.

India's energy sector, largely coal-powered, has disproportionately high emissions intensity.

CO2 Emissions Intensity

(Millions of Metric tons of CO2, by industry)

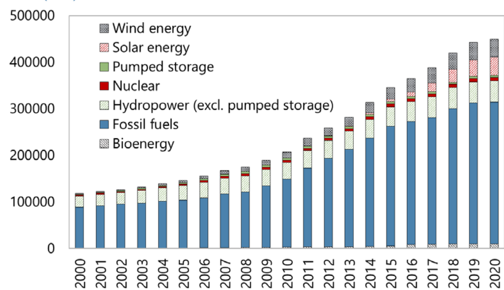


Sources: IMF, *Climate Change Indicators Dashboard*; OECD.

While modern renewables are the fastest growing energy source, fossil fuels still dominate installed capacity.

Electricity Installed Capacity

(MW)

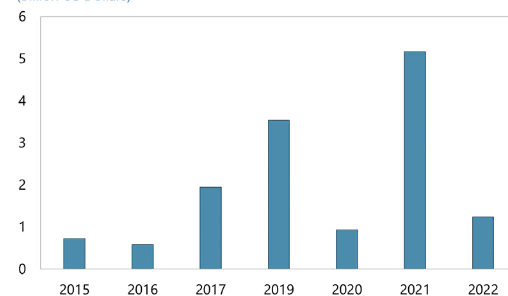


Sources: IMF, *Climate Change Indicators Dashboard*; International Renewable Energy Agency (IRENA), *Renewable Energy Statistics 2022.*

Green bond issuance is gradually gaining pace, which should help in financing the energy transition.

Green Bond Issuance

(Billion US Dollars)



Sources: IMF, *Climate Change Indicators Dashboard*; Refinitiv; Country authorities; and IMF staff calcuations.

Table 1. India: Selected Social and Economic Indicators, 2019/20-2024/25 1/

I. Social Indicators

GDP (2022/23)		**Poverty (percent of population)**	
Nominal GDP (in billions of U.S. dollars):	3,390	Poverty rate $2.15 a day (2019):	10.0
GDP per capita (U.S. dollars) (IMF staff est.):	2,408	Undernourished (2020)	16.3
Population characteristics (2021/22)		**Income distribution (2019, WDI)**	
Total (in billions):	1.41	Richest 10 percent of households:	30.6
Urban population (percent of total):	35.4	Poorest 20 percent of households:	8.1
Life expectancy at birth (years, 2020/21):	70.2	Gini index (2019):	35.7

II. Economic Indicators

	2019/20	2020/21	2021/22	2022/23	2023/24	2024/25
				Est.	Projections	
Growth (in percent)						
Real GDP (at market prices)	3.9	-5.8	9.1	7.2	6.3	6.3
Prices (percent change, period average)						
Consumer prices - Combined	4.8	6.2	5.5	6.7	5.4	4.6
Saving and investment (percent of GDP)						
Gross saving 2/	29.2	29.7	30.0	29.1	29.9	30.0
Gross investment 2/	30.1	28.8	31.2	31.0	31.7	31.9
Fiscal position (percent of GDP) 3/						
Central government overall balance	-4.8	-8.6	-6.8	-6.5	-6.0	-5.8
General government overall balance	-7.7	-12.9	-9.6	-9.2	-8.8	-8.5
General government debt 4/	75.0	88.5	83.8	81.0	82.0	82.4
Cyclically adjusted balance (% of potential GDP)	-7.6	-9.1	-8.7	-9.3	-8.8	-8.5
Cyclically adjusted primary balance (% of potential GDP)	-2.9	-3.8	-3.6	-4.1	-3.4	-2.8
Money and credit (y/y percent change, end-period)						
Broad money	8.9	12.2	8.8	9.0	10.8	7.8
Domestic Credit	8.3	9.5	9.0	13.1	12.9	9.8
Financial indicators (percent, end-period)						
91-day treasury bill yield (end-period)	4.2	3.3	3.8	6.9	...	...
10-year government bond yield (end-period)	6.1	6.2	6.8	7.3	...	...
Stock market (y/y percent change, end-period)	-23.8	68.0	18.3	0.7	...	...
External trade (on balance of payments basis)						
Merchandise exports (in billions of U.S. dollars)	320.4	296.3	429.2	456.1	436.1	460.6
(Annual percent change)	-5.0	-7.5	44.8	6.3	-4.4	5.6
Merchandise imports (in billions of U.S. dollars)	477.9	398.5	618.6	721.4	701.1	751.7
(Annual percent change)	-7.6	-16.6	55.3	16.6	-2.8	7.2
Terms of trade (G&S, annual percent change)	2.1	2.0	-8.1	-2.8	3.1	0.3
Balance of payments (in billions of U.S. dollars)						
Current account balance	-24.6	24.0	-38.7	-67.0	-65.5	-73.0
(In percent of GDP)	-0.9	0.9	-1.2	-2.0	-1.8	-1.8
Foreign direct investment, net ("-" signifies inflow)	-43.0	-44.0	-38.6	-28.0	-32.8	-44.4
Portfolio investment, net (equity and debt, "-" = inflow)	-1.4	-36.1	16.8	5.2	-30.6	-33.9
Overall balance ("+" signifies balance of payments surplus)	59.5	87.3	47.5	-9.1	40.8	54.7
External indicators						
Gross reserves (in billions of U.S. dollars, end-period)	477.8	577.0	607.3	578.4	619.2	673.9
(In months of next year's imports (goods and services))	11.1	9.0	8.1	7.8	7.7	7.9
External debt (in billions of U.S. dollars, end-period)	558.4	573.4	619.1	624.3	681.1	748.3
External debt (percent of GDP, end-period)	19.7	21.5	19.7	18.4	18.7	18.5
Of which: Short-term debt	8.3	9.5	8.5	8.1	8.1	8.1
Ratio of gross reserves to short-term debt (end-period)	2.0	2.3	2.3	2.1	2.1	2.1
Real effective exchange rate (annual avg. percent change)	3.1	-0.8	0.3	-0.4	...	...
Memorandum item (in percent of GDP)						
Fiscal balance under authorities' definition	-4.6	-9.2	-6.8	-6.4	-5.9	-5.6

Sources: Data provided by the Indian authorities; Haver Analytics; CEIC Data Company Ltd; Bloomberg L.P.; World Bank, *World Development Indicators*; and IMF staff estimates and projections.

1/ Data are for April–March fiscal years.

2/ Differs from official data, calculated with gross investment and current account. Gross investment includes errors and omissions.

3/ Divestment and license auction proceeds treated as below-the-line financing.

4/ Includes combined domestic liabilities of the center and the states, and external debt at year-end exchange rates.

Table 2. India: Balance of Payments, 2019/20-2024/25 1/

	2019/20	2020/21	2021/22	2022/23	2023/24	2024/25
				Est.	Projections	
	(In billions of U.S. dollars)					
Current account balance	-24.6	24.0	-38.7	-67.0	-65.5	-73.0
Merchandise trade balance	-157.5	-102.2	-189.5	-265.3	-265.0	-291.1
Merchandise exports	320.4	296.3	429.2	456.1	436.1	460.6
Merchandise imports	477.9	398.5	618.6	721.4	701.1	751.7
Oil	130.6	82.7	161.8	209.4	188.4	194.8
Non-oil	347.4	315.8	456.8	512.0	512.6	557.0
Services balance	84.9	88.6	107.5	143.3	142.6	151.2
Credit	213.2	206.1	254.5	325.3	336.5	361.6
Of which : Software Services	93.1	100.0	122.1	146.8	...	...
Debit	128.3	117.5	147.0	182.0	193.9	210.4
Primary income balance, net	-27.3	-36.0	-37.3	-45.9	-53.1	-53.1
Secondary income balance, net	75.3	73.6	80.5	100.9	110.0	119.9
Capital and Financial account balance	-24.7	22.6	-38.4	-68.1	-65.6	-73.0
Direct investment, net	-43.0	-44.0	-38.6	-28.0	-32.8	-44.4
Of which : Net incurrence of liabilities	56.0	54.9	56.2	42.0	42.0	64.6
Portfolio investment, net	-1.4	-36.1	16.8	5.2	-30.6	-33.9
Financial derivatives, net	-4.1	4.8	6.4	5.4	5.6	5.9
Other Investment, net	-35.6	10.6	-70.5	-41.5	-48.5	-55.3
Reserve Assets, net	59.5	87.3	47.5	-9.1	40.8	54.7
Errors and omissions	1.0	-0.3	0.5	-1.0	0.0	0.0
Overall balance 2/	-59.5	-87.3	-47.5	9.1	-40.8	-54.7
Valuation changes 3/	5.4	11.9	-17.2	-19.7	0.0	0.0
Increase in gross reserve stock (including valuation changes)	64.9	99.2	30.3	-28.9	40.8	54.7
Memorandum items:						
Foreign exchange reserves	477.8	577.0	607.3	578.4	619.2	673.9
In months of next year's imports (goods and services)	11.1	9.0	8.1	7.8	7.7	7.9
Current account balance (percent of GDP)	-0.9	0.9	-1.2	-2.0	-1.8	-1.8
Merchandise trade balance (percent of GDP)	-5.6	-3.8	-6.0	-7.8	-7.3	-7.2
Direct investment in India (percent of GDP)	2.0	2.1	1.8	1.2	1.2	1.6
Overall balance (percent of GDP)	-2.1	-3.3	-1.5	0.3	-1.1	-1.4
Gold imports (billions of U.S. dollars)	31.2	22.0	55.8	18.7	...	...
Gross domestic product (billions of U.S. dollars)	2,836	2,672	3,150	3,390	3,649	4,037

Sources: CEIC Data Company Ltd; Haver Analytics; and IMF staff estimates and projections.

1/ Data are for April-March fiscal years, based on BPM6, including sign conventions.

2/ Negative sign "-" signifies balance of payments surplus.

3/ Calculated as difference between the change in the stock of reserves and the overall balance of BOP.

Table 3. India: Reserve Money and Monetary Survey, 2019/20-August 2023/24 1/

	2019/20	2020/21	2021/22	2022/23	2023/24 August
Reserve money	(In billions of rupees, end-period)				
Reserve money	30,297	36,000	40,689	43,868	44,556
Net domestic assets of RBI	-5,607	-5,994	-3,736	-2,006	-2,956
Claims on government (net)	9,922	10,997	14,506	14,511	11,852
Center	9,897	10,963	14,490	14,504	11,688
States	25	33	16	8	164
Claims on commercial sector	132	87	166	265	52
Claims on banks	-2,141	-3,781	-5,603	-1,210	-71
Other items (net)	-13,520	-13,297	-12,805	-15,573	-14,790
Net foreign assets of RBI	35,904	41,994	44,425	45,874	47,512
	(Contribution to twelve-month reserve money growth)				
Reserve money	9.4	18.8	13.0	7.8	9.8
Net domestic assets of RBI	-17.4	-1.3	6.3	4.3	-0.8
Claims on government (net)	6.9	3.5	9.7	0.0	2.0
Net foreign assets of RBI	26.8	20.1	6.8	3.6	10.5
Monetary survey	(In billions of rupees, end-period)				
Broad money (M3)	168,000	188,446	204,937	223,438	233,208
Currency with public	23,497	27,518	30,357	32,764	32,053
Deposits	144,117	160,454	173,996	189,896	200,436
Non-bank deposits at RBI	385	474	584	778	719
Net domestic assets	129,989	142,657	156,397	174,320	182,452
Domestic credit	159,990	175,188	190,941	215,952	223,270
Net credit to government	49,604	58,504	64,776	71,655	72,745
Of which: RBI	9,922	10,997	14,506	14,511	11,852
Credit to commercial sector	110,386	116,685	126,165	144,296	150,525
Of which: Bank credit (excluding RBI)	110,255	116,598	126,000	144,031	150,473
Other items (net)	-30,001	-32,531	-34,545	-41,632	-40,818
Net foreign assets	38,010	45,788	48,541	49,118	50,756
	(Twelve-month percent change)				
Broad money (M3)	8.9	12.2	8.8	9.0	10.8
Net domestic assets	5.2	9.7	9.6	11.5	10.8
Domestic credit	8.3	9.5	9.0	13.1	13.5
Net credit to government	13.0	17.9	10.7	10.6	12.4
Credit to commercial sector	6.3	5.7	8.1	14.4	14.0
Of which: Bank credit (excluding RBI)	6.3	5.8	8.1	14.3	14.2
Net foreign assets	23.8	20.5	6.0	1.2	10.8

Sources: CEIC Data Company Ltd.; Reserve Bank of India WSS; IMF IFS, and Fund staff calculations.
1/ Data are for April–March fiscal years, unless indicated otherwise.

Table 4. India: Central Government Operations, 2019/20-2024/25 1/

	2019/20	2020/21	2021/22	2022/23	2023/24	2024/25
				Est.	Projections	
			(In percent of GDP)			
Revenue	**8.6**	**8.4**	**9.4**	**8.9**	**8.9**	**8.9**
Taxes 2/	6.8	7.2	7.7	7.7	7.6	7.7
Income tax	5.2	4.8	6.0	6.0	6.1	6.1
GST	3.0	2.8	3.0	3.1	3.2	3.3
Excise tax	1.2	2.0	1.7	1.2	1.0	1.0
Customs duties	0.5	0.7	0.9	0.8	0.7	0.7
Other taxes	0.0	0.0	0.0	0.1	0.0	0.0
Less: States' share	3.2	3.0	3.8	3.5	3.4	3.5
Grants	0.0	0.0	0.0	0.0	0.0	0.0
Other revenue 3/	1.8	1.2	1.7	1.2	1.3	1.2
Property income	1.0	0.6	0.8	0.5	0.5	0.4
Sale of goods and services	0.2	0.2	0.2	0.2	0.1	0.1
Miscellaneous and unidentified revenue	0.6	0.5	0.8	0.6	0.6	0.6
Expenditure	**13.4**	**17.0**	**16.2**	**15.4**	**14.9**	**14.7**
Expense 4/	**11.7**	**14.8**	**13.7**	**12.7**	**11.6**	**11.6**
Compensation of employees 5/	1.1	1.1	1.1	1.0	1.0	1.0
Interest	3.0	3.4	3.4	3.4	3.6	3.8
Subsidies 6/	1.1	2.8	1.9	2.0	1.3	1.1
Food 7/	0.5	2.0	1.2	1.1	0.7	0.6
Fertilizer	0.4	0.6	0.7	0.9	0.6	0.5
Petroleum	0.2	0.2	0.0	0.0	0.0	0.0
Grants and other expense	6.4	7.4	7.3	6.2	5.8	5.7
Grants	2.3	2.9	3.3	2.4	2.3	2.3
Other expense 8/	4.1	4.5	4.0	3.8	3.5	3.5
Net acquisition of nonfinancial assets	**1.7**	**2.1**	**2.5**	**2.7**	**3.3**	**3.1**
Net acquisition of nonfinancial assets	1.7	2.1	2.5	2.7	3.3	3.1
Gross Operating Balance	-3.1	-6.4	-4.2	-3.8	-2.7	-2.7
Net lending / borrowing (overall balance)	**-4.8**	**-8.6**	**-6.8**	**-6.5**	**-6.0**	**-5.8**
Memorandum items:						
Balance under authorities' definition 9/	-4.6	-9.2	-6.8	-6.4	-5.9	-5.6
Central government debt 10/	52.2	62.2	59.5	57.3	57.7	57.8

Sources: Data provided by the Indian authorities; and Fund staff estimates and projections.

1/ Data for April - March fiscal years

2/ Net tax revenue, defined as gross tax revenue collected by the central government minus state governments' share.

3/ Auctions for wireless spectrum are classified as non-tax revenues.

4/ Includes the surcharge on Union duties transferred to the National Calamity Contingency Fund.

5/ Pensions are included under expense not otherwise classified.

6/ Includes subsidy-related bond issuance.

7/ Starting in FY2020/21, includes food subsidies covered by the Food Corporation of India. For FY2020/21, excludes retroactive payment to Food Corporation of India for previous years' food subsidy bill.

8/ Other expense includes purchases of goods and services.

9/ Includes asset sales in receipts, and excludes certain non-tax revenue items. Includes the retroactive payment to Food corporation of India for previous years' foof subsidy bill.

10/ Central government debt includes SDR, and for FY2021/22 reflects the additional SDR allocation of about 0.6 percent of GDP.

Table 5. India: General Government Operations, 2019/20-2024/25 1/

	2019/20	2020/21	2021/22	2022/23	2023/24	2024/25
				Est.	Projections	
			(In percent of GDP)			
Revenue	**19.2**	**18.2**	**19.9**	**19.4**	**19.4**	**19.4**
Taxes	16.1	16.1	17.3	17.1	17.0	17.1
Grants	0.0	0.0	0.0	0.0	0.0	0.0
Other revenue	3.0	2.0	2.6	2.2	2.3	2.3
Expenditure	**26.8**	**31.1**	**29.5**	**28.6**	**28.1**	**27.9**
Expense	23.2	26.9	24.6	23.7	22.6	22.6
of which: interest	4.8	5.7	5.3	5.2	5.4	5.7
Net acquisition of nonfinancial assets	3.7	4.2	4.9	4.9	5.5	5.3
Gross Operating Balance	-4.0	-8.7	-4.7	-4.3	-3.3	-3.1
Net lending (+)/borrowing (–) (fiscal balance)	**-7.7**	**-12.9**	**-9.6**	**-9.2**	**-8.8**	**-8.5**
Net financial worth, transactions	-7.7	-12.9	-9.6	-9.2	-8.8	-8.5
Net acquisition of financial assets	-1.8	-1.8	-2.4	-1.4	-1.1	-1.0
Domestic	-1.8	-1.8	-2.4	-1.4	-1.1	-1.0
Currency and deposits	-1.4	-2.7	-2.4	-1.7	-1.6	-1.5
Loans	-0.1	1.1	0.0	0.5	0.8	0.7
Equity and investment fund shares	-0.3	-0.2	-0.1	-0.2	-0.2	-0.2
Net incurrence of liabilities	5.9	11.0	7.2	7.8	7.7	7.5
Domestic	5.9	10.7	7.0	7.8	7.6	7.4
Debt securities	5.6	9.6	4.5	6.1	5.7	5.6
Other accounts payable	0.3	1.1	2.5	1.6	1.9	1.8
Foreign	0.0	0.4	0.2	0.1	0.1	0.1
Loans	0.0	0.4	0.2	0.1	0.1	0.1
Memorandum items:						
Primary balance	-2.9	-7.2	-4.3	-4.0	-3.4	-2.8
Nondefence capital expenditure	3.1	3.5	4.3	4.3	4.9	4.8
State and union territory governments' balance 2/	-2.9	-4.2	-2.8	-2.8	-2.8	-2.7
General government debt 3/	75.0	88.5	83.8	81.0	82.0	82.4
Nominal GDP in billions of Rupees	201,036	198,299	234,710	272,407	300,983	332,980

Sources: Data provided by the Indian authorities; state level data from the RBI Study on State Finances; and Fund staff estimates and projections.

1/ The consolidated general government comprises the central government (CG) and state governments. It does not include lower tiers of government (districts, municipalities), contrary to GFSM 2014 standards. Data for April-March fiscal years.

2/ The authorities treat states' divestment proceeds, including land sales, above-the-line as miscellaneous capital receipts. IMF Staff definition treats divestment receipts as a below-the-line financing item.

3/ Includes combined domestic liabilities of CG and states governments, inclusive of MSS bonds, and sovereign external debt at year-end exchange rates. For FY2021/22 reflects the additional SDR allocation of about 0.6 percent of GDP.

Table 6. India: Macroeconomic Framework, 2019/20-2028/29 1/

	2019/20	2020/21	2021/22	2022/23	2023/24	2024/25	2025/26	2026/27	2027/28	2028/29
				Est.			Projections			
Growth (percent change)										
Real GDP (at market prices)	3.9	-5.8	9.1	7.2	6.3	6.3	6.3	6.3	6.3	6.3
Potential GDP	5.9	0.7	3.8	5.0	6.3	6.3	6.3	6.3	6.3	6.3
Output gap (in percent of potential GDP)	-0.3	-6.8	-2.0	0.1	0.0	0.0	0.0	0.0	0.0	0.0
Prices (percent change, period average)										
Consumer prices	4.8	6.2	5.5	6.7	5.4	4.6	4.1	4.1	4.0	4.0
Saving and investment (percent of GDP)										
Gross saving 2/	29.2	29.7	30.0	29.1	29.9	30.0	30.1	29.9	29.8	29.7
Gross investment 3/	30.1	28.8	31.2	31.0	31.7	31.9	31.9	31.9	31.9	31.9
Money and credit (y/y percent change, end-period)										
Broad money	8.9	12.2	8.8	9.0	10.8	7.8	8.2	9.0	8.7	9.7
Bank credit to the private sector	6.3	5.7	8.1	14.4	14.0	10.0	10.2	10.2	10.0	10.1
Fiscal position (percent of GDP)										
Central government balance 4/	-4.8	-8.6	-6.8	-6.5	-6.0	-5.8	-5.2	-4.9	-4.6	-4.4
General government balance 4/	-7.7	-12.9	-9.6	-9.2	-8.8	-8.5	-7.9	-7.5	-7.3	-7.1
General government debt 5/	75.0	88.5	83.8	81.0	82.0	82.4	82.2	81.6	80.9	80.1
External trade (percent change, balance of payments basis)										
Merchandise exports (in U.S. dollars terms)	-5.0	-7.5	44.8	6.3	-4.4	5.6	4.5	4.7	4.2	4.6
Merchandise imports (in U.S. dollars terms)	-7.6	-16.6	55.3	16.6	-2.8	7.2	5.9	6.3	6.8	6.8
Balance of payments (in billions of U.S. dollars, BMP6 (including sign conventions))										
Current account balance	-24.6	24.0	-38.7	-67.0	-65.5	-73.0	-83.0	-97.9	-116.9	-135.1
(in percent of GDP)	-0.9	0.9	-1.2	-2.0	-1.8	-1.8	-1.9	-2.0	-2.2	-2.3
Foreign direct investment, net ("-" sign is net FDI inflow)	-43.0	-44.0	-38.6	-28.0	-32.8	-44.4	-53.5	-63.9	-75.8	-89.4
Portfolio investment, net ("-" sign denotes capital inflow)	-1.4	-36.1	16.8	5.2	-30.6	-33.9	-21.4	-23.6	-26.0	-28.6
Overall balance ("+" sign denotes surplus)	59.5	87.3	47.5	-9.1	40.8	54.7	48.7	55.0	60.0	69.2
External indicators										
Gross reserves (in billions of U.S. dollars, end-period)	477.8	577.0	607.3	578.4	619.2	673.9	722.6	777.6	837.6	906.8
(in months of imports) 6/	11.1	9.0	8.1	7.8	7.7	7.9	7.9	8.0	8.0	8.1
External debt (in billions of U.S. dollars, end-period)	558.4	573.4	619.1	624.3	681.1	748.3	823.4	907.1	1,000.3	1,103.9
External debt (percent of GDP, end-period)	19.7	21.5	19.7	18.4	18.7	18.5	18.5	18.4	18.5	18.5
Of which : short-term debt 7/	8.3	9.5	8.5	8.1	8.1	8.1	8.0	8.0	8.0	8.0
Ratio of gross reserves to short-term debt (end-period) 7/	2.0	2.3	2.3	2.1	2.1	2.1	2.0	2.0	1.9	1.9
GDP in billions of U.S. dollars	2,836	2,672	3,150	3,390	3,649	4,037	4,459	4,917	5,415	5,959

Sources: Data provided by the Indian authorities; CEIC Data Company Ltd; and IMF staff estimates and projections.

1/ Data are for April-March fiscal years unless otherwise mentioned.

2/ Differs from official data, calculated with gross investment and current account.

3/ Statistical discrepancy adjusted.

4/ Divestment and license auction proceeds are treated as financing; includes subsidy related bond issuance.

5/ Includes combined domestic liabilities of the center and the states, inclusive of MSS bonds, and sovereign external debt at year-end exchange rates.

6/ Imports of goods and services projected over the following twelve months.

7/ Short-term debt on residual maturity basis.

Table 7. India: Financial Soundness Indicators, 2018/19-2022/23

	2018/19	2019/20	2020/21	2021/22	2022/23
	(In percent, unless indicated otherwise)				
I. Scheduled commercial banks					
Risk-weighted capital adequacy ratio (CAR)	**14.3**	**14.8**	**16.3**	**16.8**	**17.2**
Public sector banks	12.2	12.9	14.0	14.6	15.5
Private sector banks	16.1	16.5	18.4	18.8	18.6
Foreign banks	19.4	17.7	19.5	19.8	19.8
Number of institutions not meeting 9 percent CAR	**2**	**2**	**1**	**0**	...
Public sector banks	1	1	0	0	...
Private sector banks	1	1	1	0	...
Foreign banks	0	0	0	0	...
Net nonperforming assets (percent of outstanding net advances) 1/	**3.7**	**2.8**	**2.4**	**1.7**	**1**
Public sector banks	4.8	3.8	3.1	2.2	1.2
Private sector banks	2.0	1.5	1.4	1.0	0.6
Foreign banks	0.5	0.5	0.6	0.7	0.3
Gross nonperforming assets (percent of outstanding advances)	**9.1**	**8.2**	**7.3**	**5.8**	**3.9**
Public sector banks	11.6	10.3	9.1	7.3	5.0
Private sector banks	5.3	5.5	4.9	3.8	2.3
Foreign banks	3.0	2.3	2.4	2.9	1.9
Return on assets 2/	**-0.2**	**0.1**	**0.7**	**0.9**	**1.2**
Public sector banks	-0.7	-0.3	0.3	0.5	0.8
Private sector banks	0.6	0.4	1.1	1.4	1.6
Foreign banks	1.5	1.5	1.6	1.4	2.0
Balance sheet structure of all scheduled commercial banks					
Total assets (in percent of GDP)	87.8	88.6	98.7	92.3	...
Credit-to-deposit ratio	79.9	78.1	73.1	74.3	77.4
Government securities/total assets	20.5	20.1	22.6	21.8	...
II. Non-Banking Financial Companies 3/					
Total assets (in percent of GDP)	15.1	16.6	17.7	16.4	...
Risk-weighted capital adequacy ratio (CAR)	20.1	23.7	25.0	26.8	27.5
Gross nonperforming assets (percent of outstanding advances)	6.1	6.8	6.4	6.3	4.3
Net nonperforming assets (percent of outstanding net advances) 1/	3.3	3.4	2.7	2.3	1.3
Return on assets 2/	0.5	1.3	1.2	1.6	2.4

Source: Reserve Bank of India; Bankscope; and IMF staff estimates.

1/ Gross nonperforming assets less provisions.

2/ Net profit (+)/loss (-) in percent of total assets.

3/ As of July 31, 2022, there were 9640 NBFCs, of which 49 were deposit taking (NBFCs-D), and 415 systemically non deposit taking NBFCs (NBFCs-ND-SI).

Annex I. Uptake of Previous IMF Advice

1. **The take up of past Fund advice has been mixed**. Monetary and fiscal policies since the last Article IV have been broadly consistent with IMF advice while the challenges of structural and financial sector reforms and medium-term fiscal consolidation remain elevated.

2. **The recalibration of monetary policy has been appropriate**. After a monetary policy tightening cycle, the authorities appropriately paused policy rate actions as inflation began to moderate, while providing strong commitment to returning inflation to target.

3. **The tight fiscal stance in the FY2023/24 Budget and continued focus on infrastructure investment is in line with Staff advice**. There is still a need to communicate credible measures that will underpin fiscal consolidation over the medium term. Also, a more ambitious consolidation strategy is still needed to rebuild buffers. Revenue mobilization, particularly through reform of the GST, and better targeting of social support can help lower debt, whilst still supporting inclusive growth. In line with past IMF advice, the authorities brought previously off-budget food subsidies on budget for FY2020/21, improving fiscal transparency. The government also stopped issuing fully serviced bonds to SOEs and public agencies.

4. **Financial sector policies have been broadly well calibrated, largely moving beyond pandemic support measures, but further implementation of structural reforms is needed**. As advised by staff, policies have shifted toward facilitating the exit of non-viable firms, encouraging banks to build capital buffers and recognize problem loans. There has also been progress on financial sector reforms, including on improving the governance of PSBs, but other reforms, including privatization, are still pending.

5. **The authorities' responses to external sector developments have not always been aligned with Fund advice**. Amid the severe external shocks in 2022, the RBI used previously accumulated foreign exchange reserves to smooth excessive market volatility, but more recently FXI has contributed to the exchange rate moving within a very narrow range. There has been some progress on further liberalization to facilitate portfolio investment and FDI and promote India's integration in GVCs. However, import and export restrictions continued to be tightened, despite Fund advice to phase out such policies.

6. **Some structural reforms continue to face implementation challenges**. There is limited progress on the implementation of four new labor codes. Agricultural reforms, essential to modernizing the sector and adapting to climate change, remain pending. Land reforms have not progressed. Privatization efforts have been limited. Further strengthening of the judicial system, in line with previous staff advice, is needed. Gender gaps in the labor market remain high and wide-ranging reforms are needed to address barriers to participation and to encourage women out of unpaid activities and into paid or higher productivity jobs. The increased use of digital government services, however, represents a significant governance reform. The launch of the single window system for business approvals is also welcome and should be expanded to further reduce bottlenecks and scope for corruption.

Annex II. External Sector Assessment

<table>
<tr><td colspan="6">Overall Assessment: The external position in fiscal year 2022/23 (ending in March 2023) was moderately stronger than the level implied by medium-term fundamentals and desirable policies, suggesting that the CA deficit was somewhat smaller than implied by India’s level of per capita income, favorable growth prospects, demographic trends, and development needs. External vulnerabilities stem from weakening demand in some partner countries and volatile global financial conditions and commodity prices. In part reflecting buoyant services exports and declining oil prices, the CA deficit is projected to narrow in fiscal year 2023/24 before converging to its estimated norm over the medium term. The authorities have made some progress in external trade promotion and the liberalization of FDI and portfolio flows, but India’s trade and capital account regimes remain relatively restricted.

Potential Policy Responses: In the near term, government’s additional infrastructure spending will contribute to raising the CA deficit, thereby reducing the positive CA gap. To facilitate external rebalancing over the medium term, fiscal consolidation, development of export infrastructure, and negotiation of free trade agreements with main trading partners to provide a sustainable boost to exports of goods and services should be accompanied by further investment regime liberalization and a reduction in tariffs, especially on intermediate goods. Structural reforms could deepen integration into global value chains and attract FDI, hence mitigating external vulnerabilities. Exchange rate flexibility should act as the main shock absorber, with intervention limited to addressing disorderly market conditions.</td></tr>
<tr><td>Foreign Asset and Liability Position and Trajectory</td><td colspan="5">Background. As of the end of 2022, India’s NIIP had improved marginally to –11.1 percent of GDP from –11.5 percent of GDP at the end of 2021, reflecting both valuation changes and a base effect of fast nominal GDP growth offsetting the CA deficit. Gross foreign assets were 25.9 percent of GDP (declining from 29.2 percent of GDP at the end of 2021), while gross foreign liabilities shrank to 37.0 percent of GDP from 40.6 percent of GDP at the end of previous year. The bulk of assets were in the form of official reserves and FDI, whereas liabilities included mostly debt and FDI.

Assessment. With the CA deficit projected to narrow in 2023 and stabilize at a slightly higher level thereafter, the NIIP-to-GDP ratio is expected to remain broadly unchanged over the medium term, as robust nominal GDP expansion will offset the nominal NIIP decline resulting from projected CA deficits and valuation changes. India’s external debt liabilities are low compared with those of its peers, and short-term rollover risks are limited. The moderate level of foreign liabilities reflects India’s incremental approach to capital account liberalization, which has focused primarily on attracting FDI.</td></tr>
<tr><td>2022 (% GDP)</td><td>NIIP: –11.1</td><td>Gross Assets: 25.9</td><td>Debt Assets: 2.7</td><td>Gross Liab.: 37.0</td><td>Debt Liab.: 18.2</td></tr>
<tr><td>Current Account</td><td colspan="5">Background. In fiscal year 2022/23, the CA deficit widened to 2.0 percent of GDP, from 1.2 percent of GDP in the previous year, in the context of a high fiscal deficit. As the pandemic restrictions were lifted, imports rebounded faster than exports on the back of pent-up domestic demand, rising private investments, and a surge in prices of oil and some other commodities after Russia’s invasion of Ukraine. The CA deficit is projected to narrow to about 1.8 percent of GDP in fiscal year 2023/24 largely reflecting the expected decline in oil import costs. Over the medium term, the CA deficit is projected to converge to its norm of about 2.4 percent of GDP.

Assessment. The EBA cyclically adjusted CA balance stood at –0.9 percent of GDP in fiscal year 2022/23. The EBA CA regression estimates a norm of –2.3 percent of GDP, with a standard error of 0.7 percent, thus implying a CA gap of 1.5 percent of GDP. In the IMF staff’s judgment, a CA deficit of up to 2½ percent of GDP is financeable in the medium term by a combination of steady FDI inflows, more volatile portfolio flows susceptible to changes in global risk appetite, and public and private external borrowings. Additional cyclical considerations factoring in the transitory impacts of the COVID-19 pandemic on travel and transport services are assessed to be near 0.[1] Thus, the IMF staff assesses the CA gap to be 1.5 percent of GDP, with a range of 0.8 to 2.1 percent of GDP. Positive policy contributions to the CA gap stem mostly from the domestic credit gap, while negative contributions come from changes in FX reserves and capital controls.</td></tr>
</table>

2022 (% GDP)	CA: –2.0	Cycl. Adj. CA: –0.9	EBA Norm: –2.3	EBA Gap: 1.5	COVID-19 Adj.: 0.0	Other Adj.: 0.0	Staff Gap: 1.5
Real Exchange Rate	**Background**. In the first half of 2022, widening CA deficit and portfolio investment outflows resulted in depreciation pressures on the rupee. These pressures abated and reversed when the CA deficit narrowed and investor sentiments improved in the second half of 2022 and early 2023. The average REER in 2022 appreciated by about 1 percent from its 2021 average. As of April 2023, the REER was 2.8 percent below the 2022 average. **Assessment**. The IMF staff CA gap implies a REER gap of –7.8 percent (with an estimated elasticity of 0.19 applied). EBA REER index and level models suggest an overvaluation of 12.5 percent and 10.6 percent, respectively. Consistent with the staff CA gap, however, the IMF staff assesses the REER gap to be in the range of –11.4 to –4.2 percent, with a midpoint of –7.8 percent, for fiscal year 2022/23.						
Capital and Financial Accounts: Flows and Policy Measures	**Background**. Net FDI inflows remained stable at about 1 percent of GDP. Volatile portfolio investments recorded small net outflows of about 0.2 percent of GDP (compared with net outflows of about 0.5 percent of GDP in the prior year), while other investments, reflecting mostly debt-creating inflows, moderated to 1.0 percent of GDP from about 2.2 percent of GDP in FY2021/22. During the year, the Indian authorities made further steps toward capital account liberalization by further increasing limits on external borrowing and widening the scope of government bonds available for foreign investors, which could help moderate the interest costs associated with financing the CA deficit. **Assessment**. While FDI inflows covered a part of the CA deficit in FY2022/23, further structural reforms and improvement of the investment regime to promote FDI are needed. Volatile portfolio investments are very sensitive to changes in global financial conditions and country risk premia. The expected inclusion of India in international bond indices could significantly increase foreign participation in India's bond market and support portfolio inflows to finance the CA deficit over the medium term.						
FX Intervention and Reserves Level	**Background**. In the first half of 2022, official FX reserves decreased from historically high levels in 2021, reflecting a widening CA deficit, portfolio investment outflows, and valuation changes. The reserves increased in subsequent months as the CA deficit narrowed and investor confidence improved. During this time, the Reserve Bank of India's FX interventions aimed to smooth excessive market volatility and contributed to the rupee's exchange rate stability. During December 2022-October 2023, the observed stability of the exchange rate prompted reclassification of India's *de facto* exchange rate regime from "floating" to "stabilized arrangement" for that period, while the *de jure* classification remained "floating." Reserves stood at $562.7 billion at the end of 2022. **Assessment**. Various criteria confirm that the official FX reserves are adequate for precautionary purposes. As of the end of 2022, they represented about 198 percent of short-term debt (on residual maturity), about 106 percent of the IMF's composite metric (for "stabilized arrangement"), and about seven months of import coverage. In view of moderately strong external position and adequate reserves level, FX interventions should be limited to addressing disorderly market conditions.						

[1] The cyclical adjustment and COVID-19 adjustors have been computed based on the fiscal year (as opposed to the calendar year) to take into account the quarterly dynamics of commodity prices and travel and transport services between the second quarter of 2022 and the first quarter of 2023.

Annex III. Risk Assessment Matrix 1/

Sources of risk	Risk likelihood	Expected impact	Policy response
		External risks	
Intensification of regional conflict(s).	High	Escalation of Russia's war in Ukraine or other regional conflicts and resulting economic sanctions disrupt trade (e.g., energy, food, tourism, and/or critical supply chain components), remittances, FDI and financial flows, and payment systems, and lead to refugee flows.	Diversify critical import sources. Secure export market access through multilateral and bilateral trade agreements. Accelerate transition towards renewable energy.
Commodity price volatility.	High	A succession of supply disruptions (e.g., due to conflicts, uncertainty, and export restrictions) and demand fluctuations causes recurrent commodity price volatility, external and fiscal pressures in EMDEs, contagion effects, and social and economic instability.	Improve targeting of transfers to protect the most vulnerable and accelerate shift to renewable sources of energy. Maintain exchange rate flexibility to absorb external shocks but intervene to prevent disorderly currency movements.
Monetary policy miscalibration.	Medium	Amid high economic uncertainty and financial sector fragility, major central banks pause monetary policy tightening or pivot to loosen policy stance prematurely, de-anchoring inflation expectations, triggering a wage-price spiral and spillovers to financial markets.	Tighten fiscal and monetary policies to anchor inflation expectations and prevent second-round effects of commodity price shocks; increase transfers to the poor as needed to alleviate the impact of inflation.
Abrupt global slowdown or recession.	Medium	Global and idiosyncratic risk factors combine to cause a synchronized sharp growth slowdown, with recessions in some countries, adverse spillovers through trade and financial channels, and market fragmentation causing sudden stops in EMDEs.	Rebuild fiscal buffers and maintain strong external position to be ready to withstand such shocks. Maintain exchange rate flexibility to absorb external shocks. If the shocks materialize, use fiscal/monetary policy space to support economic activity and the most vulnerable.
Deepening geoeconomic fragmentation.	High	Broader and deeper conflict(s) and weakened international cooperation result in a more rapid reconfiguration of trade and FDI, supply disruptions, protectionism, technological and payments systems fragmentation, rising input costs, financial instability, a fracturing of international monetary and financial systems, and lower potential growth.	Diversify and secure supply of critical commodities. Play a stabilizing role in the region by promoting mutually beneficial cooperation. Continue building capacity for the use of Indian rupee for international trade invoicing and settlement.
Cyberthreats.	Medium	Cyberattacks on physical or digital infrastructure (including digital currency and crypto assets ecosystems) or misuse of AI technologies trigger financial and economic instability.	Further improve protection of India's digital assets against hacking attempts. Maintain back-up copies of critical databases.

1/ The Risk Assessment Matrix (RAM) shows events that could materially alter the baseline path. The relative likelihood is the staff's subjective assessment of the risks surrounding the baseline ("low" is meant to indicate a probability below 10 percent, "medium" a probability between 10 and 30 percent, and "high" a probability between 30 and 50 percent). The RAM reflects staff views on the source of risks and overall level of concern as of the time of discussions with the authorities. Non-mutually exclusive risks may interact and materialize jointly.

Sources of risk	Risk likelihood	Expected impact	Policy response
Domestic risks			
Higher private consumption and investment	**Medium (Upside risk)**	Stronger than expected consumer demand and private investment, possibly financed by digitalization-driven resource mobilization, would raise growth.	Productivity-enhancing reforms, along with nimble and vigilant supervision of lending, will help further support sustainable growth. Consider accelerating fiscal consolidation.
Social discontent.	**Medium**	Rising food and fuel prices, or the pursuit of difficult structural reforms could create social discontent. In addition, uncertainty may increase in the run up to elections. This could lead to capital outflows, slowing economic growth and the drive for reform.	Increase spending on social protection to the poorest segments. Restore and preserve social stability. Communicate clearly to explain the benefits from structural reforms and protect the most vulnerable from possible adverse impacts.
Financial sector vulnerabilities.	**Medium**	An external or domestic shock could lead to credit stress, weighing on asset quality and capital, thereby reducing risk appetite among bank and nonbank lenders. Persistently high and concentrated credit growth could lead to deterioration in underwriting standards and drive debt servicing burdens to elevated levels, increasing financial sector vulnerabilities in subsequent downturns.	Encourage sound risk management, recognize problem loans, and expedite asset resolution to prevent the buildup of balance sheet vulnerabilities. Implement targeted prudential policies to reduce any emerging risks. Implement governance reforms in the public sector banks.
Weakening fiscal position and materialization of fiscal risks.	**Medium**	Weakening of fiscal position could lead to a sharp increase in financing costs and the realization of contingent liabilities, with broader implications for financial conditions and the financial system.	Enhance fiscal policy space through a credible medium-term fiscal consolidation strategy anchored on stronger revenue mobilization and increased expenditure efficiency. Reduce the interconnectedness between the sovereign and banks' balance sheets
Natural disasters related to climate change.	**Medium**	More frequent natural disasters deal severe damage to infrastructure and amplify supply chain disruptions and inflationary pressures, causing water and food shortages and reducing medium-term growth.	Invest in infrastructure that mitigates the impact of natural disasters. Accelerate transition to a carbon-neutral green economy. Strengthen the social safety net. Support climate resilient agriculture.

Annex IV. Sovereign Risk and Debt Sustainability Assessment

Figure 1. India: Risk of Sovereign Stress

Horizon	Mechanical signal	Final assessment	Comments
Overall	…	Moderate	The overall risk of sovereign stress is moderate. Favorable interest-grow th differential support a gradual reduction in debt. How ever, debt remains elevated at the end of the projection period and gross financing needs are substantial. Long-term risks from investment to address climate change adaptation and mitigation are high.
Near term 1/			
Medium term	Moderate	Moderate	Medium-term risks are assessed as moderate. Debt declines over the medium term and hence is likely to stabilize, although it remains at an elevated level. GFN are substantial and banks are more exposed to the general government compared to peers. The stress test on contingent liabilities indicates that sizeable financing buffers are needed to absorb potential shocks.
Fanchart	Moderate	…	
GFN	Moderate	…	
Stress test	...	…	
Long term	…	High	Long-term risks are high because considerable investment is required to reach India's climate change mitigation targets and improve resilience to climate stresses and natural disasters. This suggests that new and preferrably concessional sources of financing are needed, as w ell as greater private sector investment and carbon pricing or equivalent mechanism.
Sustainability assessment 2/			
Debt stabilization in the baseline			Yes

DSA summary assessment

Commentary: India is at a moderate overall risk of sovereign stress. Debt gradually declines over the projection period, driven by favourable interest-grow th differential. In particular, grow th has returned to potential and the RBI has paused its rate hike cycle as inflation is returning to w ithin its tolerance band. How ever, debt remains at an elevated level and gross financing needs are substantial. Risks to debt sustainability are moderated by India's debt composition, comprising of long-dated, fixed rate, local currency denominated securities held by residents. Foreign currency denominated public debt is low and largely on a concessional basis. The reliance on financing from domestic banks can crow d out private investment. Long-term debt sustainability risks are high, stemming from investments required to address the challenges of climate change mitigation and adaptation.

Source: Fund staff.

Note: The risk of sovereign stress is a broader concept than debt sustainability. Unsustainable debt can only be resolved through exceptional measures (such as debt restructuring). In contrast, a sovereign can face stress w ithout its debt necessarily being unsustainable, and there can be various measures—that do not involve a debt restructuring—to remedy such a situation, such as fiscal adjustment and new financing.

1/ The near-term assessment is not applicable in cases w here there is a disbursing IMF arrangement. In surveillance-only cases or in cases w ith precautionary IMF arrangements, the near-term assessment is performed but not published.

2/ A debt sustainability assessment is optional for surveillance-only cases and mandatory in cases w here there is a Fund arrangement. The mechanical signal of the debt sustainability assessment is deleted before publication. In surveillance-only cases or cases w ith IMF arrangements w ith normal access, the qualifier indicating probability of sustainable debt ("w ith high probability" or "but not w ith high probability") is deleted before publication.

Figure 2. India: Debt Coverage and Disclosures

	CG	GG	NFPS	CPS	Other	Comments
1. Debt coverage in the DSA: 1/	CG	GG	NFPS	CPS	Other	
1a. If central government, are non-central government entities insignificant?					n.a.	

2. Subsectors included in the chosen coverage in (1) above:

Sector		Subsectors captured in the baseline	Inclusion	Comments
CPS / NFPS / GG: expected / CG	1	Budgetary central government	Yes	
CPS / NFPS / GG: expected / CG	2	Extra budgetary funds (EBFs)	No	
CPS / NFPS / GG: expected / CG	3	Social security funds (SSFs)	No	
CPS / NFPS / GG: expected	4	State governments	Yes	
CPS / NFPS / GG: expected	5	Local governments	No	See commentary below
CPS / NFPS	6	Public nonfinancial corporations	No	
CPS	7	Central bank	No	
CPS	8	Other public financial corporations	No	

3. Instrument coverage:	Currency & deposits	Loans	Debt securities	Oth acct. payable 2/	IPSGSs 3/

4. Accounting principles:	Basis of recording		Valuation of debt stock		
	Non-cash basis 4/	Cash basis	Nominal value 5/	Face value 6/	Market value 7/

5. Debt consolidation across sectors:	Consolidated	Non-consolidated

Color code: chosen coverage | Missing from recommended coverage | Not applicable

Reporting on intra-government debt holdings

	Issuer \ Holder	Budget. central govt	Extra-budget. funds	Social security funds	State govt.	Local govt.	Nonfin. pub. corp.	Central bank	Oth. pub. fin corp	Total
1	Budget. central govt				3,037					3,037
2	Extra-budget. funds									-
3	Social security funds									-
4	State govt.	4,618								4,618
5	Local govt.									-
6	Nonfin pub. corp.									-
7	Central bank									-
8	Oth. pub. fin. corp									-
	Total	4,618	-	-	3,037	-	-	-	-	7,655

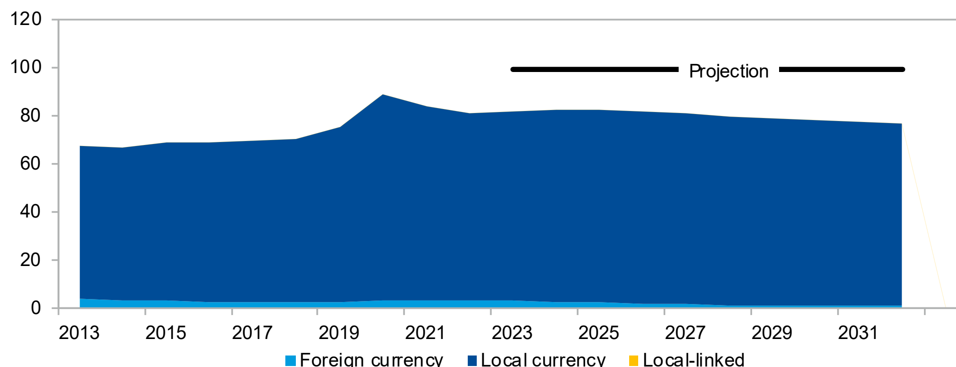
(Issuer rows grouped: CPS (1–8), NFPS (1–6), GG: expected (1–5), CG (1–3).)

1/ CG=Central government; GG=General government; NFPS=Nonfinancial public sector; PS=Public sector.
2/ Stock of arrears could be used as a proxy in the absence of accrual data on other accounts payable.
3/ Insurance, Pension, and Standardized Guarantee Schemes, typically including government employee pension liabilities.
4/ Includes accrual recording, commitment basis, due for payment, etc.
5/ Nominal value at any moment in time is the amount the debtor owes to the creditor. It reflects the value of the instrument at creation and subsequent economic flows (such as transactions, exchange rate, and other valuation changes other than market price changes, and other volume changes).
6/ The face value of a debt instrument is the undiscounted amount of principal to be paid at (or before) maturity.
7/ Market value of debt instruments is the value as if they were acquired in market transactions on the balance sheet reporting date (reference date). Only traded debt securities have observed market values.

Commentary: The coverage in this SRDSA is for the central and state government. Authorities are working to expand the perimeter of public debt statistics to include local government and recently released a publication on municipal finances which covers 70 percent of urban local bodies in India. The debt of these municipal corporations are small, estimated at 0.05 percent of GDP in 2019/20. The SRDSA includes debt issued by SOEs that are fully serviced by the Government of India.

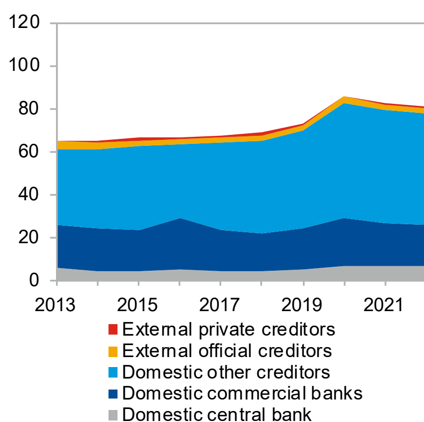
Figure 3. India: Public Debt Structure Indicators

Debt by currency (percent of GDP)



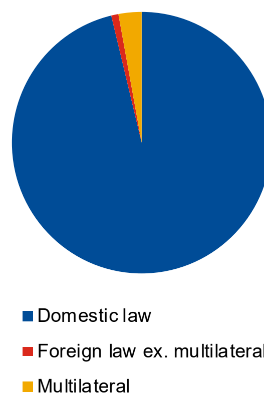
Note: The perimeter show n is general government.

Public debt by holder (percent of GDP)



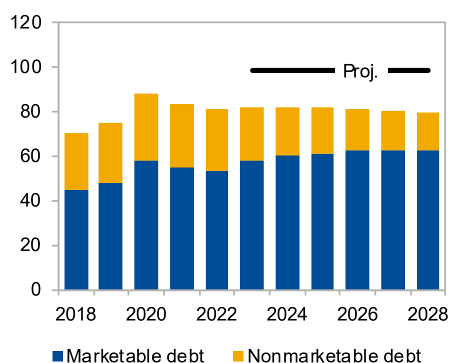
Note: The perimeter show n is general government.

Public debt by governing law, 2022 (percent)



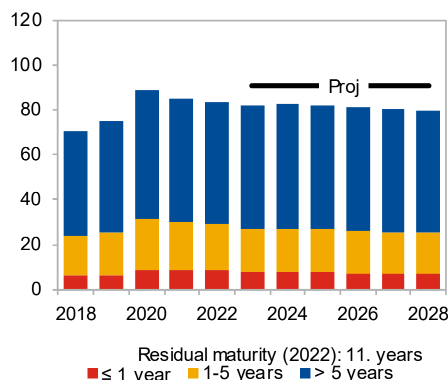
Note: The perimeter show n is general government.

Debt by instruments (percent of GDP)



Note: The perimeter show n is general government.

Public debt by maturity (percent of GDP)



Note: The perimeter show n is general government.

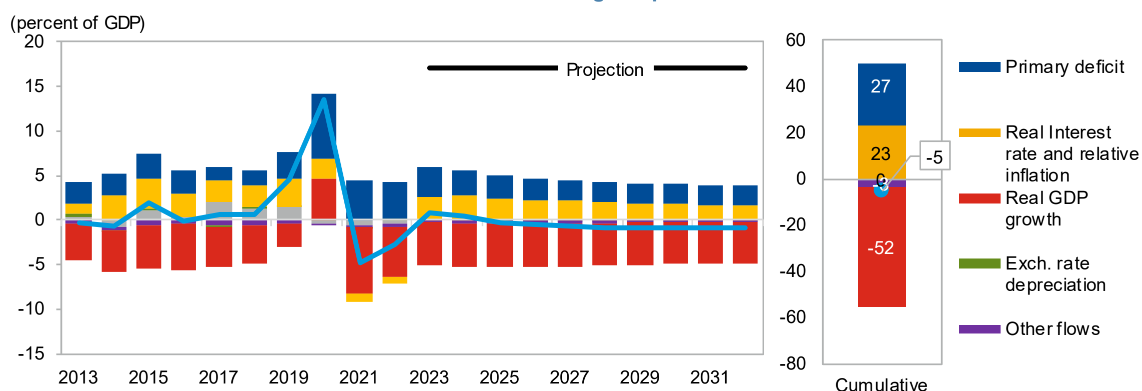
Commentary: The bulk of financing needs is expected to continue to be met by the issuance of medium and long-term debt denominated in domestic currency and held by residents. Specifically, the distribution of issuances across different maturities follow those observed in FY2022/23. Foreign-currency denominated debt are largely on concessional terms. The inclusion of India in global bond indices should provide India w ith access to a w ider pool of investors, and likely to increase nonresident ow nership in India's bond market.

Figure 4. India: Baseline Scenario

(percent of GDP unless indicated otherwise; fiscal year)

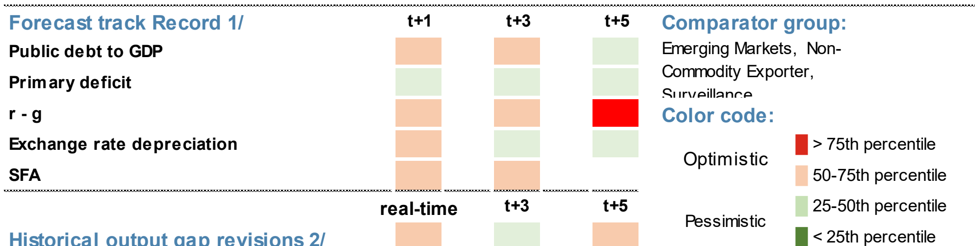
	Actual	Medium-term projection						Extended projection			
	2022	2023	2024	2025	2026	2027	2028	2029	2030	2031	2032
Public debt	81.0	81.9	82.3	82.1	81.5	80.8	79.9	79.1	78.2	77.3	76.4
Change in public debt	-2.7	0.9	0.4	-0.2	-0.6	-0.8	-0.8	-0.8	-0.9	-0.9	-0.9
Contribution of identified flows	-2.3	0.9	0.4	-0.2	-0.5	-0.7	-0.8	-0.8	-0.9	-0.9	-0.9
Primary deficit	4.1	3.4	2.9	2.5	2.3	2.3	2.2	2.2	2.3	2.3	2.3
Noninterest revenues	19.3	19.3	19.3	19.4	19.5	19.6	19.7	19.7	19.7	19.7	19.7
Noninterest expenditures	23.4	22.7	22.2	21.9	21.8	21.9	21.9	21.9	21.9	22.0	22.0
Automatic debt dynamics	-6.2	-2.3	-2.1	-2.4	-2.6	-2.7	-2.7	-2.8	-2.9	-2.9	-2.9
Real interest rate and relative inflation	-0.7	2.6	2.7	2.5	2.3	2.2	2.0	1.9	1.8	1.7	1.6
Real interest rate	-0.7	2.6	2.7	2.4	2.3	2.1	2.0	1.9	1.8	1.7	1.6
Relative inflation	0.0	0.0	0.1	0.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Real growth rate	-5.7	-4.8	-4.9	-4.9	-4.9	-4.9	-4.8	-4.7	-4.7	-4.6	-4.6
Real exchange rate	0.2	…	…	…	…	…	…	…	…	…	…
Other identified flows	-0.3	-0.3	-0.3	-0.3	-0.3	-0.3	-0.3	-0.3	-0.3	-0.2	-0.2
Contingent liabilities	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
(minus) Interest Revenues	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1
Other transactions	-0.2	-0.2	-0.2	-0.2	-0.2	-0.2	-0.2	-0.2	-0.2	-0.2	-0.1
Contribution of residual	-0.4	0.0	-0.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Gross financing needs	15.8	15.1	15.2	15.2	14.9	13.9	13.7	13.5	13.6	13.2	12.3
of which: debt service	11.7	11.7	12.4	12.8	12.6	11.7	11.6	11.3	11.4	11.0	10.1
Local currency	11.5	11.4	12.1	12.6	12.4	11.5	11.4	11.2	11.3	10.9	10.0
Foreign currency	0.3	0.3	0.3	0.3	0.3	0.2	0.2	0.2	0.2	0.1	0.1
Memo:											
Real GDP growth (percent)	7.2	6.3	6.3	6.3	6.3	6.3	6.3	6.3	6.3	6.3	6.3
Inflation (GDP deflator; percent)	8.2	3.9	4.1	4.1	4.1	4.0	4.0	4.0	4.0	4.0	4.0
Nominal GDP growth (percent)	16.1	10.5	10.6	10.7	10.7	10.6	10.5	10.5	10.5	10.5	10.5
Effective interest rate (percent)	7.2	7.4	7.7	7.4	7.1	6.9	6.8	6.6	6.5	6.4	6.3

Contribution to change in public debt

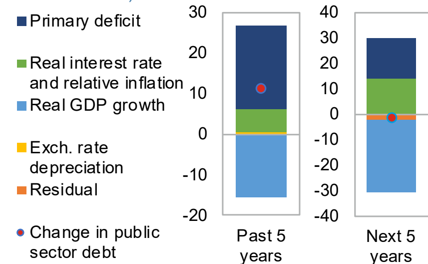


Staff commentary: Public debt will gradually decline over the medium term, reflecting continued favorable interest-growth differential and lower contribution from primary defiicts due to fiscal consolidation; economic growth is at potential, inflation is expected to return to the RBI's central target and the monetary policy tightening cycle has paused. Debt remains high by the end of the medium term. Similarly, gross financing needs are substantial, averaging 15 percent of GDP over the medium term. Other transactions capture proceeds from asset sales.

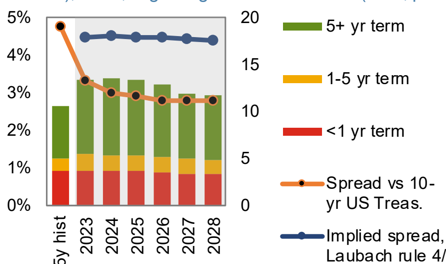
Figure 5. India Realism of Baseline Assumptions



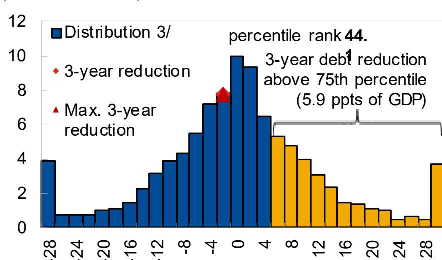
Public Debt Creating Flows
(Percent of GDP)



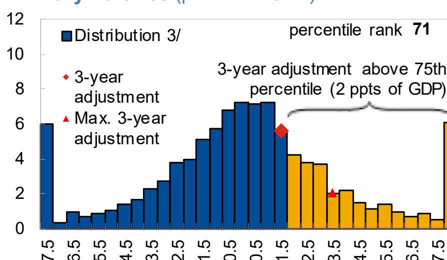
Bond Issuances (bars, debt issuances (RHS, %GDP); lines, avg marginal interest rates (LHS, percent))



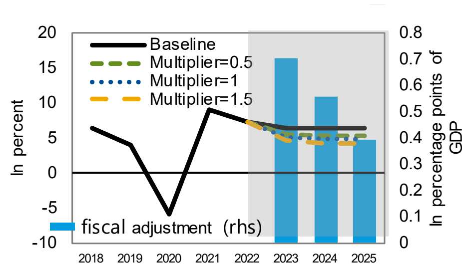
3-Year Debt Reduction
(Percent of GDP)



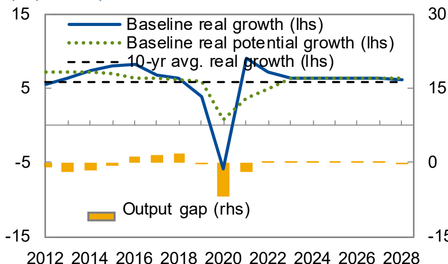
3-Year Adjustment in Cyclically-Adjusted Primary Balance (percent of GDP)



Fiscal Adjustment and Possible Growth Paths
(lines, real growth using multiplier (LHS); bars, fiscal adj. (RHS)



Real GDP Growth
(in percent)



Commentary: The forecast track record does not flag any realism issues, showing a mix of optimism and pessimism that are within accepted bounds. Debt creating flows over the medium term reflect fiscal consolidation and sound economic growth, while historically they largely reflect the response to the pandemic. Spreads narrow over the projection as India has paused its monetary policy tightening cycle. Since spreads reflect this policy decision, the Laubach rule is less applicable over the projection period. The three year debt adjustment are around the median of comparator countries. While the adjustment in the CAPB is ambitious compared to peers, it is feasible compared to India's historical experience. The effects of fiscal consolidation on GDP growth are offset by a recovery in investment, which has higher multipliers.

Source : IMF Staff.

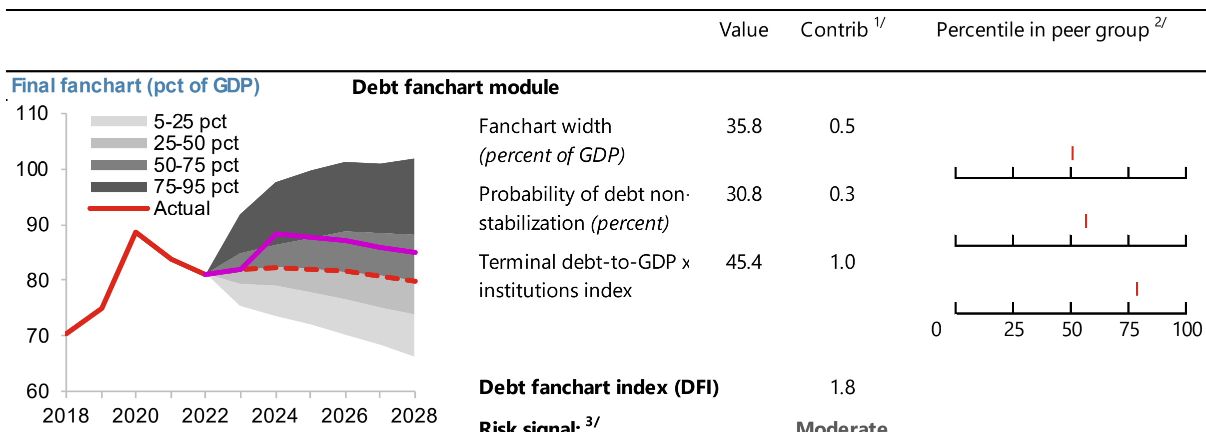
1/ Projections made in the October and April WEO vintage.

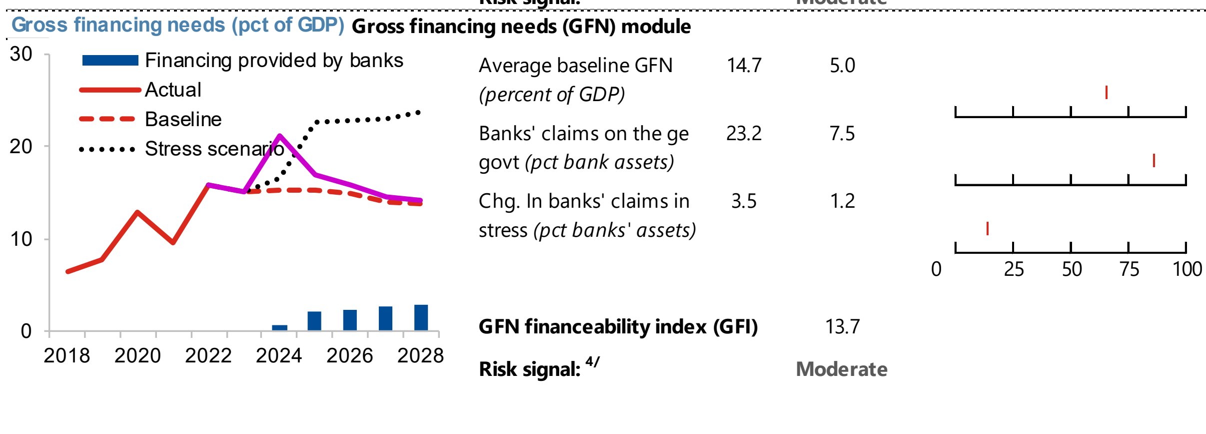
2/ Calculated as the percentile rank of the country's output gap revisions (defined as the difference between real time/period ahead estimates and final estimates in the latest October WEO) in the total distribution of revisions across the data sample.

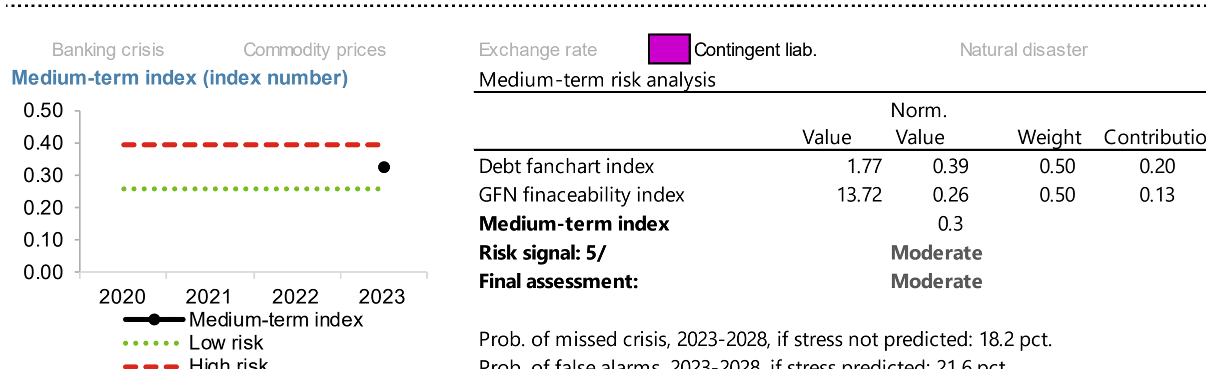
3/ Data cover annual observations from 1990 to 2019 for MAC advanced and emerging economies. Percent of sample on vertical axis.

4/ The Laubach (2009) rule is a linear rule assuming bond spreads increase by about 4 bps in response to a 1 ppt increase in the projected debt-to-GDP ratio.

Figure 6. India: Medium-Term Risk Assessment







The analysis suggest a moderate risk of sovereign stress over the medium term. While debt is likely to stabilize in the medium term, it does so at an elevated level. Gross financing needs are substantial and banks' claim on government are high compared to peers. The increase in GFN under a stress test is sizeable. Contingent liabilities, including those related to electricity distribution companies increase debt sustainability and financing risks.

Source: IMF staff estimates and projections.

1/ See Annex IV of IMF, 2022, Staff Guidance Note on the Sovereign Risk and Debt Sustainability Framework for details on index calculation.

2/ The comparison group is emerging markets, non-commodity exporter, surveillance.

3/ The signal is low risk if the DFI is below 1.13; high risk if the DFI is above 2.08; and otherwise, it is moderate risk.

4/ The signal is low risk if the GFI is below 7.6; high risk if the DFI is above 17.9; and otherwise, it is moderate risk.

5/ The signal is low risk if the GFI is below 0.26; high risk if the DFI is above 0.40; and otherwise, it is moderate risk.

Figure 7. India: Long-Term Risk Assessment

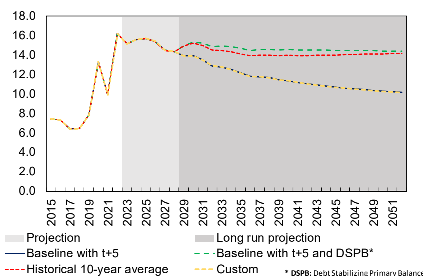
Large Amortization Trigger

Projection	Variable	Risk Indication
Medium-term extrapolation	GFN-to-GDP ratio Amortization-to-GDP ratio Amortization	
Medium-term extrapolation with debt stabilizing primary balance	GFN-to-GDP ratio Amortization-to-GDP ratio Amortization	
Historical average assumptions	GFN-to-GDP ratio Amortization-to-GDP ratio Amortization	
Overall Risk Indication		

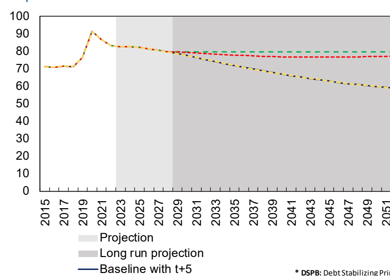
Alternative Baseline Long-term Projections (including Custom scenario)

	Baseline extension of fifth projection year	Custom baseline
Real GDP growth	6.3%	6.3%
Primary Balance-to-GDP ratio	-2.2%	-2.2%
Real depreciation	-3.4%	-2.0%
Inflation (GDP deflator)	4.0%	4.0%

GFN-to-GDP ratio



Total public debt-to-GDP ratio



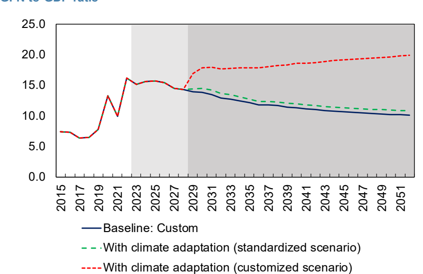
Projection; Long run projection; Baseline with t+5; Baseline with t+5 and DSPB*; Historical 10-year average; Custom

* DSPB: Debt Stabilizing Primary Balance

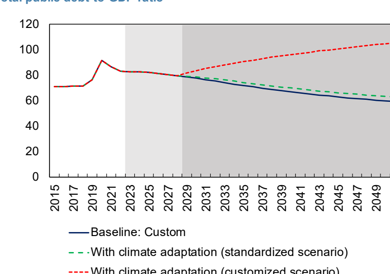
Commentary: Following fiscal stimulus implemented during the pandemic, India's gross financing needs are at an elevated level. Favourable interest-growth differential and fiscal consolidation in the post-pandemic period is expected to gradually reduce debt and gross financing needs. In the baseline, the primary deficit at the end of the projection period is below the debt stabilizing primary deficit. The bulk of this adjustment occurs in the first three years of the projections and is considered feasible (see Realism Table).

Climate Change: Adaptation

GFN-to-GDP ratio



Total public debt-to-GDP ratio

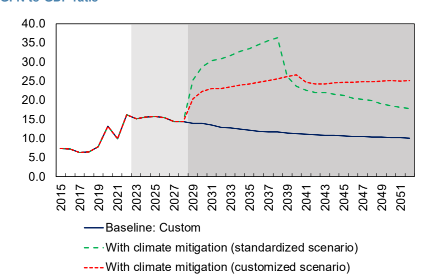


Baseline: Custom; With climate adaptation (standardized scenario); With climate adaptation (customized scenario)

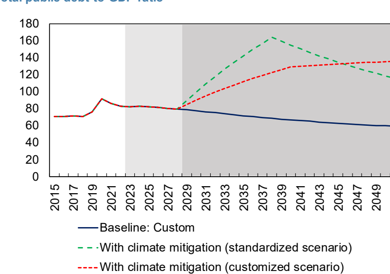
Commentary: Climate change adaptation needs in India goes beyond those sectors covered in the standardized scenario (strengthening physical assets and coastal protection) to include climate-resilient agriculture, given the importance of this sector to the economy and livelihoods.The customized scenario reflects these broader adaptation investment needs, estimated at 3 percent of GDP. With traditional financing sources, debt is expected to reach over 100 percent of GDP, signalling that concessional sources of financing and greater private sector involvement are needed.

Climate Change: Mitigation

GFN-to-GDP ratio



Total public debt-to-GDP ratio



Baseline: Custom; With climate mitigation (standardized scenario); With climate mitigation (customized scenario)

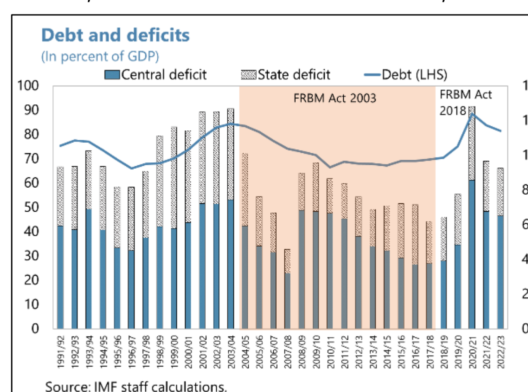
Commentary: India's investment needs to meet its climate change mitigation targets are sizeable, estimated at between 4-8 percent of GDP per year (Ghosh and others, 2023). If these investments were funded using the same instruments that are used to finance the general government deficit, then debt could reach as high as 136 percent of GDP. This suggests that concessional sources of financing, greater private sector involvement and carbon pricing or equivalent mechanism are needed.

Annex V. India's Medium Term Fiscal Framework[1]

Like many countries, India's medium term fiscal framework was suspended to enable the authorities to respond to the COVID-19 pandemic. That said, even prior to the pandemic, the fiscal anchors specified in the framework were repeatedly breached. With the economic recovery entrenched, there is an opportunity to revamp the framework to incorporate lessons from the pandemic and align it with international best practice.

Background

1. Medium-term fiscal frameworks (MTFF) are a statement of the fiscal strategy, consistent with fiscal objectives and targets to ensure macroeconomic stability and fiscal sustainability. The fiscal aggregates specified in the framework, such as the level of revenue, expenditure and financing informs the annual budget process[2]. In India the framework for the Union is guided by the Fiscal Responsibility and Budget Management (FRBM) Act 2018, which specifies a target debt to GDP ratio for the central and state governments of 40 and 20 percent, respectively, to be achieved by 2024/25, along with a ceiling on the fiscal deficit for the central government of 3 percent. The initial FRBM Act 2003 did not specify a debt target, rather it directed the Union government to present to parliament a 3-year rolling plan for the elimination of the revenue deficit and reduction of the fiscal deficit to 3 percent of GDP. States mirrored this FRBM Act and hence many states do not have debt as an anchor, and when there is a debt anchor, it may not be aligned with the general government debt target adopted by the center (Patel and Singh, 2022)



2. The 2021/22 Budget stated that the FRBM Act targets would not be applicable due to the COVID-19 pandemic and that the Act would be amended. Specifically, the 3 percent deficit ceiling was removed, and the medium-term expenditure framework (including medium-term fiscal projections) was not presented to parliament.[3] While the framework does allow for an expansion of the deficit under certain conditions by, at most, an additional 0.5 percent of GDP, this was insufficient for the pandemic response[4]. Since pausing the FRBM Act, the de-facto fiscal anchor for

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[1] Prepared by Dinar Prihardini

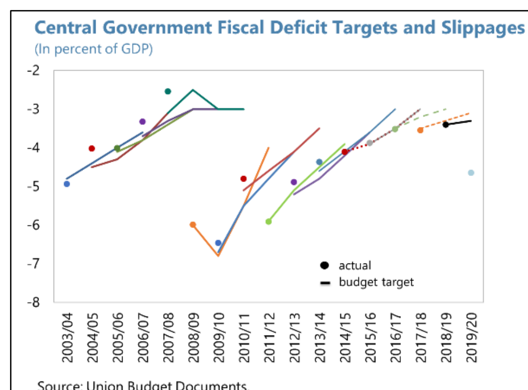
[2] For some countries MTFFs include comprehensive budget procedures and detailed projections, while for others they are a more general strategy. They can also include specific, legally binding, numerical rules, or only a statement of fiscal objectives.

[3] Other components of the Act, such as the ceiling on and reporting of government guarantees remained in force.

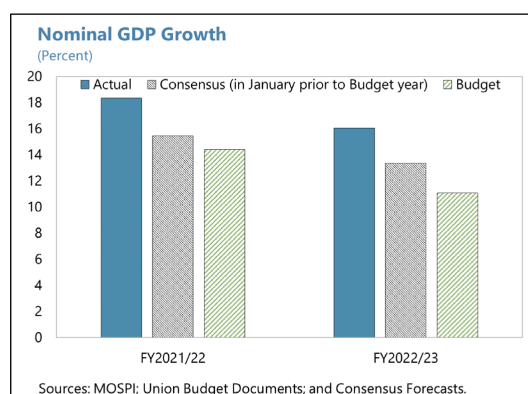
[4] The conditions include: considerations of national security; acts of war, calamities of national proportion, collapse of agriculture severely affecting farm output and incomes; far-reaching structural reforms with unanticipated fiscal implications, and a decline in real output growth of at least 3 percentage points below the average for the previous four quarters. Activation of the escape clause requires parliamentary approval.

the center has been a deficit target of 4.5 percent of GDP by 2025/26, while the states follow the annual deficit path recommended by the 15th Finance Commission (for FY2023/24 it is 3.5 percent of GDP, of which 0.5 percent is contingent on achieving power sector reforms)[5,6]

3. Prior to the pandemic, the target for the center's deficit were repeatedly breached. For the center, fiscal deficit outturns have fallen short of the desired medium-term consolidation path, partly due to overoptimistic revenue projections. Though this trend has been reversed: since FY2021/22 revenue projections have been based on conservative macroeconomic projections and the central government's deficit targets have been met. In contrast state deficits have generally been below 3 percent of GDP since FY2005/06, since borrowing of states is regulated by the center[7]. The use of off-budget spending by the center and states also renders adherence to the headline deficit target less meaningful. That said, the introduction of the FRBM Act did coincide with a period of sustained improvement in the fiscal deficit. The center also brought previously off-budget food subsidies on budget in FY2021/22.



Source: Union Budget Documents.



Sources: MOSPI; Union Budget Documents; and Consensus Forecasts.

Implementing an Effective Medium-Term Fiscal Framework

4. MTFFs can improve the prospects of achieving fiscal sustainability, by operationalizing fiscal rules and explicitly managing fiscal risks. They serve as a forward guidance to annual budgets so that these budgets are consistent with the medium-term fiscal anchor. Consistently delivering on fiscal targets would foster market and public confidence, reinforce the commitment to fiscal sustainability and help ensure more stable economic conditions. Importantly, credible fiscal plans can reduce borrowing costs, increasing fiscal space and helping to reduce the fiscal effort required to stabilize debt (Bianchi and others, 2019; Hatchondo and others, 2021).

5. Effective MTFFs balance credibility and flexibility. Effective MTFFs would have the following characteristics (Caselli and others, 2022): realistic and internally consistent medium-term

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[5] The central government's deficit target was announced in the FY2022/23 Budget presented to Parliament. It is not legally binding.

[6] The Commission provides recommendations regarding center-state fiscal relations.

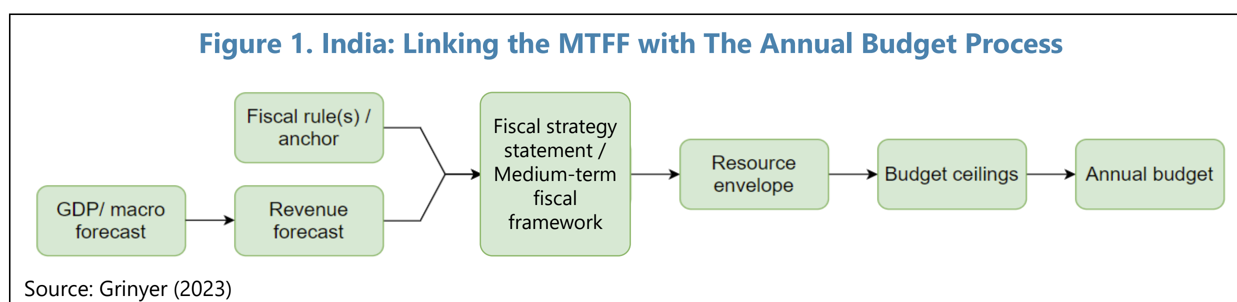
[7] Under the Constitution, States need the consent of the central government to borrow if the state has an outstanding loan from the Center. Currently all states have outstanding loans from the center.

macroeconomic projections; a feasible fiscal path; flexibility in response to shocks; transparency with respect to fiscal anchors and guardrails; following a risk-based approach for debt sustainability; an assessment of fiscal risks; checks and balances; and they would be well integrated within the budget process.

6. The review of the FRBM Act provides an opportunity to strengthen India's MTFF. India's central government public financial management (PFM) and budget systems are sound, with a strong financial compliance basis. This serves as a good springboard to take fiscal planning to the next level (Fouad and others, 2018). Areas of improvement include the following.

- *A stronger link between the MTFF, fiscal objectives, and the budget process*. A successful MTFF needs to be well integrated with the budget process or there will be deviations between the fiscal strategy and budget. A Fiscal Strategy Statement (which would replace the current Macroeconomic Framework Statement and Medium-Term Fiscal Policy Statement) outlining the government's fiscal objectives, including the adjustment path, costing of new policy measures and reforms, and associated funding envelope, should be discussed by Cabinet early in the budget cycle (e.g., August), tabled in Parliament and published. This pre-budget statement would be the vehicle through which the main elements of the MTFF are publicly communicated. It would launch the 'top-down' budgeting process, by setting the overall spending ceiling that is communicated to line ministries, who, in turn, would be required to submit three-year budget estimates (Fouad and others, 2018). Indeed, many emerging market G-20 countries, such as Brazil, Indonesia, Mexico and South Africa, are required by law to produce a pre-budget statement.

Figure 1. India: Linking the MTFF with The Annual Budget Process



Source: Grinyer (2023)

- *A comprehensive assessment of fiscal risks and mitigation strategies, given their potential impact on debt sustainability.* This would include risks arising from, inter alia: general macroeconomic conditions; policies (e.g., delays to revenue or expenditure measures); the financial sector (particularly given the importance of public sector banks for financing); state-owned enterprises; PPPs, pension liabilities, environmental risks, guarantees and contingent liabilities. An example of risks that would be important to include for India are: guarantees of the central government (2.2 percent of GDP in March 2022); SOE loan guarantees by state government (4.5 percent of GDP); and possible bail out of state electricity distribution companies, estimated at 2.3 percent of GDP, based on the experience of past bailouts (Mukherjee and others, 2022). The comprehensive assessment of risks should be used to develop alternative scenarios and

inform policy makers when preparing the medium-term fiscal strategy and set the appropriate level of contingency margins.

- *Improving transparency by closing data gaps.* Though significant progress has been made to improve the coverage of fiscal data, India is one of three G20 countries which does not report general government data in line with GFS (Blagrave and Gonguet, 2019). Consolidated data for the center and states is part of the MOF's Indian Public Finance Statistics, but this comes with a one-year lag. Progress is being made on increasing coverage to local governments: the RBI recently published data on municipal state finances covering 70 percent of urban local bodies; there is also good progress being made on publishing quarterly central government data under GFS standards. Closer coordination is needed across the various levels of government to close data gaps and shorten reporting lags. Efforts could include the establishment of common reporting standards, a shared calendar, and a dedicated platform to share fiscal information (Blagrave and Gonguet, 2019).

7. Sub-national governments also play an important role in ensuring fiscal sustainability. Expenditure at the state level account for approximately 57 percent of total recurrent spending and 67 percent of capital expenditure (excluding defense). They are also exposed to substantial risks, including contingent liabilities from electricity distribution companies (Mukherjee and others, 2022). The recommendations discussed above should also apply to state level fiscal responsibility laws. At a minimum, states should align their fiscal anchors to be consistent with the post-pandemic FRBM Act. An option is to differentiate fiscal anchors across states depending on their current fiscal position and debt sustainability risks, The finance commission could provide recommendations for the appropriate anchor and medium-term adjustment path. This is similar to the newly proposed fiscal rules for EU member states (see Box). Currently, states have little market incentive to implement ambitious consolidation paths given that yields of state government securities are within a narrow band, despite large variations in fiscal performance.

8. Given missed fiscal targets in the pre-pandemic years, the new MTFF should incorporate checks and balances to support accountability and assist in building credibility. The new framework should also discuss how to address repeated deviations or non-compliance. In many countries, independent fiscal councils fulfil this role through an assessment of fiscal plans and performance, evaluation of macroeconomic and fiscal forecasts, monitoring adherence to fiscal rules and costing of policy measures. The number of fiscal councils have increased over time, and in 2021, there were 49 countries with fiscal councils (Davoodi and others, 2022). Credibility can also be supported through institutional and procedural reforms that introduce greater transparency surrounding the fiscal adjustment path. This would enable real-time, ex-ante assessment of the fiscal strategy by the wider public (e.g., markets, press, civil society). This can be achieved by reporting on the assumptions underlying the adjustment path and explicitly costing the policy measures that are driving the adjustment. As noted earlier, an assessment of the risks surrounding the fiscal plan and associated contingency plans should also be presented because this also helps build credibility around the baseline projections. In many cases, medium-term fiscal plans are based on optimistic assumptions for revenue growth, which makes achieving the fiscal objectives more difficult. To

circumvent this, some jurisdictions (e.g., Canada, United Kingdom, Netherlands) use independent economic projections to develop their revenue forecasts. Alternatively, the budget economic forecast can be compared to consensus forecasts, with an explanation for any large deviations.

Fiscal Rules and Anchors for India

9. In the aftermath of the pandemic, the debt target specified by the FRBM Act is no longer appropriate and a new fiscal anchor is needed. Public debt levels in India and many countries are now well above what was considered 'safe', casting doubt on the relevance of such targets (Caselli and others 2022). Although fiscal rules have come under such criticism, there is evidence that placing numerical targets on broad budget aggregates can help contain deficits. Fiscal principles or standards which move away from numerical guides towards broader guidelines for fiscal responsibility work well in countries with high levels of fiscal transparency and where there is active discourse, including amongst the voting public, on fiscal sustainability (IMF, 2021). For India, general government debt above 66 percent of GDP is estimated to have a detrimental effect on growth, but with current debt levels at around 81 percent of GDP, returning to these debt levels in the near future is not realistic (Pattanaik and others, 2023). What is needed as part of the revamped MTFF is a medium-term numerical anchor and fiscal strategy that are consistent with India's development goals, while rebuilding fiscal buffers at an appropriate pace. Numerical fiscal rules signal the government's intentions clearly and increase accountability, while the broader framework can incorporate flexibility in response to shocks (see discussion on escape clauses below).

10. Globally, it is common to have a debt rule that is operationalized using limits on expenditure or the budget balance. In 2021, out of the 105 jurisdictions with a fiscal rule, one third had a debt rule with a deficit limit and expenditure ceiling, while another quarter had a debt rule with a budget balance rule (Davoodi and others, 2022).

- If a *debt anchor* is chosen, staff recommend that it should be set sufficiently below the debt limit so that in the face of shocks, there is only a low probability of breaching the limit. The estimate of the debt limit can be guided by the level of primary balance that can be sustained over long periods—if debt surpasses the debt limit it becomes unsustainable as it would require unrealistically large primary surpluses to contain debt growth.

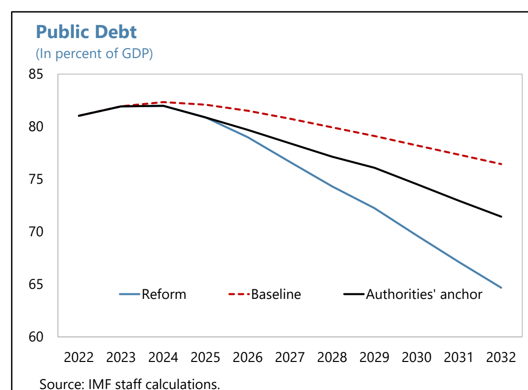
- *Deficit limits* could contribute to pro-cyclical fiscal policy, though this can be mitigated by having more flexibility in the framework or targeting cyclically adjusted (i.e., structural) fiscal balances. The challenge then comes from estimating the cyclical component and communicating this to the wider public. Since FY2022/23, the de-facto fiscal anchor for India has been a general government deficit target of 7.5 percent of GDP by FY2025/26.

- *Expenditure rules* are less pro-cylical, but could mute the incentive to raise additional revenues. These rules are more common in advanced economies, while debt rules are more common in developing economies (Davoodi and others, 2022). This could reflect the untapped domestic revenue mobilization potential in developing economies, including India, which can fund

additional expenditures.[8] India's public and private expenditure needs to reach the sustainable development goals in health, education, water and sanitation, electricity and roads are significant, estimated at 6.2 percent of GDP per year (Garcia-Escribano and others, 2021). Quantitative fiscal simulations for India illustrate that it is possible to increase capital expenditure, while maintaining fiscal objectives (Akin and others, 2017).

11. Regardless of the rule chosen, fiscal plans should incorporate a comprehensive risk assessment, including through a debt sustainability analysis. One such framework is the IMF's Sovereign Risk and Debt Sustainability Framework (SRDSF), presented in Annex IV, which assesses risks in the short, medium, and long term. The fiscal risks analysis discussed earlier should also inform the medium-term plan and can be used to calibrate alternative stress scenarios in the debt sustainability analysis. The SRDSF considers stress tests based on the realization of contingent liabilities, macro-fiscal shocks, maturity shortening and debt holder shocks. Fiscal plans should take into consideration long-term risks and challenges, such as climate change, facing the economy. The investment needed to reach net zero by 2070 for India has been estimated at between 4 and 8 percent of GDP per year (Ghosh and others, 2023). If India were to finance this investment with the current mix of funding sources, this would push debt to over 130 percent of GDP and increase annual financing needs to around 27 percent of GDP per year (see Annex IV Figure 6). There should also be consistency between the medium-term anchor and the operational rules; currently, the fiscal deficit is defined more narrowly than the stock of debt[9].

12. India's fiscal adjustment path needs to be more ambitious than in the baseline to rebuild fiscal buffers at a faster pace. For India, favourable debt dynamics imply that debt would stabilize even when running persistent primary deficits. Based on currently announced policies, the primary deficit gradually narrows to around 2 percent of GDP by FY2028/29[10]. Maintaining this deficit and assuming nominal economic growth of 10.5 percent and interest rate at 6.25 percent implies that debt would eventually stabilize at around 57 percent of GDP (see SRDSA Annex IV for macroeconomic assumptions). However, starting from current debt levels, this would take decades to reach; in ten years debt is still above 76 percent of GDP. Given the shocks that India has been subject to, this path does not rebuild buffers at a sufficient pace and debt could potentially



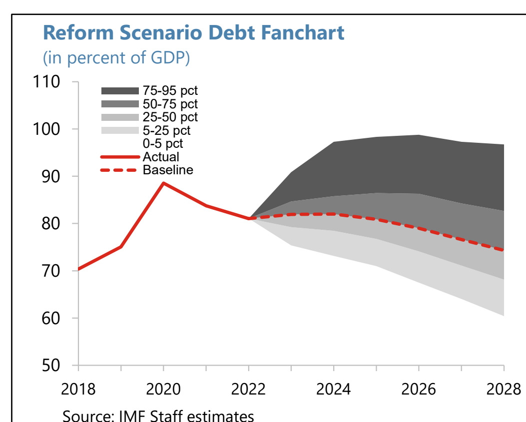
[8] One way to address this is to make the expenditure path conditional on revenue performance (see Brazil example in Box below).

[9] The fiscal deficit for the center is defined as flows recorded under the Consolidated Fund of India, whereas the debt measure includes these flows as well as liabilities recorded in the public account and financial liabilities of entities owned or controlled by the central government which it repays or services (Blagrave and Gonguet, 2019).

[10] For comparison, in the five years prior to the pandemic, the primary deficit averaged 2.2 percent of GDP and in the ten years preceding the pandemic the primary deficit averaged 2.6 percent of GDP.

reach over 100 percent of GDP in the medium term (see fanchart in Annex IV, Figure 6). Similarly, the authorities' de-facto fiscal anchor implies a primary deficit of 1.5 percent of GDP, and maintaining the primary deficit at this level would see debt remain at elevated levels, reaching 71 percent of GDP by FY2032/33. Following staff's proposed reform scenario and targeting a primary deficit of 0.4 percent of GDP by FY2027/28 would rebuild buffers at a faster pace, with debt reaching 74 percent of GDP in FY2028/29 and 65 percent of GDP by FY2032/33. The reform path makes it likely that debt would remain below 100 percent of GDP over the next five years.

13. Escape clauses introduce flexibility within the rules, allowing fiscal policy to respond to large economic shocks. International experience suggests that they should specify: a limited and clearly defined set of events that would trigger their activation; the authority who can activate the clause; the timeline and procedures for returning to the fiscal rule; an effective control mechanism and a good communication strategy (Gbohoui and Medas, 2020)[11]. India's escape clause limited the deviation to 0.5 percent of GDP and was insufficient to respond to a shock as large as the pandemic. Going forward, the size of the allowed deviation should be reviewed. Importantly for India, the activation of escape clauses should be accompanied by a medium-term plan to either return to the anchor or a review of the anchor in line with the new economic environment. Since escape clauses are triggered during a period of heightened economic uncertainty, clarity on the medium-term fiscal plan is even more important to anchor expectations and demonstrate commitment to sustainability. The plan should demonstrate that the adjustment path would restore fiscal sustainability in the aftermath of the crisis.



Summary

14. The review of the FRBM Act, following its suspension during the pandemic, provides an opportunity to strengthen India's MTFF to align it with international best practice and incorporate lessons from the pandemic. Areas of improvement include (i) a stronger link between the MTFF, fiscal objectives and the budget process, (ii) a comprehensive assessment of fiscal risks and mitigation strategies, and (iii) closing data gaps. Part of the revamped MTFF should be a medium-term anchor and fiscal rule that are consistent with India's development goals, while rebuilding fiscal buffers at an appropriate pace and maintaining flexibility in the face of shocks. The anchor should be a fiscal aggregate which can guide overall fiscal policy and ensure a path to sustainability. The chosen anchor and rationale for the choice, should be communicated to the wider

[11] Some countries also have quantitative benchmarks for when escape clauses are triggered. For example, in Ecuador the escape clause is triggered when the projected annual economic growth is 2 percentage points below long-term economic growth and a negative output gap is expected.

public. Medium term plans should operationalize fiscal rules that are consistent with meeting the anchor. To do this, they need to be well integrated into the annual budget process.

Returning to Fiscal Rules: Country Examples

Countries are beginning to reinstate fiscal rules following widespread deviations during the pandemic. Globally, over 30 countries activated escape clauses, 20 modified the limits specified in their rule and many, including India, opted to suspend their fiscal rules (Davoodi and others, 2022). This section provides selected examples of countries that have begun reinstating their fiscal rules, including those that have taken the opportunity to revise their rules.

European Union

In April 2023, the European Commission (EC) put forward a legislative proposal to reform and simplify its fiscal rules. The proposals seek to move to a more risk-based surveillance framework that puts public debt sustainability at its core, while promoting sustainable and inclusive growth, and aims at strengthening national ownership by requiring each member state to present a medium-term fiscal plan, covering investment, structural reforms and fiscal policy for the upcoming four years. While high-debt countries are required to present a plan that convincingly demonstrates a downward trajectory for public debt to GDP, countries themselves set the policies underpinning compliance with targets, operationalized through multi-year expenditure targets. Member States will present annual progress reports to facilitate more effective monitoring and enforcement of the implementation of these commitments. A minimum adjustment of 0.5 percent of GDP per year will have to be implemented so long as the overall deficit remains above 3 percent of GDP. The debt and deficit benchmarks of 60 percent of GDP and 3 percent of GDP, respectively, would remain. Member states with debt and deficit above these benchmarks would be issued a country-specific, 'technical trajectory' by the EC to guide expenditure targets. The adjustment period in the Commission's proposal is four years—at the end of which debt needs to be put on a downward trajectory. Countries implementing ambitious structural reforms or public investments can extend this adjustment period by up to seven years. The activation of escape clauses would be determined by the European Council, based on the recommendation of the EC. The proposals, which emphasizes a risk-based framework and focuses on medium term fiscal strategies, are broadly in line with IMF Staff recommendations. IMF Staff also recommend that (i) a stronger role for national fiscal institutions, including to assess fiscal plans; and (ii) introduction of an EU fiscal capacity (Arnold and others, 2022).

Brazil

In March 2023 Brazil announced annual targets for the primary deficit for 2024 to 2026, aiming to reach a primary surplus of 1 percent of GDP by the end of this period. The new fiscal rules place a cap on spending growth to 70 percent of revenue growth in the previous 12 months, it is also limited to between 0.6 and 2.5 percent above inflation. There are penalties for non-compliance, if deficit targets are not met, expenditure growth would be restricted to 50 percent of revenue increases. The new fiscal framework was well received by markets, Brazil's credit rating outlook was upgraded from stable to positive by S&P in June 2023 due to better-than-expected performance as well as the emerging fiscal framework which reduced uncertainty regarding fiscal policy. IMF Staff welcomes the authorities' commitment to improve the fiscal position, guided by the new fiscal rule. Staff recommended a more ambitious fiscal effort, anchored in an enhanced fiscal framework, that builds on the new rule.

Indonesia

Indonesia's deficit ceiling of 3 percent of GDP was relaxed from 2020 to 2022. The debt ceiling of 60 percent of GDP was not eased as Indonesia entered the pandemic with government debt of 30 percent of GDP, well below the ceiling. Returning to the deficit ceiling was achieved one year early, with a deficit of 2.4 percent of GDP in 2022. The authorities have re-affirmed their commitment to the deficit ceiling with a budgeted deficit of 2.8 percent of GDP in 2023. Debt reached 40.1 percent of GDP in 2022. IMF Staff considered the deficit ceiling to be an appropriate and credible anchor. A medium-term strategy that clarifies medium-term budget objectives, risks and contingency policies is needed to support the development agenda.

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Annex VI. Recent and Planned Capacity Development

Surveillance/Program Priorities	Recent CD Activities	Planned CD Activities
• Enhancing policy space through a credible and clearly communicated medium-term fiscal consolidation strategy. • Financial sector and regulatory policies and financial structural reforms, including promoting governance to safeguard the resilience of the economy. • Steadfast implementation of announced and additional structural reforms.	• TA on fiscal-related issues at the state level (Medium-term fiscal framework and fiscal strategy, cash management, commitment control, strategic budgeting, performance measures, budget documentation etc. See box below for specific examples) • Technical mission to review the RBI's stress testing model framework. • Closing G20 data gaps, including by organizing customized Government Financial Statistics (GFS) workshop for officials. • Real sector statistics: updating CPI and developing double deflation procedures to derive estimates of GDP in constant prices, and the use of VAT data for GDP compilation.	• Ongoing workplans in FY2024 include (i) TA and training on fiscal issues- all at the state level (Medium term fiscal framework, strategic budgeting, cash management, commitment control, fiscal risks, budget documents and performance measures; (ii) TA on compilation of financial accounts and balance sheets; (iii) TA and training on compiling a producer price index for services (iv) macro, monetary, fiscal, and debt-related cohort training at the national level, including training for incoming economists and mid-career officers at the Reserve Bank of India; probationary officers in the Indian Civil Service, including the Indian Economic Service, and the Indian Administrative Service, as well as for the Central Board of Direct Taxes. • Technical dialogue with the MOF's Budget office, with priorities on i. Debt and Cash Management strategies; ii. Budget Formulation including Supplementary Budgets and gender budgeting; iii. Expenditure Management, and iv. Fiscal Analysis & Fiscal Forecasting • Enhancing technical cooperation with the RBI's Financial Stability Department on the stress testing model framework. • Focusing on AML/CFT issues, including a regional AML/CFT workshop, in the context of India's upcoming FATF (fifth round) assessment, coordinated with the MOF.

Box 1. India: Sub-national Fiscal Reforms: Examples from Odisha and Tamil Nadu

Odisha and Tamil Nadu are implementing an ambitious program of Public Financial Management (PFM) reforms. Amongst other initiatives, these states are developing a medium-term fiscal framework (MTFF) and fiscal risk assessment to help guide fiscal sustainability and navigate shocks to the economy. These PFM modernization efforts are supported by capacity development (CD) from SARTTAC.

Odisha and Tamil Nadu have implemented a set of difficult fiscal reforms and are continuing to work on improving the effectiveness of fiscal policy. Examples of past fiscal reforms include the following.

- Odisha implemented measures in the 2000s that markedly improved its fiscal position, amid strong macroeconomic performance. The measures include: a series of revenue mobilization effort; a favorable revenue award under the 12th Finance Commission; and expenditure rationalization measures, including a freeze on public sector hiring. This fiscal consolidation was supported by PFM reforms, such as the development of a fiscal framework that was diligently adhered to. As a result, Odisha reduced debt to 15 percent of GSDP in FY2012/13 following a peak at 51 percent in FY2002/03. At the same time, Odisha's economy grew by an average of 9.1 percent, 1.5 percentage points above national average, and the authorities reported a 25-percentage point reduction in the poverty rate between FY2004/05 and FY2020/21.

- In 2022, Tamil Nadu announced a major package of electricity sector reforms that are intended to place the electricity SOEs on a sustainable financial footing. Electricity tariffs for commercial consumers were increased by 25 percent, for the first time since 2012. A formula-based annual tariff adjustment mechanism was also introduced, though subsidies for certain customers remains. Reports suggest that these reforms reduce contingent liability risks for the state and that a bailout could cost the Tamil Nadu budget 5.2 percent of state-level GDP (Mukherjee and others, 2022).

Currently, SARTTAC is working with both states to modernize PFM to support each state's ongoing fiscal reforms. Engagement with Odisha began in 2019 and covers CD in MTFF, fiscal risk assessment, commitment control and cash management. SARTTAC's cooperation with Tamil Nadu began in 2021 covering the MTFF, strategic budgeting, fiscal risk management, budget communications, and cash and public investment management. Both engagements have brought tangible benefits to these states and provides a good example of fiscal governance to other Indian states. For example, Assam has benefitted from peer learning experiences on PFM reforms organized by SARTTAC with Odisha, Tamil Nadu and other Indian states. SARTTAC is now providing CD support to Assam with a focus on strategic budgeting and the MTFF, performance budgeting and budget documentation, and fiscal risk management. Officials from these and other states have also joined selected regional training in SARTTAC to expose them to international good practices in area such as cash, fiscal risk and public investment management.

Odisha's MTFF and fiscal risk assessment helped the state navigate shocks to the economy. Odisha's authorities noted that the MTFF, particularly assessing the impact of upside and downside risk scenarios on public finances enabled them to prepare a sound strategy to respond to economic shocks, which served them well during the pandemic. The authorities also noted that completing a fiscal risk assessment helped in formulating appropriate mitigation measures. Odisha's experience in working with SARTTAC to build capacity in managing fiscal risks was presented at the 2022 Spring Meetings.

Tamil Nadu has worked diligently to improve budget transparency, including through the release of a Citizen's Budget. Tamil Nadu, with the support of SARTTAC, released a Citizen's Budget for FY2022/23. The Citizen's Budget summarizes and explains basic budget information using simple, clear language that can be understood by a broad target audience. It outlines the government's economic and fiscal policy trends as well as revenue and expenditure decisions. Tamil Nadu's experience in improving their budget documentation and transparency was showcased as part of a peer-learning exercise between Indians states convened by SARTTAC.

Annex VII. An Application of the Integrated Policy Framework (IPF) to Managing Adverse Scenarios in India[1]

1. **India's economy remained strong notwithstanding external shocks**. Growth has been supported by robust domestic demand. Headline and core inflation, which had been elevated last FY due to a war-induced commodity price surge as well as the impact from pent-up demand, have eased. India faced strong external pressures beginning in March 2022 as advanced economies simultaneously tightened monetary policy in response to high inflation and global oil prices spiked following the war in Ukraine. These led to Rupee depreciation against the US dollar and a decline in FX reserves, partly reflecting foreign exchange intervention (FXI) by the Reserve Bank of India (RBI). Nonetheless, the pressures have reversed, with capital inflows gaining pace and replenishing FX reserves.

2. **India's economy is faced with global headwinds amid high uncertainty**. Inflation could remain high and even rise on the back of further shocks, including from an intensification of the war in Ukraine and weather-related shocks. Global financial sector turbulence could return on the back of inflation surprises and expectations of further central bank rate hikes. These shocks could lead to a renewal of external pressures on India, as investors' risk appetite shifts toward safe havens. These downside risks, if materialized, could lower India's growth, elevate inflation, and potentially give rise to financial sector stress. To manage these consequences, macroeconomic policy management will have an important role and the policy mix will have to be carefully calibrated.

3. **Guided by the Integrated Policy Framework (IPF), this annex analyzes the appropriate policy mix for India in response to adverse shocks**. Under the IPF, optimal policy combinations depend on country characteristics and underlying frictions as well as the nature of shocks.

The model is calibrated to reflect India's following characteristics:

I. ***Robust growth, high inflation, and ample external buffers***. India's economy has recovered strongly from the pandemic. The output gap is effectively closed. At the same time, inflation has moderated significantly from its peak, but it is still above the mid target of 4 percent. India's external position is assessed to be moderately stronger than implied by fundamentals and desirables policies, with foreign exchange reserves covering more than 150 of ARA metric at end-2022.

II. ***Considerable amount of dominant currency invoicing***. In 2019, almost 90 percent of India's total exports and imports were invoiced in US dollars (Boz et al, 2019). Where dominant currency pricing and financing are widespread, the short-term response of trade volumes to exchange rates is likely to be more muted and to manifest mostly through imports while export firms are naturally hedged. Therefore, to counteract substantial macroeconomic shocks or external imbalances, more significant exchange rate shifts may be required and may justify

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[1] By Chen, K., Kolasa, M., Linde, J., Schneider, P., Suphaphiphat, N., and Wang, H.

supportive macroeconomic policies, including FXI when large exchange rate fluctuations carry adverse side effects (Adler et al, 2020).

III. ***IPF Frictions***: While the exchange rate should continue to act as a shock absorber, the IPF provides guidelines on the use of FXI as well as principles for the specific "use cases" tied to key IPF frictions: (A) to address destabilizing premia from arbitrage frictions in shallow FX markets; (B) to counter financial stability risks due to FX mismatches; and (C) to help preserve price stability when exchange rate changes risk de-anchoring inflation expectations.

- **FX mismatches appear to be contained**: India's external borrowing is relatively small compared to its peers, with half of foreign currency denominated borrowing hedged as of June 2023.[2] In 2020, the RBI rolled out measures that deepened its FX markets, such as longer trading hours, merging facilities for residents and non-residents, free cancellation and rollover of contracts and relaxation of underlying asset requirements to facilitate FX transactions and develop onshore NDF markets which potentially help limit the exposure to FX risks (BIS, 2022). Despite the presence of a large offshore market, some domestic banks are allowed to participate in the offshore NDF market, which has helped reduce the spread between onshore and offshore rates that previously existed (Kumar and Rituraj (2020))

- **Exchange rate pass-through is estimated to be low and inflation expectations are well-anchored**: India introduced a flexible inflation target framework in 2015. Long-term inflation expectations have been, on average, well-anchored. The exchange rate passthrough is relatively low, estimated to be around 7 percent based on RBI's quarterly projection model. Nonetheless, several studies find that the exchange rate passthrough can be asymmetric, where the passthrough in the case of appreciation is larger than that of depreciation.[3]

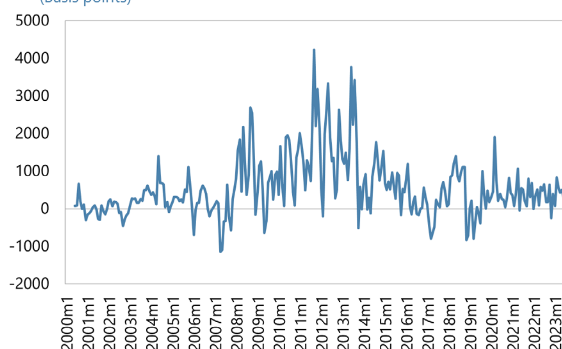
- **Staff analysis points to episodes of destabilizing risk premia from arbitrage frictions in shallow FX markets, while in most cases India's FX market appears deep and liquid**. In general, India's FX market is relatively liquid, with high FX turnover and narrow bid-ask spread. The UIP premium has been largely low and stable, with volatility spiking during certain large outflow episodes, including the global financial crisis, the NBFC crisis in 2018, and, to a lesser extent, the March 2020 COVID-19 outbreak. Nevertheless, FX market dynamics, including the extent of volatility, are hard to fully assess in the presence of FXI.

[2] 46 percent of FX external currency borrowing, excluding FDI borrowings from foreign parent companies, was unhedged in March 2023.

[3] RBI Bulletin February 2023.

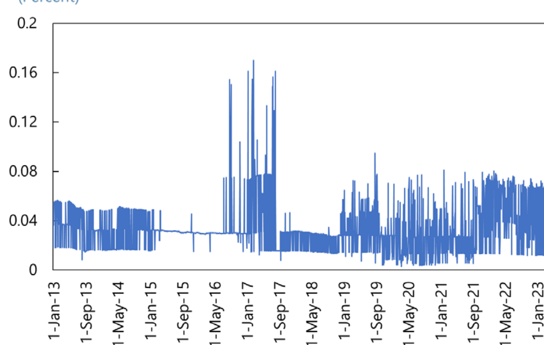
Figure 1. India: Foreign Exchange Market

UIP Risk Premia
(Basis points)



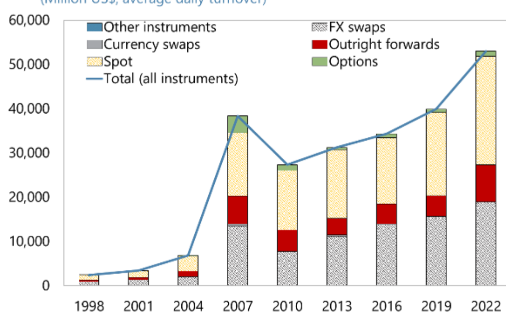
Source: IMF IPF database.

Bid-ask Spread
(Percent)



Sources: IMF IPF database.

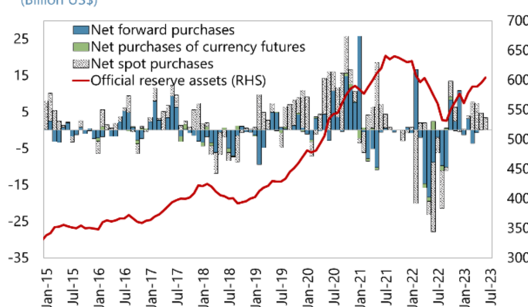
FX Turnover
(Million US$, average daily turnover)



Source: BIS.

https://www.bis.org/statistics/rpfx22.htm?m=2677

RBI FX Intervention
(Billion US$)



Sources: Haver Analytics; and IMF staff calculations.

Sources: IMF IPF database, BIS, Haver Analytics, and IMF staff calculations

- **The estimated IMF's quantitative IPF (QIPF) model[4] suggests that India's FX market depth could be time-varying**. Estimation of the model with Bayesian likelihood methods allowing for time-variation in FX market depth (between highly liquid and shallow FX markets) favors a mostly deep but occasionally shallow market. The regime-switching estimation identifies, for example, —the Global Financial Crisis (2008Q2) and the beginning of the COVID-19 outbreak (2020Q2), as episodes when the market became notably shallower.

- **Nature and size of shocks**: Even in the presence of shallow FX markets, FXI should be used only if shocks are large, posing significant risks to the central bank's objectives, and if FXI can be effective in supporting these objectives. This requires that the shock, such as one resulting in a widening of uncovered interest parity (UIP) premia and a sharp change in the exchange

[4] The model is a linearized version of the Adrian et al (2021) IPF model, extended to include a supply side of the economy, and estimated using Indian data based on Bayesian techniques. Its impulse responses (IRFs) to major shocks are broadly consistent with that from the RBI's QPM model (RBI Bulletin February, 2023).

rate, lies towards the tails of the distribution, thereby triggering frictions in a manner that is likely to cause significant risks to central bank objectives.

4. **A scenario analysis is used to illustrate policy responses guided by the integrated policy framework**. We consider two scenarios and two policy options:

- **Scenario 1**: Global inflation pressure intensifies due to supply constraints as a result of global trade fragmentation and a wider geopolitical conflict. Central banks in major advanced economies respond by raising the policy rate faster than anticipated in the baseline. India's economy is also hit by inflationary shocks and the RBI needs to resume its tightening cycle by raising the policy rate despite a softening of the economy. India faces some depreciation of the exchange rate, but inflation expectations remain well-anchored and there is no large UIP premium shock.

- **Scenario 2**: Disorderly tightening of global financial conditions. This scenario assumes aggressive interest rate hikes which result in global financial market turmoil, leading to a sharp slowdown in the global economy. India's economy is also hit by large UIP risk premium shocks which cause the exchange rate to depreciate significantly. In addition, domestic credit market conditions tighten, output declines due to both negative spillovers from the foreign economy and the tightening of monetary and financial conditions.

- **Policy options**: Impact of the shocks can be mitigated through two policy options; i) interest rate policy only (IR only) allows adjustment in the policy rate and ii) Interest rate policy and the FXI (IR+FXI) allows the use of foreign exchange intervention as a complementary tool.

5. **Under adverse scenario 1, policymakers face a tradeoff between safeguarding price stability and stabilizing output**. Model simulations show that external shocks (stronger price- and wage-pressures in India's most important foreign trading partners) lead to a significant increase in core inflation in foreign economies during 2023-2025, compared to the baseline.[5] In response to a surge in inflation, foreign central banks need to raise interest rates during the same period. Interest rate hikes abroad lead to almost 4 percent Rupee depreciation in real effective terms. The depreciation, together with adverse spillovers on domestic price- and wage- pressures in India push up India's core inflation by almost 2 percentage points at its peak. The output gap, which is effectively closed under the baseline, now turns negative, largely driven by a drop in domestic demand, notwithstanding some gain in net exports. Policymakers face a tradeoff between output and inflation stabilization.

6. **Under the IPF guideline, FXI is not warranted in this adverse shock as the FX market remains deep without adverse currency risk-off shocks**. Under the IR only option, the RBI needs to raise policy rate by about 0.3 percentage points at its peak, compared to the baseline as inflation expectations remain well anchored. Over the medium term, inflation will gradually converge to the

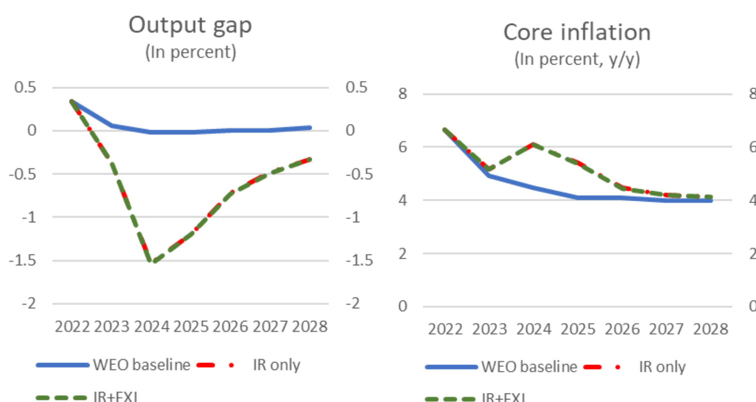
[5] Assuming deep FX market as the UIP premium remains stable.

4 percent headline inflation target while a negative output gap will gradually improve. The use of FXI, in conjunction with the interest rate policy, (IR+FXI) does not provide additional benefits of easing exchange rate depreciation, closing output gap, nor mitigating inflationary pressures.

Figure 2. India: Scenario 1- Global Trade Fragmentation

Note: 0 represents initial quarter when shocks have not yet materialized.

Figure 3: India: Scenario 1- Deviation from WEO Baseline



7. Under Scenario 2, global financial market turmoil, as a result of aggressive interest rate hikes in the US and other key central banks, leads to a risk-off episode with capital outflows and higher domestic risk premiums. Such large shocks, if happening when the FX market is notably shallower, can cause significant exchange rate depreciation. Model simulation suggests that the combination of capital outflow and risk premium shocks leads to a sharp depreciation of the real rupee exchange rate (15 percent at its peak). Despite gaining competitiveness, India's exports would decline as foreign demand declines although net exports would, on average, remain positive as imports also fall. Nonetheless, the downturn in domestic demand would outweigh the improvement in net trade with India's output gap negatively impacted and worsening over time. India's core inflation would increase slightly driven by the depreciation.

8. When destabilizing capital outflows arise in shallow FX markets, FXI can ease inflation-output tradeoff for policymakers. The scenario assumes that large capital outflow shocks occur when India's FX market turns shallower. In such a scenario, the use of FXI could provide better output-inflation outcomes. In particular, an FX intervention of about 2.5 percent of GDP will help moderate inflationary pressures by reducing the UIP risk premia and limiting the extent to which the rupee depreciates (from 15 percent to 5 percent at peak). Core inflation will rise, but by less compared to its rise under only IR policy and will converge to 4 percent headline inflation target towards the end of the projection period. Furthermore, the use of FXI takes some pressure off the policy rate hike, which reduces the drag on domestic activity. Specifically, the output gap under the IR+FXI policy option, despite being negative from adverse shocks, will gradually improve over the medium term when both interest rate and FXI are used, while the output gap under the IR only policy option deteriorates further over time. When both policy tools are used, the smaller policy rate hike also implies a smaller increase in the long-term rate and may be less disruptive to domestic fixed income and funding markets.

9. While FXI should be part of the policy toolkit in dealing with external shocks, it should only be used under certain circumstances. Our second simulation illustrates the benefits of FXI in helping to achieve macro and financial stability when adverse external shocks hit and FX markets are

illiquid. Nonetheless, the scope for using FXI relies on its effectiveness in stabilizing the exchange rate. In some cases, having a meaningful impact on the exchange rate may require the use of large amounts of reserves, making FXI costly, and infeasible if reserves are limited. However, as illustrated by the first scenario, FXI is notably less effective when the FX market is deeper, and our model estimations indicate that India's FX market is often deep and liquid. Accordingly, the effectiveness of FXI in easing inflation-output trade-offs is likely to be limited in normal times when the FX markets are liquid.

Figure 4: India: Adverse Scenario 2, Risk-Off Shock from Global Financial Turbulence

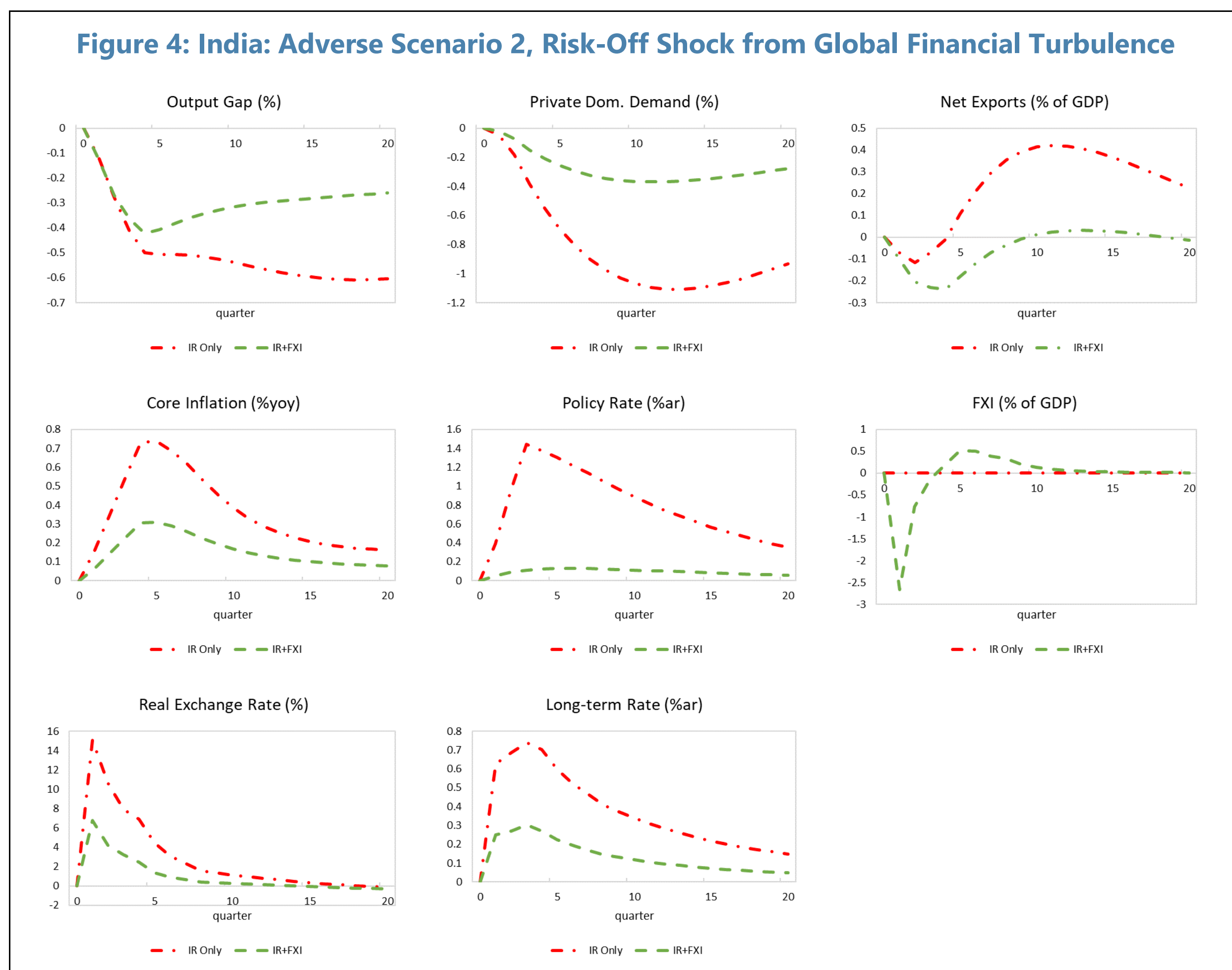
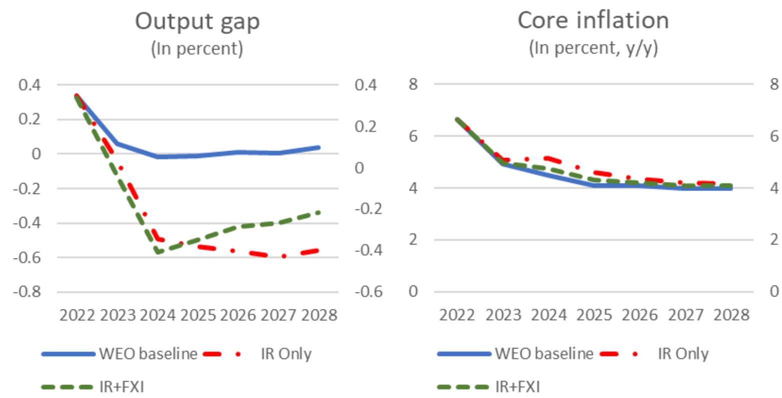


Figure 5. India: Scenario 2- Deviation from WEO Baseline



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Annex VIII. Progress on 2017 FSAP Key Recommendations[1]

Recommendation	Authority	Time frame	Status
Policies to Address Vulnerabilities			
Improve the governance and financial operations of public sector banks (PSBs) and develop a strategic plan for their consolidation, divestment, and privatization.	Ministry of Finance (MoF)	S	• The January 2018 Banking Reforms Roadmap lists six "reform themes", including strengthening public sector banks (PSBs); increasing credit supply; and deepening financial inclusion and digitalization. A first assessment of reform progress was released in February 2019. • More recently, more leadership posts were created at PSBs by separately appointing non-Executive Chairpersons alongside the post of CEO/Managing Director. The Banks Board Bureau, established by the government in 2016 as an autonomous recommendatory body, is now responsible for advising the government, including on the selection and appointment of Board of Directors in PSBs; matters relating to appointments, confirmation or extension of tenure and termination of services of the Board of Directors, and suitable training and development programs for management personnel in PSBs. • Plans announced in August 2019 involve enhancing PSBs' management accountability to the Board. PSBs can now recruit Chief Risk Officers from the market. The terms of directors on the Board's Management Committee will be extended to strengthen their contributions, the loan sanction thresholds for approval by Management Committee of Board (MCB) were raised to enable more focused attention to higher-value loan proposals, and a mandate was given to Boards for training directors and evaluate their performances annually. • The number of PSBs as of March 2021 stands at 12, reduced via consolidation within PSBs space. A majority stake in a PSB (classified as other- PSB) was sold to the state-owned Life Insurance Corporation of India and the bank has been classified as private sector bank since January 21, 2019, for regulatory purpose. • In the recent budget speech, Finance Minister of India has announced that in addition to IDBI Bank, two Public Sector Banks will be privatized. Government of India and RBI are discussing the modalities.

Conduct granular assessments of banks' capital needs and require additional provisions and swift recapitalization and restructuring.	Reserve Bank of India (RBI), MoF	S	• A recapitalization plan was announced in October 2017 to inter alia support credit growth and have PSBs meet regulatory capital requirement. Indian rupee (INR) 881 billion was infused in FY2017/18 (excluding INR 19 billion injected during the year before the announcement of the Plan). The capital injection in FY2018/19 was raised from INR 650 billion to INR 1.06 trillion. An additional INR 700 billion in FY2019/20 and INR 200 billion in FY2020/21 has been infused. In FY2021/22, INR 46 billion has been infused. • Since the third quarter of 2018, the Banks Board Bureau conducts quarterly assessments of PSB capital requirements. These are reported to the government and the RBI. • RBI has also been carrying out an assessment of the capital needs of banks and the same is being shared with the Government of India.
Redesign the corporate debt restructuring mechanisms to make them more flexible.	RBI	S	The Prudential Framework for Resolution of Stressed Assets issued by the RBI on June 7, 2019 (replacing the erstwhile guidelines issued on February 12, 2018) lays out the principles underlying the new regulatory approach for resolution of stressed assets, including early recognition and reporting of default; discretion of lenders to design and implement resolution plans (RPs); and a system of disincentives for delays in implementation of RPs. RPs can be tailored to address the specific nuances of financial stress associated with a borrower and the respective commercial considerations of the lenders, subject to certain boundary conditions and prudential requirements so as to ensure that only viable resolution plans are implemented. Wherever necessary, RBI will issue directions to banks for initiation of insolvency proceedings against borrowers for specific defaults. The in-built flexibility of the Prudential Framework was demonstrated during the COVID-19 pandemic where the RBI could open a window for resolution under the framework with only a few tweaks rather than having to put in place a totally new framework for COVID-19 related stress.
Financial Sector Oversight Framework			
System-wide oversight and macroprudential policies - Retain regulators' role in collecting firm-level data.	MoF	M	At present, regulators continue to collect data directly from financial institutions and financial service providers in their respective domain.

Banking supervision - Review loan classification and provisioning rules in the context of IFRS, and with respect to special loan categories.	RBI	S	Indian Accounting Standards (Ind AS) was planned to be implemented by Scheduled Commercial Banks (SCBs), excluding regional rural banks from April 1, 2018, vide RBI Circular dated February 11, 2016. However, the implementation was deferred for the second time in March 2019, till further notice, pending necessary legislative amendments. In the meanwhile, a Discussion Paper on Introduction of Expected Credit Loss Framework for Provisioning by banks was released by RBI on January 16, 2023, for stakeholders' comments. The proposed approach is to formulate a principle-based guideline for provisioning, supplemented by regulatory backstops, wherever necessary. The key requirement under the proposed framework shall be for the banks to classify financial assets into one of the three categories - stage 1, stage 2, and stage 3, depending upon the assessed expected credit losses on them, at the time of initial recognition as well as on each subsequent reporting date and to make necessary provisions.
- Amend the legal framework to provide the RBI with full supervisory powers over PSBs and clarify its legal independence.	Government	M	No amendments have been made to the legal framework.
Insurance supervision - Introduce a risk-based solvency regime and risk-based supervision.	IRDAI	S	10-member steering committee was formed in September 2017 to implement risk-based capital regime. Consultancy Evaluation Committee has been formed and is in process of finalizing request for proposal document to be issued to the consultants shortlisted. A project committee of IRDAI to study and develop an appropriate framework for risk-based supervision (RBS) submitted a report in November 2017. An Implementation Committee was formed in January 2018, which submitted its interim report in June 2018. IRDAI circulated its intention of moving towards RBS Framework circulated to insurance companies in October 2018. Central Points of Contact were designated for 5 insurance companies on a pilot basis in November 2018, and expression of interest was released in March 2019 for consultancy services for development and implementation of RBS Framework. As no eligible bidders were found, based on Authority's advice, the EOI was once again released in December 2019. The process is yet to be concluded. In

			the meantime, IRDAI had designated Central Points of Contact (CPoCs) for 60 insurers, who will on a periodic basis generate Insurer Profile Summaries that depict the risk profile of insurance. The Authority in its 112th meeting held on 17/03/2021 approved the appointment of a consultant. It has also developed a 'Risk Dash Board' and 'Insurer Profile Summary' formats.
Securities regulation - Transfer legal authority over public-listed company reporting to the Securities and Exchange Board of India and introduce a risk-based review of company disclosures.	Government, SEBI	M	The Companies Act 2013 (CA-13) provides minimum requirements for a company with respect to preparation, circulation, filing and review of various disclosures through specified reports/returns. It provides for constitution of National Financial Reporting Authority as an independent regulator for audit to ensure complete independence, thoroughness, and accountability on the part of auditors. Arrangements for information sharing between the Ministry of Corporate Affairs and SEBI exist, which is simultaneous, and timely disclosure of information is required on the exchange platforms by the companies. SEBI has specified additional sectoral requirements for listed companies through various regulations. SEBI issued a circular in May 2018 to further streamline the procedures relating to non-compliance with all relevant provisions of Listing Obligations and Disclosure Requirements (LODR) and a dedicated division monitors the compliance. SEBI has also developed a smart aggregator model called Early Warning System, which is designed to aggregate financial and other publicly available information, filed by listed companies. This system is being continuously evaluated and tested to include certain alert-based functionalities wherein alerts could be generated based on triggering of threshold limits of certain pre-defined financial and non-financial parameters.
- Adopt a strategy to unify regulation of commodities trading markets.		S	The regulatory framework envisages four level monitoring of listed entities. • At the first level, the company secretaries and boards of listed entities ensure compliance by the entity.

			• At the second level, apart from gate keeping by statutory auditors, SEBI has also mandated secretarial audit of compliances of all listing and other SEBI regulations; this is an independent review performed by practicing company secretaries. • At the third level, stock exchanges monitor compliance with all such listing obligations by listed entities. • The fourth level is the regulatory oversight by SEBI. SEBI is of the view that the current arrangement is working well and going forward, SEBI aims to make it more effective in consultation with stock exchanges. An Expert Committee to study and promote creation of an operational and legal framework to integrate spot and derivatives markets for commodities trading was set up on June 13, 2017. It submitted its report along with recommendations on February 12, 2018, many of which have already been implemented by RBI/SEBI.
10. Financial markets infrastructure oversight - Improve stress testing scenarios and methodologies.	Clearing Corporation of India (CCIL)	S	CCIL revised its credit stress test model in July 2017 to include some hypothetical scenarios along with the historical scenarios. CCIL has made the following revisions to its Stress testing and Default Fund sizing approaches since July 2018: • Since July 2018, stress losses are assessed more conservatively by assuming that the members will default in their incremental Mark-to-Market (MTM) margin and Volatility margin requirements. • Since February 2019, any downward revision in Default Fund at the time of month-end evaluation is subject to a floor of 85% of the prevailing default fund. This ensures that there is no sudden drop in default handling resources and adequate coverage is maintained most of the times. • Since September 2019, in Forex Forwards and Rupee Derivatives segments, CCIL is maintaining the Default Funds as per the Cover 2 criterion, i.e. the sum of the highest stress loss on account of a member and its affiliates and the second highest stress loss on account of a member and its affiliates in the past six months, plus stress losses on account of five weak entities. Consequently, CCIL's contribution towards default waterfall, which

			is linked to the member contributed default fund, has also increased significantly. • Also, since September 2019, a 25% weightage is given to the highest stress loss of a member while determining the member's default fund requirement. This is in addition to the existing parameters, gross position and initial margin, carrying the weightages of 50% and 25% respectively. • Stress testing methodology has been adequately modified to incorporate clearing member structure in Securities, Forex Forwards and Rupee derivatives segments. In these segments, client level losses (ignoring gains) under a given stress scenario are aggregated with their respective clearing member's gains or losses. • Since October 2020, the threshold for intra-month revision in default fund is lowered and made equal to the prevailing level of default fund. This means that in an event, the highest Cover 1/Cover2 stress loss exceeds the prevailing level of Default Fund, additional contributions are called from the members of the segment. Earlier the threshold was set equal to 95% of total prefunded resources (i.e. default fund plus CCIL's Skin-in-the-Game (SIG)). • Since February 2021, with implementation of auction-based default handling in derivatives segments, the Stress Period of Risk (SPOR), associated with the shifts in risk factors used for generating stress scenarios, has been increased from two days to five days in Forex Forwards segment and from three days to five days in Rupee Derivatives segment for trades linked to the Mumbai Interbank Offer Rate (MIBOR) benchmark. • Since October 2021, CCIL maintains prefunded default handling resources as 125% of Cover 1/ Cover 2 stress loss, as the case may be, plus stress losses on account of five weak entities. For each clearing service, members are required to contribute 80% of the requirement or higher, whereas CCIL contributes to the extent of 20% of the requirement (subject to availability of balance in Settlement Reserve Fund (SRF)). Prior to October 2021, in case of an event, if the balance in SRF could be insufficient to meet the increased requirement, then the SRF corpus was pro-rata allocated across all segments and the aggregate prefunded default handling resources for

			each clearing service would be lower than 125% of the respective Cover 1/Cover 2 stress losses. • Since January 2022, with the increase in Margin Period of Risk in Securities segment, the Stress Period of Risk (SPOR) has also been increased from three days to five days. • With introduction of Clearing Service for interest rate swap (IRS) trades linked to Modified MIFOR (MMFOR) effective from April 2023, the Stress Testing process for Rupee Derivatives MIFOR sub-segment is suitably modified to compute stress losses on Mumbai Inter-bank Forward Outright Rate (MIFOR) and MMFOR trade portfolios at aggregate level, with no set-off available against gains on either portfolios. The MIFOR Default Fund is available for management of default of members in either, or both the trade portfolios. The stress testing scenarios and methodologies are reviewed by CCIL on an ongoing basis. In addition, a comprehensive review of the stress testing processes and methodologies in CCIL is done every year by external experts.
Crisis management framework - Resolution legislation should preserve RBI's full supervisory authority over going concern banks, and promote equal treatment of domestic and foreign creditors. - Improve the frameworks for emergency liquidity assistance, deposit insurance, and crisis preparedness.	Government RBI, Government	S M	The consultations with Government of India regarding the proposed legislative framework for resolution of banks and other Regulated Entities (REs) of RBI i.e., on erstwhile Financial Resolution and Deposit Insurance (FRDI) Bill, , now re-phrased as Financial Sector Development and Regulation (Resolution) Bill (FSDRR Bill), 2021 has been a work in progress. The issues relating to duplication of supervisory authority in the pre-resolution phase, strengthening of resolution tools and safeguards, recovery and resolution plans, treatment of domestic and foreign liability holders, and matter of crisis preparedness are expected to be adequately accommodated in the ongoing reconsideration of the Bill, in consultation with the RBI. • The Deposit Insurance and Credit Guarantee Corporation Act, 1961 was amended on August 27, 2021 with a view to ensuring time bound interim payment of deposits to depositors, up to the amount insured, in case of banks with restrictions on withdrawal of deposits placed by the Reserve Bank. These amendments came into force from September 1, 2021.

			• A key amendment to the Act mandates that the payment to depositors is to be completed within 90 days from the date of imposition of such direction by the Reserve Bank. The insured bank has to submit claim after imposition of such restriction within 45 days; and the Corporation has to get the claims verified within 30 days and pay the depositors within the next 15 days. In case the Reserve Bank finds it expedient to bring a scheme of amalgamation/compromise or arrangement/reconstruction, the liability of the Corporation will get extended by a further period of 90 days. Some of the other amendments are as under: The DICGC may raise the limit of 15 paise per ₹100 of deposits on insurance premium with the prior approval of the Reserve Bank taking into consideration its financial position and to the interests of the banking of the country as whole; and (ii) the DICGC, with the approval of its Board, may defer or vary the repayment period for the insured bank to discharge its liability to the DICGC and charge penal interest of 2 per cent over the repo rate per annum for the amount to be repaid to the Corporation in case of delay. Crisis preparedness. Under the Financial Stability and Development Council framework, it has recently been decided to further strengthen the 'Early Warning Group' and the frequency of its meetings has been increased from once in three months to at least every two months. Further, the systemic concerns arising out of a particular entity or entities identified by the sectoral regulator are deliberated, on case-to-case basis, amongst the financial sector regulators at the EWG level. Emergency liquidity assistance. The RBI has a board-approved lender of last resort policy in place that incorporates constructive ambiguity and flexibility that would help limit risk of moral hazard.
Market integrity - Subject domestic politically-exposed persons to adequate due diligence and qualify domestic tax evasion as	MoF	S	The definition of politically exposed persons remains as those who have been entrusted with public functions in a foreign country, including Indians serving in high positions in a foreign country. Tax evasion through foreign income and assets is a predicate offence to money laundering (Section 51 of the Black Money (Undisclosed Foreign Income and Assets) and Imposition of Tax Act,

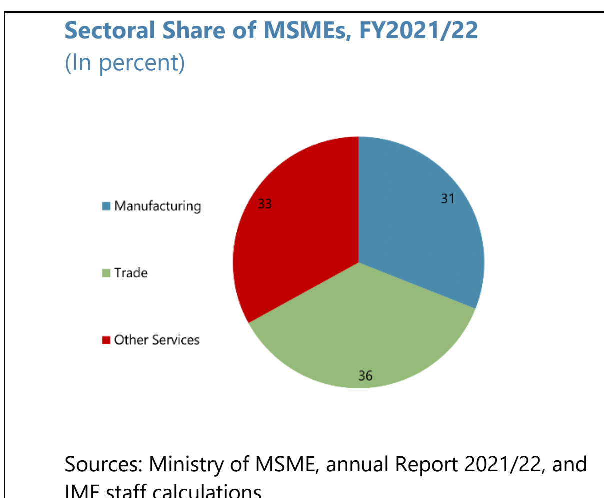
predicate offense to money laundering.			2015). While domestic tax evasion qualifies as a tax crime in the Indian context, it has not yet been made a predicate offence to money laundering.
Market Development			
Progressively reduce the SLR to help deepen markets and encourage lending.	RBI	S	The SLR has been reduced from 22.5 percent in June 2014 to 18 percent of net demand and time liabilities (NDTL) since April 2020. Level 1 High Quality Liquid Assets (HQLAs) for the purpose of computing the LCR, inter alia, include (a) Government securities in excess of the mandatory SLR requirement and (b) within the mandatory SLR requirement, Government securities to the extent allowed under (i) Marginal Standing Facility (MSF), [which is 2 percent of NDTL], and (ii) Facility to Avail Liquidity for Liquidity Coverage Ratio (FALLCR) [which is 16 per cent of the banks' NDTL since April 2022]. Thus, taking into account the carve out allowed under FALLCR and MSF, the SLR has been aligned with the Liquidity Coverage Ratio
Undertake a cost-benefit and gap diagnostic of the PSL program and develop a plan to reduce its scope and ensure it targets underserved segments.	RBI, MoF	M	A review of the PSL guidelines was carried out and revised guidelines were issued to banks on September 4, 2020. Significant changes brought out under the revised guidelines include financing of start-ups; increased limits for renewable energy, including solar power and compressed bio gas plants; higher limits for health infrastructure, increasing the targets for lending to 'Small and Marginal Farmers' and 'Weaker Sections' in a phased manner. Further, to address the regional disparities in the flow of priority sector credit, an incentive framework has been put in place for banks whereby higher weight are assigned for incremental priority sector credit in the identified districts where credit flow is comparatively lower and lower weights are assigned for incremental priority sector credit in identified districts where the credit flow is comparatively higher. Overall, the revised guidelines aim to encourage and support environment friendly lending policies to help achieve Sustainable Development Goals (SDGs).

S = short term, M = medium term.

Annex IX. Financing Micro, Medium, and Small Enterprises[1]

Micro, small, and medium enterprises are a significant contributor to the Indian economy, accounting for at least 19 percent of jobs and 30 percent of output. However, access to finance continues to be a significant headwind for growth in the sector. Both supply and demand factors have constrained credit, as information asymmetries, mismatch between lenders and borrowers, and market frictions feature prominently. While banks are the largest source of MSME lending, nonbank financial companies and fintechs are playing an increasing role as both partner and competitor.

Sectoral Share of MSMEs, FY2021/22
(In percent)



Sources: Ministry of MSME, annual Report 2021/22, and IMF staff calculations

1. **Micro, small, and medium enterprises (MSMEs[2]) are important pillars of the Indian economy**. They contribute large shares to GDP, exports, and employment. These enterprises are spread relatively evenly across sectors. In FY2021/22 the Ministry of MSMEs reported that there were over 63 million unincorporated non-agriculture MSMEs in India, which together employed 111 million people, or about 19 percent of the workforce.[3] In terms of output, MSMEs contributed around 30 percent of GDP annually over the last decade. According to the International Finance Corporation, only about 15 percent of businesses in the MSME sector were registered in 2018, and while the launch of the Udyam online MSME registration portal increased the number of registered MSME substantially, the lack of complete official data on MSMEs suggests the contribution of MSMEs to the Indian economy may be significantly underestimated.[4,5] For instance, the National Accounts Statistics for 2021-22

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[1] Prepared by Patrick Schneider and Margaux MacDonald.

[2] In 2020, the authorities revamped and harmonized the definition of an MSME to use thresholds for turnover and investment as the measurement, rather than just investment (which previously excluded some services firms).

[3] This is based on the 2015-16 National Sample Survey. As of October 2023, there were over 28 million MSMEs registered on the government Udyam portal, which is the Indian government's official online registration portal for MSMEs that was launched in 2020. Estimates of the MSME workforce vary widely. CRISIL (2022) estimates MSMEs employ 60 percent of the workforce, while the Periodic Labor Force Survey estimates that the percentage of workers engaged in unincorporated enterprises owned by households (some of which may be registered under the 'micro' category of MSMEs is 71.4 percent in 2020-21. Together, the MSMEs registered on the Udyam portal state they employ 142 million persons.

[4] Lack of detailed, up to date information about the MSME sector is seen as a problem for policymakers; the last All MSME survey was in 2009, followed by the National Sample Survey in 2015-2016. The Udyam portal will provide more timely information on MSMEs as its coverage broadens, but registration is voluntary and a large share of enterprises in the sector remain unregistered.

[5] According to the IFC, registered MSMEs are defined as MSMEs that file business information such as investment, nature of operations, manpower with District Industry Centers (now replaced by online registration under Udyog

(continued)

estimate the share of the household sector, which has a significant overlap with MSMEs, was around 44 percent of GDP. Regarding trade, MSMEs accounted for about 45 percent of India's total exports in FY22 (down from close to 50 percent in prior years).[6] The top export destinations were the United States, United Arab Emirates, Hong Kong Special Administrative Region, the United Kingdom, and Germany.

2. **Access to finance has long been a headwind for the MSME sector**. Accurate data is lacking but past estimates suggest a large majority of MSMEs have never received formal credit, and rely on informal sources where available, implying a large credit gap of unmet demand and higher costs[7]. Moreover, a plurality of Indian firms[8] reported that access to finance is the biggest obstacle they face for doing business, with the issue somewhat more pressing for small and medium sized firms. Among MSMEs, around one-third are believed to be at least partly or fully financially constrained.[9] lack of access to financing or higher costs of capital could also disincentivize firms from joining the formal economy. Access to finance and potential policy support can also be seen in the context of broader challenges facing MSMEs. For example, integration into local and global supply chains may be tied into the ability to borrow. Some studies suggest enterprises that have joined e-commerce networks have had greater access to financing, while fintech platforms may also be able to directly leverage sales data for credit purposes.[10]

3. **Formal lending to MSMEs is led by banks**, **though the landscape is diverse** with scheduled commercial banks, small finance banks, urban cooperative banks, nonbank financial companies, and increasingly fintech companies playing a role. Banks have regulatory quotas under Priority Sector Lending for MSME lending, including a specific allotment to micro enterprises[11]. The share of bank credit to MSMEs has been broadly stable over the last decade at about 13-15 percent, a decline during the pandemic notwithstanding. The authorities have developed a wide array of loan

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Aadhaar system) of the State or Union Territory in which they operate. The data on enterprise output and performance is periodically tracked by the government agencies. Unregistered MSMEs are those whose output performance is not adequately tracked by government agencies. Estimates suggest only about 30 percent of firms in the unorganized (informal) sector are registered (Mehrotra, 2023).

[6] Source: MSME Minister of State in written reply to Parliament. https://www.financialexpress.com/industry/sme/msme-eodb-msmes-share-in-indias-exports-till-august-in-current-fiscal-nears-fy22-level-govt-data/2919932/

[7]Based on assessment by International Finance Corporation in 2017-2018 and Parliamentary Report 2022.

[8] World Bank Enterprise Survey (2022).

[9] World Bank, IFC, MSME Finance Gap 2018-19 Update. Among the residual of non-financially constrained firms, this includes those that did not apply for a loan and firms that applied for loans that were approved in full.

[10] Annual Survey of Micro, Small, and Medium Enterprises (MSMEs) In India: Leveraging E-commerce for the Growth of MSMEs.

[11] For scheduled commercial banks under Priority Sector Lending, there is a target of 7.5 percent of Adjusted Net Bank Credit (ANBC), or Credit Equivalent Amount of Off-Balance Sheet Exposure, to micro enterprises.

guarantees and refinancing programs (such as CGTMSE[12] and MUDRA[13]) and most recently the Emergency Credit Line Guarantee Scheme (ECLGS[14]). Other programs (e.g. TReDS platform[15]) have been designed to address specific problems, such as delayed receivables that can drive financing needs for working capital, with recent legislation in the FY2023/24 budget also designed to disincentivize buyers from delaying payments to MSMEs Authorities have also worked to expand access to private and public capital markets, through nascent efforts such as the SME IPO Platforms and Self Reliant India Fund. Bank credit growth to MSMEs accelerated in 2021 and surpassed 30 percent y/y in early 2022 (average 20 percent for the year), supported by the economic recovery, the implementation of the ECLGS, and the revision of the MSME definition in July 2020. However, since then bank credit growth to MSMEs decelerated to 15 percent in FYQ123/24 (compared to 15.8 percent increase in total credit).

4. **Characteristics of MSME lending**. MSME lending remains somewhat segmented by lender and borrower type. Loan ticket sizes have increased again after dipping during the pandemic, with the average loan for micro enterprises at R8.1 million compared to R4.4 million for small, and R9.8 million for medium.[16] Private banks make up a majority of lending to small and medium enterprises, while PSBs and NBFCs are more prominent in the micro segment. Accordingly, the average loan size of private banks tends to be larger than that of PSBs and NBFCs. Delinquency rates tend to be lowest for private banks, and the highest for NBFCs, though this may partially reflect composition effects, as private banks devote a higher share to low risk originations[17]. Notably, the share of borrowers classified as high risk is demonstrably higher among medium-sized enterprises, which could reflect factors that stand outside of the credit risk model, including structural bias, greater access to lenders for larger borrowers, or more effective collateral for example. In FY23Q1, loan approval rates—which may also reflect bank effectiveness at converting inquiries into loans—among lower risk inquiries were highest for private banks (39 percent), and lowest at public banks (22 percent), fairly similar for medium risk, and slightly higher for private banks at high risk (where approval rates were considerably lower across all lenders).

5. **Financing challenges can be broadly classified into supply and demand problems**, though information asymmetries, mismatch between lenders and borrowers, and market frictions feature prominently. These challenges can be particularly acute for micro enterprises. On the supply side, historically, lenders (particularly banks) have found the underwriting process costly and less

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[12] Credit Guarantee Fund Trust for Micro and Small Enterprises (CGTMSE)

[13] Micro Units Development and Refinance Agency

[14] ECLGS guarantees totaling 3.61 lakh crore (to 1.19 crore borrowers) have been issued. The program was launched in May 2020, and extended until March 2023.

[15] Trade Receivables Discounting System (TReDS) is a platform allowing the trading, settlement, and discounting of bills and invoices from MSMEs, with eligible participants including banks, NBFCs, and corporates.

[16] FY23Q4, based on Transunion CIBIL Data. Transunion CIBIL is one of the four large credit agencies in India.

[17] Low, medium, and high risk are defined by CIBIL MSME Rank (CMR) scores, developed by Transunion Cibil, which is designed to predict the probability of an MSME becoming NPA in the next 12 months.

straightforward, given the lack of collateral and financial information among MSME borrowers. Moreover, lending to MSMEs may not always be appealing for risk averse loan officers, given the smaller ticket sizes, higher default rates, and potentially challenging collections, despite margins tending to be attractive. Weaker bank penetration in some lower income states and rural areas may also play a limiting factor. On the demand side, prospective borrowers may lack proper documentation to secure loans or believe they are ineligible, while the process of disbursing funds may take too long. Surveys suggest MSME borrowers have been reluctant to apply for formal credit ratings, and traditional credit risk models tend to be a poor fit for firms that lack accurate financial information, have limited capital, and may not be interested in scaling up. In addition, various government programs have overlapping mandates which may be difficult for borrowers to access or understand.[18]

6. The rapidly expanding nonbank financial, fintech, and digital lending landscape has significant potential, t**hough the ecosystem is still developing and may take time to become a driver of growth at the macro level**. Fintechs and NBFCs can help intermediate credit to MSMEs as both partners and competitors to the traditional banking system. Various models exist where fintechs may receive funding directly from banks to lend onwards, or indirectly as a lending agent, often conducting customer outreach, credit analysis, and collections themselves. Lending partnerships through so called "co creation" models, can allow NBFCs or fintechs to leverage the balance sheets of larger institutions, combined with their own platforms and data advantages. Recent regulatory developments have helped clarify the nature of some such arrangements[19] to improve transparency, though supervisory follow up will be needed as the interaction between different players (fintechs, NBFCs, banks) is constantly evolving. More broadly, new initiatives such as the Account Aggregator (for MSMEs), Public Tech Platform for Frictionless Credit, National Financial Information Registry, could also facilitate a smoother credit process for lenders if implemented effectively. Ensuring adequate consumer protection, developing data transparency, and monitoring financial stability risks should continue to be prioritized going forward.

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[18] RBI Expert Report

[19] The RBI released a digital lending framework in September 2022, following by clarification on First Loss Default Guarantees in June 2023, which placed a 5 percent cap on default guarantees and formalized some requirements.

MSME Definition

MSME Classification-New (as of July 2020)

	Micro	Small	Medium
Investment in plant and machinery	<= Rs. 1 million (US$ 12 thousand)	>Rs. 1 million <= Rs. 10 million (US$ 122 thousand)	>Rs. 10 million <= Rs. 50 million (US$ 611 thousand)
Turnover	<= Rs. 5 million (US$ 61 thousand)	>Rs. 5 million <=Rs. 50 million (US$ 611 thousand)	>Rs. 50 million <= Rs. 250 million (US$ 3.05 million)

MSME Classification-Old -Old

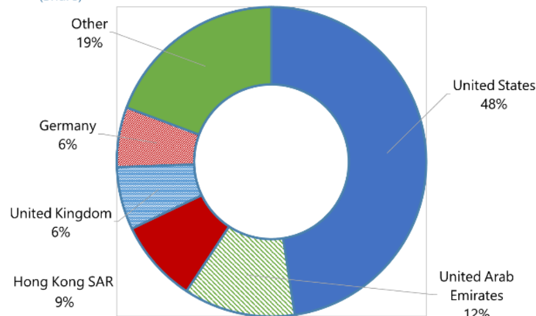
	Micro	Small	Medium
Manufacturing sector-investment in plant and machinery	<= Rs. 2.5 million (US$ 30.5 thousand)	>Rs. 2.5 million <= Rs. 50 million (US$ 611 thousand)	>Rs. 50 million <= Rs. 100 million (US$ 1.22 million)
Service sector-investment in equipment	<= Rs. 1 million (US$ 12 thousand)	>Rs. 1 million <=Rs. 20 million (US$ 244 thousand)	>Rs. 20 million <= Rs. 50 million (US$ 611 thousand)

Notes: 1/US $ conversions are approximate, assuming an exchange rate of 0.0122 $/rupee. 2/Old classification does not include thresholds of turnover.

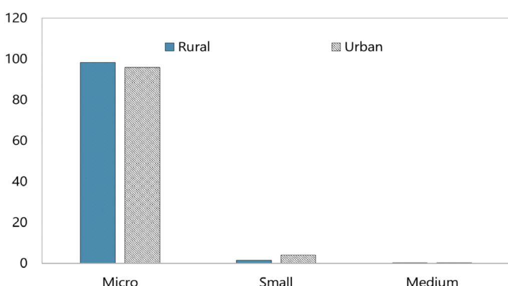
Figure 1. India: MSME: Contribution to the Indian Economy

Registered MSMEs contribute around 30 percent to GDP.

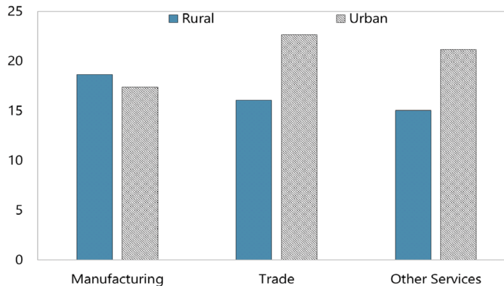
The United States is the top export destination of MSMEs.



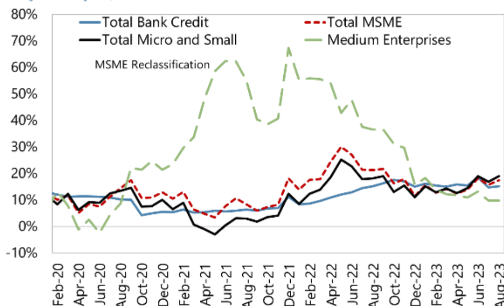
Within the MSME sector, micro enterprises account for the largest share of employment



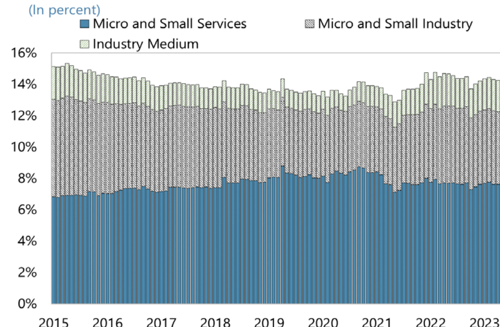
In urban areas, more workers are in trade and service MSMEs.



MSME credit growth has been strong since the pandemic, though it has eased in recent months



Bank credit to MSMEs makes up about 14% of overall lending



Sources: Statista; Ministry of Micro, Small, and Medium Enterprises; MOSPI; The Financial Express; RBI; and IMF staff calculations.
Note: Panel 1 shows the share of MSME gross value added in all India gross domestic product at current prices. In panel 6, total outstanding credit is aggregated from sectoral totals given a structural break in the headline series.

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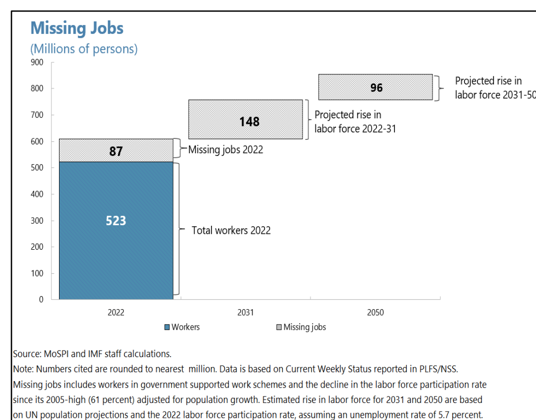
Annex X. Drivers of Growth in India[1]

India has been one of the fastest growing countries globally in recent years. Yet this growth has been uneven, with many sectors far from the technological frontier and many workers still employed in low-productivity jobs, together contributing little to overall value added. For India to harness its full potential, it is critical to understand what has driven growth in the past, where growth can come from in the future, and how workers can both contribute to and benefit from a growing Indian economy.

A. Motivation

1. India has witnessed strong growth in recent years, yet many Indian workers remain in low paying, lower productivity jobs. Real GDP growth has averaged over 6 percent since 2000, on the back of a large and expanding services sector. This growth has lifted an estimated 415 million people out of multidimensional poverty since 2005 (Arbatli-Saxegaard and others, 2022). At the same time, manufacturing sector growth has remained sluggish and over half of all workers remain in low-productive jobs in agriculture, construction, and trade. India needs to create productive, well-paying jobs in labor-intensive sectors for its growing population to achieve higher, more inclusive, and sustainable growth going forward.

2. India needs to create between 145-330 million jobs for its growing population by 2050. India's working age population (defined as 15 years and older) stood at just over 1 billion in 2022.[2] Of this group, 50 percent were working (the labor force participation rate was 53 percent and the unemployment rate 5.7 percent according to PLFS data). Assuming India is at full employment at the current unemployment rate, the country was missing an estimated 3-87 million jobs in 2022.[3] Based on population projections, India will need to create 145-330 million jobs by 2050 to maintain its current labor force participation rate (and its current unemployment rate).[4]



Source: MoSPI and IMF staff calculations.
Note: Numbers cited are rounded to nearest million. Data is based on Current Weekly Status reported in PLFS/NSS. Missing jobs includes workers in government supported work schemes and the decline in the labor force participation rate since its 2005-high (61 percent) adjusted for population growth. Estimated rise in labor force for 2031 and 2050 are based on UN population projections and the 2022 labor force participation rate, assuming an unemployment rate of 5.7 percent.

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[1] Prepared by Cristian Alonso and Margaux MacDonald.

[2] United Nations, World Population Prospects.

[3] The low end of this range includes only 3 million workers who are currently in government work guarantee schemes (MNREGA). The upper end of the range also includes 84 million jobs that would exist had the LFPR remained at its 2005 level of 61 percent. While the 2005 level is from the Employment Unemployment Survey, and not the PLFS, and thus not strictly comparable, a 60 percent LFPR is also the average LFPR of other G20 emerging market economies and thus a reasonable comparator. We count MNREGA workers as missing jobs because these jobs are for otherwise willing workers who cannot find work elsewhere.

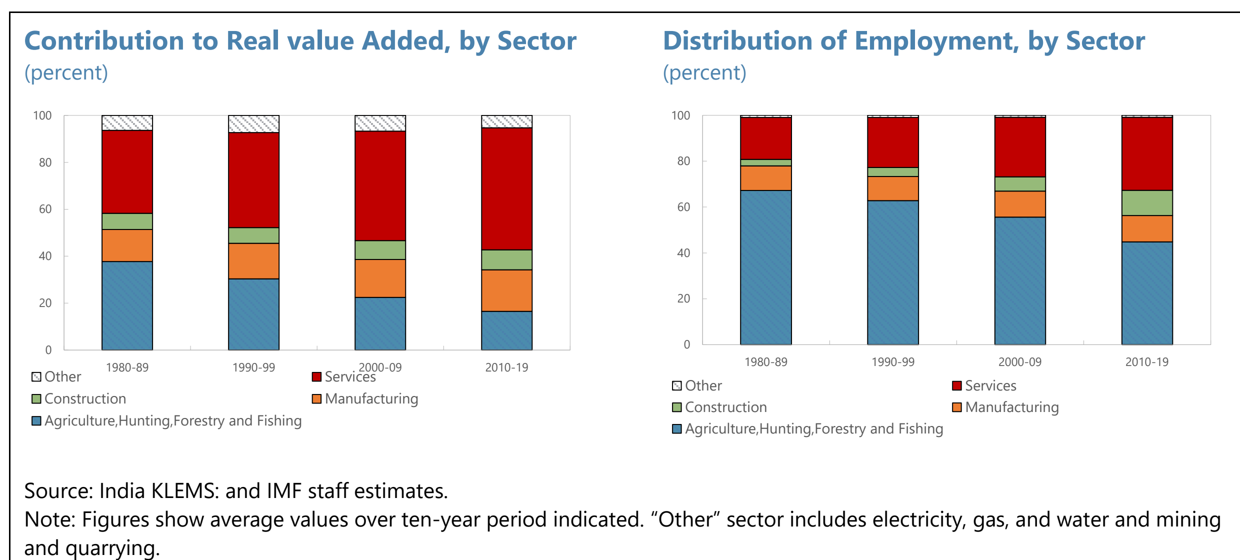
[4] These numbers include missing jobs in 2022. The lower end of the range assumes the current LFPR, the upper end of the range assumes a 61 percent LFRP. This analysis does not incorporate predictions on the future of work and how jobs—and therefore individuals' ability and willingness to work—may change over time.

3. Underemployment is a problem in India as it is in many EMs, but it is difficult to quantify. Our estimate of missing jobs may be a lower bound if one also considers underemployment. The latter includes, for example, those working part time but desiring fully time work, those over-skilled for their jobs (see the policy option section of this annex), and those working as unpaid family labor (especially women, see Annex X). It would also be important to take into consideration the number of non-farm jobs needed to be created. As the Indian economy continues to shift from farm to non-farm work, employment in the categories of unpaid family worker, own-account workers, and casual workers will decline, and more regular wage jobs in urban areas will be needed to absorb this extra labor.

B. Growth and Employment Drivers

4. Economic activity in India has shifted over time from agriculture to services. Agriculture's share of value added declined from over 40 percent in 1980 to 15 percent in 2019. The share of value added in the services sector simultaneously grew from just over 30 percent of value added to over 55 percent. Growth of other major sectors in the economy, including manufacturing and construction, has been relatively flat over this period.

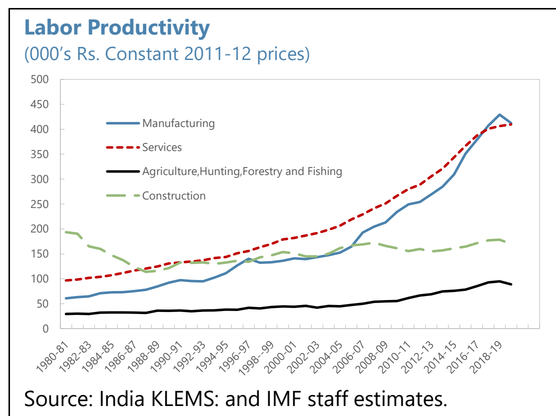
5. While agriculture's share of value added has declined, it has remained the dominant source of employment. The share of workers in the agriculture sector did decline over time but has remained high: over 42 percent of workers are classified as working in agriculture and allied sectors. The decline in workers in the agriculture sector was made up for by a rise in employment in services and construction. While the share of workers in services has risen to about 34 percent since 1980, the sectors' value-added contribution to the economy has increased much more. Construction has also become an important employer, with about 12 percent of workers in 2019. Notably the nature of employment in the construction sector -low-skill, largely casual workers—is similar to that in agriculture, and there is often significant movement of workers between the two sectors, especially in rural areas. Reflecting its sluggish value-added growth, employment in the manufacturing sector has also increased minimally over time.



Source: India KLEMS: and IMF staff estimates.
Note: Figures show average values over ten-year period indicated. "Other" sector includes electricity, gas, and water and mining and quarrying.

6. With a low share of value added and large employment base, productivity in the agriculture and construction sectors has grown slower than other sectors since 1980. In comparison, labor in 2019-20 in manufacturing and services was over 4.5 times more productive than in agriculture. With low productivity workers in agriculture and construction making up over half the Indian workforce, there is significant potential to boost growth by enacting productivity-enhancing reforms to the sectors which will free workers to move to other, more productive sectors. This would also be beneficial to workers themselves, as wages are generally reflective of productivity.

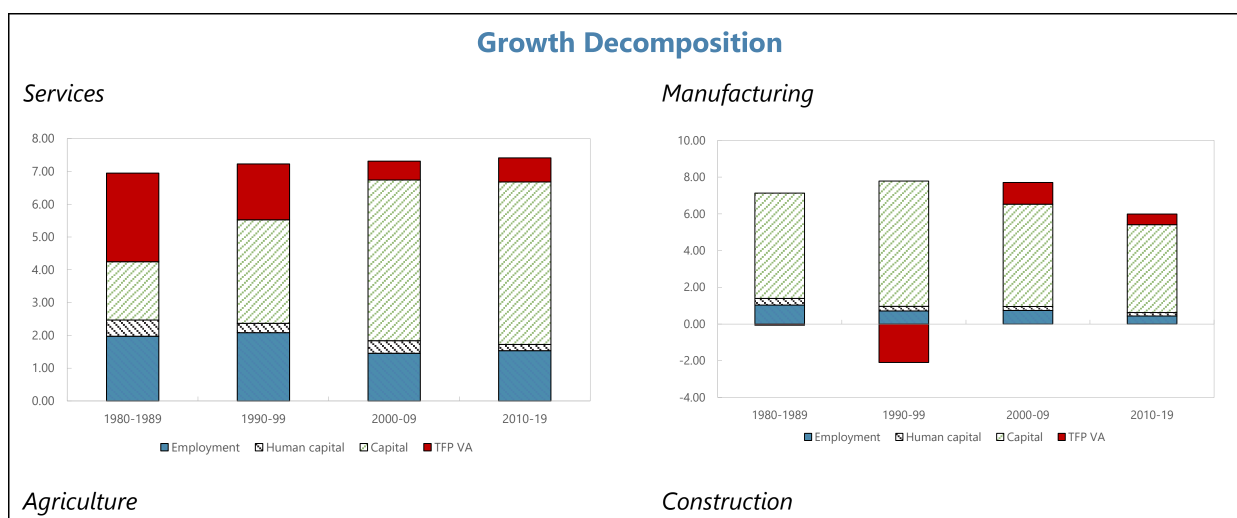
Labor Productivity
(000's Rs. Constant 2011-12 prices)

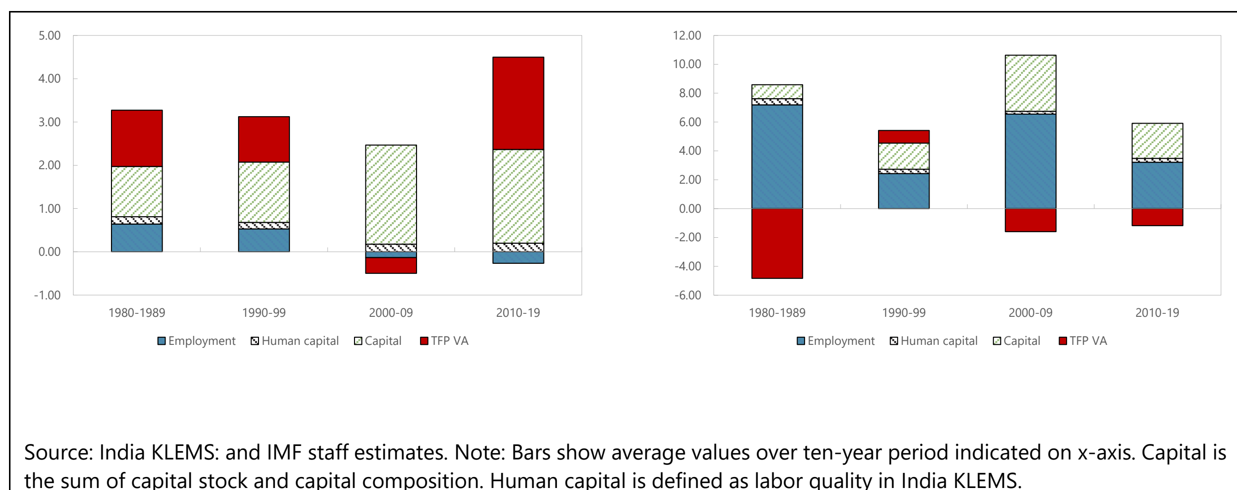


Source: India KLEMS: and IMF staff estimates.

7. Sectoral growth decompositions suggest that physical capital has driven growth across most sectors of the Indian economy. Value added growth in India has shifted away from being labor-driven in the 1970s-80s towards more physical capital and TFP-driven in recent decades. This has been linked to pro-business reforms in the 1980s, market reforms in the early 1990s, the liberalization of the economy and increases in FDI, and rapid growth in the services sectors (Kotera and Xu, 2023, and references therein). On a sectoral-basis capital and TFP have become more important in the services sector in particular, India's main driver of value added. This suggests that while services are largely supporting the Indian economy—broadly on account of the structural reforms—job creation in that sector has not sufficient to deliver the number of formal, high productivity jobs needed to raise growth and fully employ the working age population. The limited contribution of employment to value added in agriculture stems from the overall decline in workers in that sector. For construction, growth has been largely driven by the shift of workers into the sector with little benefits from overall productivity.

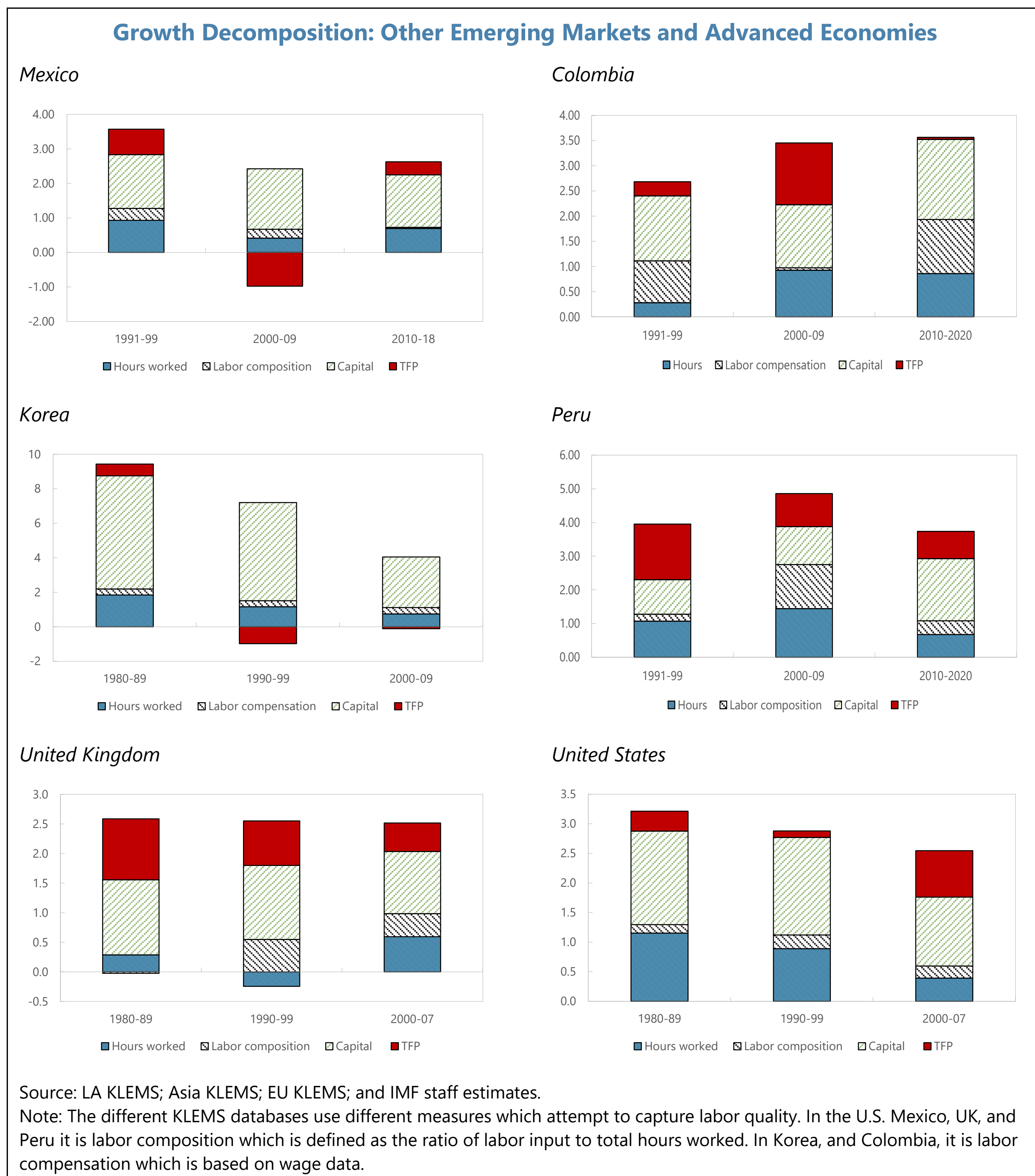
Growth Decomposition





Source: India KLEMS: and IMF staff estimates. Note: Bars show average values over ten-year period indicated on x-axis. Capital is the sum of capital stock and capital composition. Human capital is defined as labor quality in India KLEMS.

8. Emerging market economies tend to have drivers of growth balanced between capital and labor inputs; India's growth recently has however been more capital-driven. Like many other emerging markets, India has a large population of low-skilled workers. Unlike other emerging markets, however, growth in India is driven in large part by capital and TFP (Kotera and Xu, 2023), making it more comparable to advanced economies. For a more detailed comparison of development trajectory of India relative to its South Asian peers specifically, see Salgado and Anand (2023). By supporting the growth of large, productive sectors like manufacturing much of India's labor could be absorbed – and thereby making labor a more important contributor to growth. Furthermore, high quality spending on improving education and training would help boost the contribution from labor quality, as has been observed in other emerging markets.

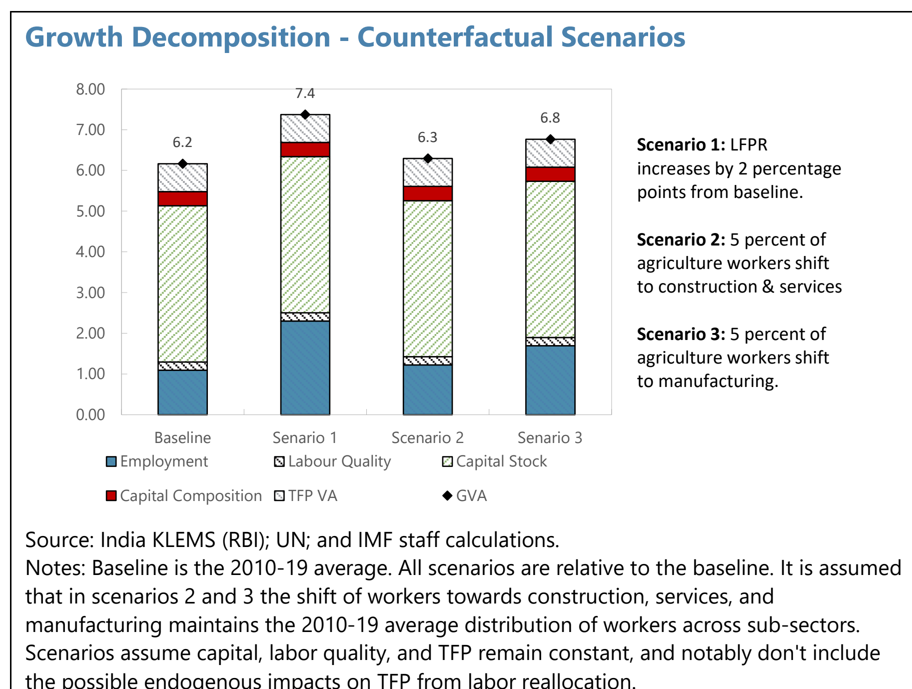


Source: LA KLEMS; Asia KLEMS; EU KLEMS; and IMF staff estimates.
Note: The different KLEMS databases use different measures which attempt to capture labor quality. In the U.S. Mexico, UK, and Peru it is labor composition which is defined as the ratio of labor input to total hours worked. In Korea, and Colombia, it is labor compensation which is based on wage data.

9. **As more productive sectors create jobs, the rebalancing of workers out of agriculture and into more productive work would boost growth**. A simple counterfactual exercise shows that if the labor force increased by 2 percentage points (about 22 million people) or if 5 percent of the agriculture workforce were to shift into either services (including half into construction) or manufacturing, it could contribute up to 1.2 percentage points to value added growth, relative to the recent historical average. This would require an increase in supply of jobs in more productive

sectors like manufacturing, which itself will require additional reforms. This could include reforms to land use, for promoting larger firm sizes and for hiring of more female workers, among others. Furthermore, because workers can't shift seamlessly between most occupations, this may involve some extent of re-skilling, which could further boost growth via increases in human capital.

Growth Decomposition - Counterfactual Scenarios

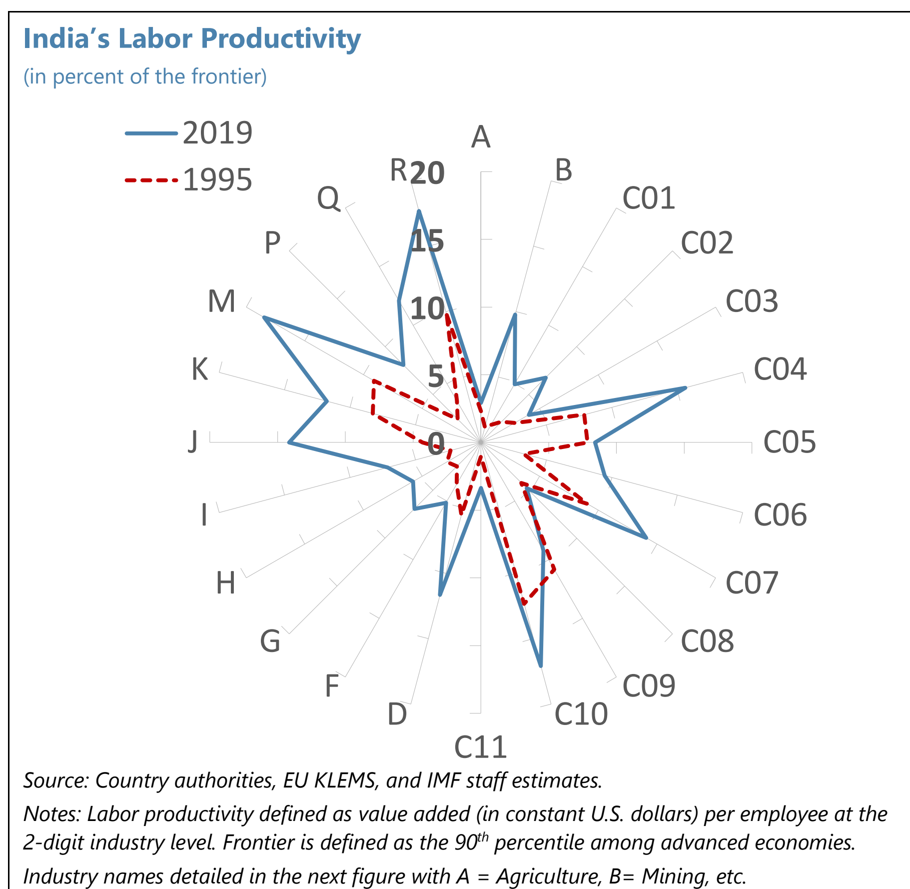


Source: India KLEMS (RBI); UN; and IMF staff calculations.
Notes: Baseline is the 2010-19 average. All scenarios are relative to the baseline. It is assumed that in scenarios 2 and 3 the shift of workers towards construction, services, and manufacturing maintains the 2010-19 average distribution of workers across sub-sectors. Scenarios assume capital, labor quality, and TFP remain constant, and notably don't include the possible endogenous impacts on TFP from labor reallocation.

C. Catching up to the Technological Frontier

10. The catch-up of Indian industries to the technological frontier has been uneven. We compare Indian labor productivity by industry to the technological frontier, which we define as the 90th percentile of labor productivity among advanced economies included in the KLEMS database.[5] Agriculture has remained stuck at low productivity levels since 1995. In 1995, the productivity of a worker in agriculture in India was only 2.3 percent of that observed for a country at the technological frontier. By 2019, it had increased to only 2.9 percent. Catch-up to the frontier was also weak for several manufacturing industries (wood and paper, chemicals, electrical and optical equipment, and other manufacturing). Manufacturing of machinery regressed over this period, moving backwards by 2 percentage points in terms of distance to the labor productivity frontier. Productivity in construction improved marginally, catch-up to the technological frontier was much faster in mining and petroleum refining, as well as information and business services, health, and other services. Overall, services have been more dynamic in catching-up to the technological frontier. Labor productivity in business services is at 18 percent of the frontier.

[5] We define labor productivity as the value added (in constant U.S. dollars) per employee at the industry level. Results are robust to using value added measured in industry-specific PPP-adjusted U.S. dollars.

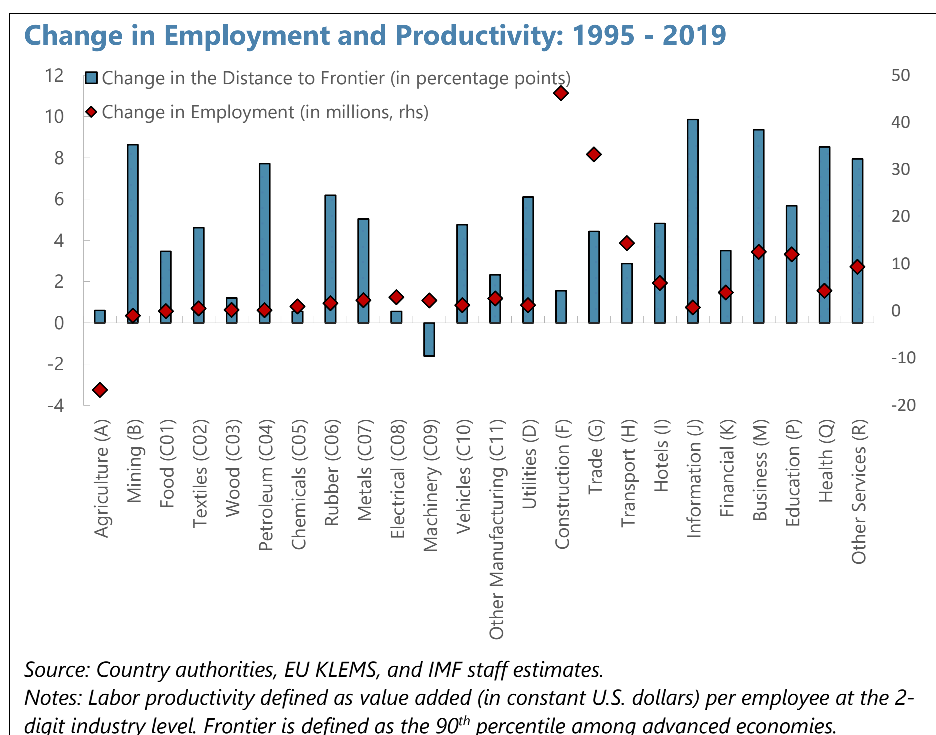


Source: Country authorities, EU KLEMS, and IMF staff estimates.

Notes: Labor productivity defined as value added (in constant U.S. dollars) per employee at the 2-digit industry level. Frontier is defined as the 90th percentile among advanced economies. Industry names detailed in the next figure with A = Agriculture, B= Mining, etc.

11. Reallocation of workers towards more dynamic sectors could accelerate growth and raise wages for Indian workers. Employment in agriculture declined by 17 million between 1995 and 2019, which is encouraging. But with agriculture still accounting for 43 percent of the workers in the country, significantly more reallocation towards higher value-added jobs would be needed. Employment grew the most in construction (46 million) and trade (33 million), both relatively low-productivity industries that exhibited limited catch-up to the technological frontier over the last two and a half decades. Manufacturing added only 15 million jobs over this period, a tenth of the net job creation. Employment in business services did increase remarkably by 13 million workers from just 1.6 million in 1995 to 14 million in 2019, while the industry narrowed the distance to the technological frontier by 9 percentage points—a very positive outcome. Other industries with fast catch-up such as mining, petroleum refining, and information services, have added few jobs as expected given their relatively low labor-intensity. Thus, there is room for India to grow both by accelerating the catch-up to the technological frontier across industries and by reallocating workers from low value-added jobs, particularly in agriculture, to higher value-added jobs in manufacturing and services over the coming decades.

Change in Employment and Productivity: 1995 - 2019



Source: Country authorities, EU KLEMS, and IMF staff estimates.
Notes: Labor productivity defined as value added (in constant U.S. dollars) per employee at the 2-digit industry level. Frontier is defined as the 90th percentile among advanced economies.

12. Strong performance by Indian firms, measured by sales per employee, is associated with size. Sales per employee, an imperfect proxy of labor productivity, can be computed at the firm level for medium and large firms across the world included in the ORBIS database. In line with the results at the industry level, the median productivity of Indian firms is low, averaging 17 percent of the sales per employee by frontier firms across industries. But there are some sectors with firms exhibiting sales per employee closer or even above the frontier, such as manufacturing of jewelry and soap, printing of newspapers, and other professional services. Furthermore, there are 126 Indian firms already operating at the technological frontier in the sense that their sales per employee are above that of the 95th percentile for non-Indian firms. Twelve of those Indian firms at the frontier operate in computer programming or other information technology services, and another seven engage in jewelry manufacturing. These strong Indian performers tend to be large firms. Three quarters of the Indian firms operating at the frontier have assets greater than $100 million whereas only half of the Indian firms not at the frontier have such level of assets. They are also slightly more likely to be foreign-owned, with 10 percent of the Indian firms at the frontier being foreign-owned compared to 7 percent for non-frontier Indian firms.[6] The success of these Indian firms stresses the importance of removing obstacles preventing firms to grow and fostering foreign direct investment. In addition, the presence of these strong performers across industries is consistent with India's increasing diversification and complexity of exports (Nageswaran and Unnikrishnan, 2023; Harvard's Growth Lab, 2023).

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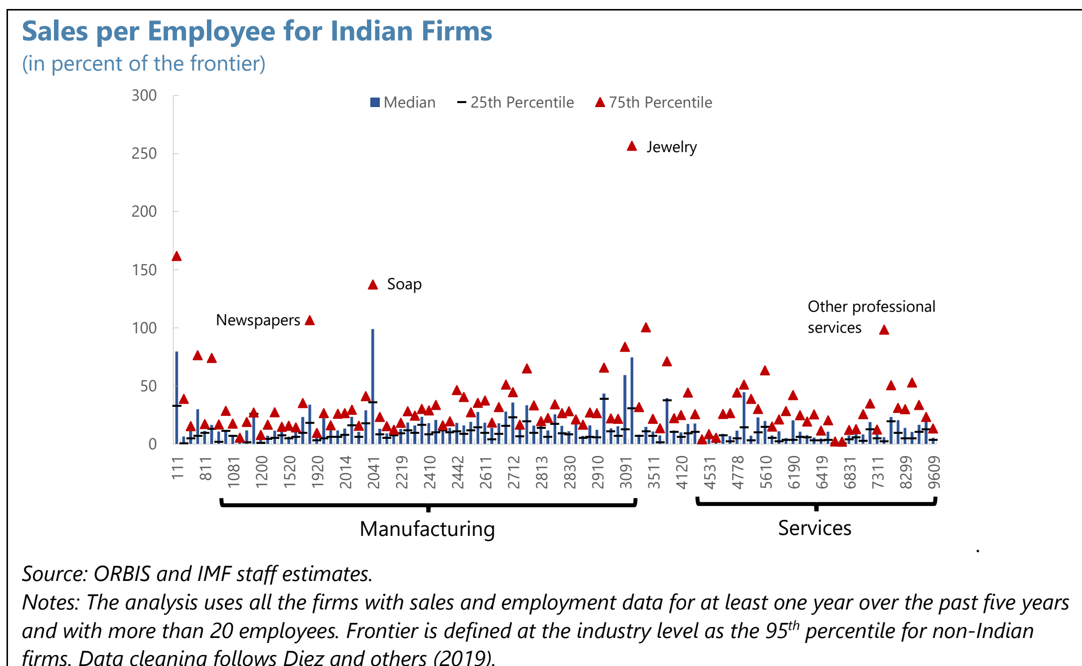
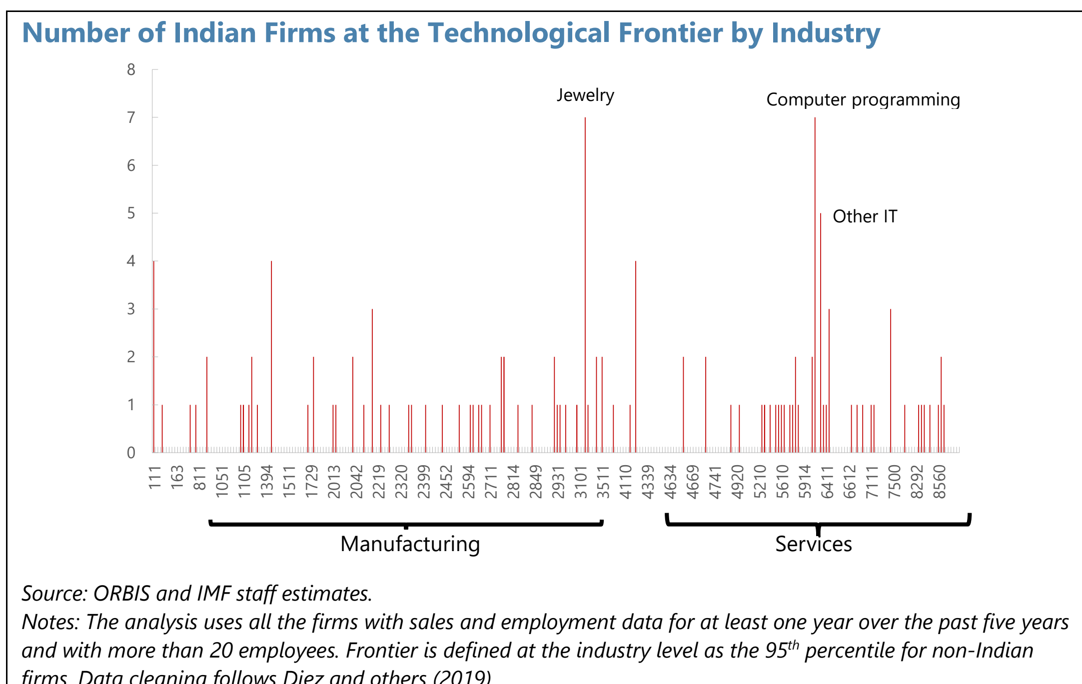
[6] A firm is defined to be foreign owned if its global ultimate owner as identified by ORBIS is not Indian. This correlation is in line with previous literature that has found that FDI can increase productivity (Smarzynska Javorcik, 2004; Zhao and Zhang, 2010: Li and Tanna, 2019).



Sales per Employee for Indian Firms
(in percent of the frontier)

Source: ORBIS and IMF staff estimates.
Notes: The analysis uses all the firms with sales and employment data for at least one year over the past five years and with more than 20 employees. Frontier is defined at the industry level as the 95th percentile for non-Indian firms. Data cleaning follows Diez and others (2019).



Number of Indian Firms at the Technological Frontier by Industry

Source: ORBIS and IMF staff estimates.
Notes: The analysis uses all the firms with sales and employment data for at least one year over the past five years and with more than 20 employees. Frontier is defined at the industry level as the 95th percentile for non-Indian firms. Data cleaning follows Diez and others (2019).

D. Policies Needed to Foster Growth and Employment

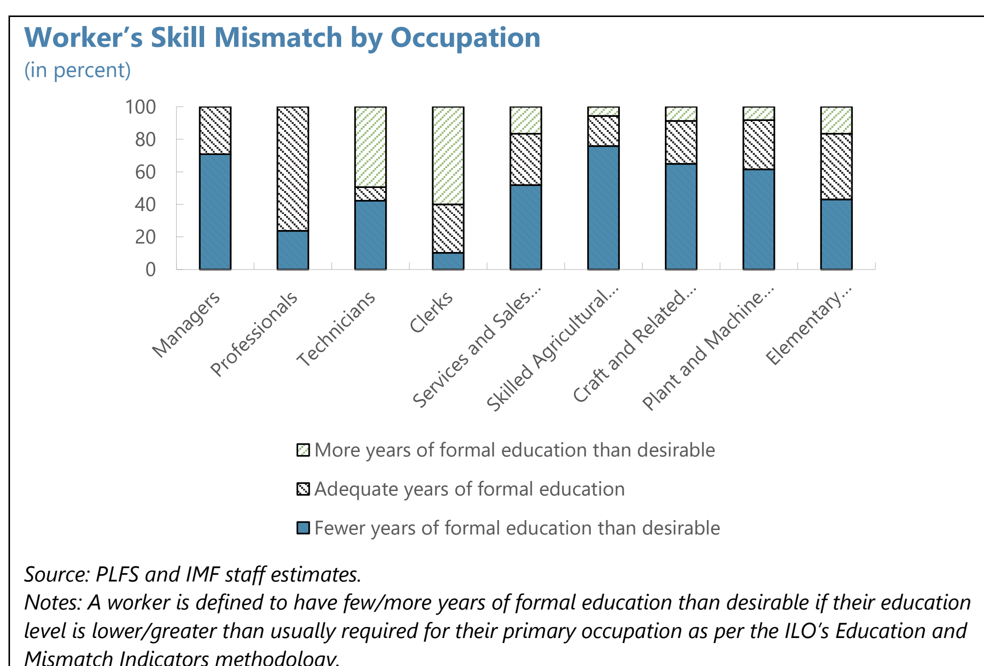
13. Structural reforms can help India accelerate growth and leverage its promising demographic dividend:

- ***Strengthening education and skilling***. Despite significant investments in education and progress in educational enrollment, India's labor force has relatively fewer years of formal education and the quality of its education remains low (ASER, 2023). Only 61 percent of the

population aged 25 and older have at least completed primary education, compared to an average of 71 percent among lower-middle income peers and 89 percent among upper-middle income countries. This translates into skill shortages in the labor force.[7] Three quarters of India's skilled agricultural workers are considered to have fewer years of formal education than desirable because they have not completed primary education. Over 60 percent of craft and related workers and plant and machine operators and assemblers and 52 percent of services and sales workers have similarly had too few years of formal schooling. There are also some pockets of overeducation with workers having more years of formal education than what would be desirable for their occupation. This is the case for clerks and technicians, and appears particularly prevalent in Chandigarh, Puduchery, Andaman & N. Island, Haryana, and Delhi. The authorities are working on addressing these challenges, including through the 2020 National Education Policy aiming to revamp the education system towards meeting their aspirational goals for the 21st century (GoI, 2020). They are also working on a dynamic, industry-centric, and forward-looking skilling ecosystem, including through technologically-equipped Industrial Training Institutes with a combined annual enrollment of 1.24 million students, Technical and Vocational Education and Training integration in schools and higher education institutes, apprenticeship for 740 thousand trainees, industry-aligned short-term training, and catalyzing entrepreneurship. They have launched Skill India Digital as a platform for skilling and job matching and have designed courses for new skills such as coding, AI, robotics, mechatronics, IOT, 3D printing, and drones piloting and maintenance.

Worker's Skill Mismatch by Occupation

(in percent)



Source: PLFS and IMF staff estimates.

Notes: A worker is defined to have few/more years of formal education than desirable if their education level is lower/greater than usually required for their primary occupation as per the ILO's Education and Mismatch Indicators methodology.

[7] Skill mismatch is determined by using ILO's Education and Mismatch Indicators methodology (ILO, 2023) on employment and occupation data by worker from the PLFS. For instance, a worker employed in an elementary occupation is considered to have adequate years of formal education if s/he has completed primary education, and is considered to have more/fewer years than desirable if s/he has more/fewer years of formal education than completed primary.

- ***Advancing labor market reforms***. The authorities completed the passage of four new labor codes at the federal level, which streamline significantly labor regulations in the country. However, implementation of these reforms, which are pending notification of the rules by the Centre and state governments, should progress more rapidly. Evidence shows that in India, these strict labor market regulations have contributed to a misallocation of labor (Mohommad and others, 2021). Furthermore, loosening restrictive employment protection legislation would lead to an increase in total employment over time (including female employment), though it may briefly cause a decline in employment during the initial reallocation of labor (Agarwal and others, 2022). As such, working with states to accelerate the reform momentum in this area would be essential to further enhance labor market flexibility while still providing adequate protection for workers.

- ***Fostering trade integration***. The authorities are making steady progress in negotiating new bilateral trade agreements that would open new markets for Indian exports and would subject Indian producers to healthy competition that would help them move closer to the technological frontier (Dabla-Norris and others, 2023). Removing tariff and non-tariff barriers remains a key priority to further advance trade integration and boosting productivity, labor market outcomes, and ultimately, growth.

- ***Removing red tape and other obstacles to private sector growth***. The authorities' efforts to remove bureaucratic inefficiencies and improve the business climate are supported by their digitalization push. For example, the launch of the Udyam Portal aims to streamline registration for MSMEs. In addition, their Production-Linked Incentive schemes (PLIs) are being perceived by market participants as a signal of the government's intention to work with the private sector to remove obstacles holding back investments and employment. PLIs provide subsidies to firms that meet investment and employment targets in specific sectors. The multiyear cost of the existing PLIs assuming full implementation is relatively low at 0.72 percent of FY 2022/23 GDP and the authorities estimate they may help create up to 6 million jobs (GoI, 2022). While it is too early to assess these schemes and the data is not available yet, targeted and temporary industrial policy could help address market failures. At the same time, however, it would be important to subject these schemes to rigorous cost-benefit analysis, to keep them time-bound, and to ensure competition is fostered. Importantly, PLIs do not replace broader market reforms, which should continue to be prioritized.

- ***Continuing the public investment push***. Efforts by the Union government are expected to raise public investment by the center to 3.3 percent of GDP in 2023/24, twice as much as in 2018/19, and are being complemented by the provision of soft loans to states for them to raise their investments as well. Stronger physical public infrastructure, together with India's world-class digital public infrastructure, will help increase the productivity of the private sector.

- ***Strengthening the social safety net***. A more flexible and targeted social safety net can help support the structural transformation of India's economy and facilitate migration of workers from rural to urban areas in search of better-paying jobs (Alonso and others, 2023). For

example, the rollout of "One-Nation, One-Ration Card" during the COVID-19 pandemic allowed migrant workers to benefit from their food subsidies wherever they were at the time.

- ***Facilitating access to credit***. The health of the financial and corporate sector has improved significantly over the last few years, but continued nimble and vigilant supervision would be needed to ensure healthy credit growth, supporting a rise in private investment (Schipke and others. 2023). In addition, facilitating the exit of non-viable firms and promoting asset resolution remain core priorities.

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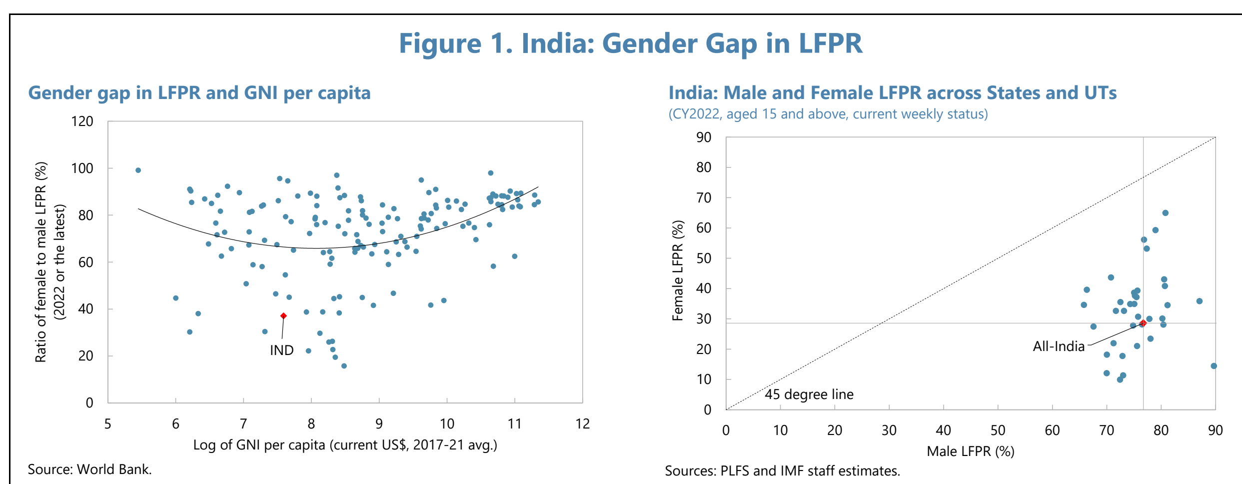
Annex XI. Female Labor Force Participation in India[1]

While improving recently, gender gaps in the labor force participation rate (LFPR) in India remain high. As 63 percent of females are participating in unpaid activities (domestic duties or helping family business), encouraging females to shift into paid and higher productivity employment is crucial for enhancing gender inclusion and further boosting growth. Various policy measures, including easing time constraints, strengthening skills, fostering non-agriculture jobs, and addressing safety concerns, could help boost the female LFPR.

1. Gender gaps in the Indian labor market remain high (Figure 1). While improving recently, the female labor force participation rate (LFPR) in India remains low and below historical levels.[2] In CY2022, the female LFPR in India was 28.6 percent, compared to 76.7 percent for males.[3] While a cross-country comparison between income and gender gaps in the LFPR suggests a U-shaped relationship, India remains well below its economic peers in terms of female LFPR. Further, the LFPR for women with advanced education in India is well below most other countries, which is not the case for men with advanced education.[4] In addition, a large heterogeneity in the female LFPR exists across states and union territories (UTs) in India, ranging from 10 to 65 percent in CY2022, while differences for males are relatively smaller. Hence, the gender gap (ratio of female to male LFPR) differs significantly across states and UTs, ranging from 80 to 14 percent.



[1] Prepared by Shinya Kotera and Margaux MacDonald

[2] Data in this appendix is based on the Periodic Labor Force Survey (PLFS), unless otherwise noted.

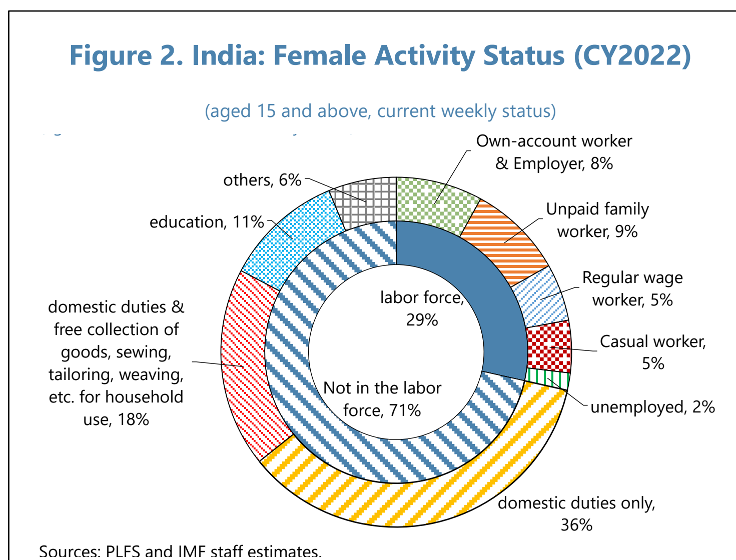
[3] Based on the PLFS Current Weekly Status (CWS) classification, which is most closely aligned with the International Labor Organization's definition of labor force.

[4] Source: International Labor Organization, using latest available data since 2012. The female LFPR in India for females with advanced education (tertiary or higher) is 33 percent, versus an average of 70 percent globally. For men with advanced education the LFPR is 83 percent in India, versus 81 percent in the global sample.

2. The majority of females attend to unpaid activities, instead of engaging in paid work (Figure 2). As of 2022, 71 percent of females are outside of the labor force, and the majority of them are instead primarily participating in domestic activities. According to the official labor force survey, around 55 percent of females answered that childcare or homemaking is the main reason for not entering the labor market in both rural and urban areas.[5] Among females in the labor force, unpaid family workers account for the largest share (31 percent), followed by own-account workers (28 percent). It would be worth noting here that these unpaid activities could make it challenging to measure females' participation in the labor market accurately, suggesting the presence of measurement errors in sizing the female LFPR.[6]

Figure 2. India: Female Activity Status (CY2022)

(aged 15 and above, current weekly status)



Sources: PLFS and IMF staff estimates.

3. Many factors, both from the demand and supply side, seem to affect female LFPR or paid job opportunities for females (Figure 3). Supply-side factors affecting female LFPR include time constraints due to domestic and caregiving work (IWWAGE, 2021), lack of relevant skills (Mehrotra & Parida, 2017), and social norms (Bernhardt et al., 2018). Lower mobility due to limited bus service and safety concerns could also discourage females from undertaking non-agriculture jobs (Siddique (2022) and Lei et al. (2019)). On the demand side, mechanization of agriculture coupled with limited availability of non-agricultural and regular part-time employment opportunities, especially in rural areas, likely dampen female LFPR (Afridi et al. (2020), Fletcher et al. (2017), and Chatterjee et al. (2015)). In addition, gender-biased occupational segregation and employment practices adversely affect female LFPR (Kapsos et al., 2014).

4. India has introduced numerous programs to help boost female LFPR. The Pradhan Mantri Sahaj Bijli Har Ghar Yojana and Jal Jeevan Missions have helped bring reliable, continuous access to electricity and water to homes. The National Rural Livelihoods Mission has connected almost 90 million women with self-help groups that provide collateral free loans and connect them with skills training (including for plumbing, LED bulb making, and repairing drones, among other activities). To encourage participation and ensure economic security and quality employment, India has included in labor laws approved by the center provisions for wage parity, enhanced paid maternity leave, required mandatory childcare facilities at employers over a certain size and

[5] Based on the Periodic Labor Force Survey for 3Q of 2020 to 2Q of 2022 and females aged 15 and above.

[6] Several studies (e.g., Deshpande & Singh (2021) and Kapsos et al. (2014)) have pointed out the measurement errors in female LFPR in India because of 1) the difficulty of differentiating between domestic duties and helping family enterprises and 2) the fragmented and short-term nature of female employment.

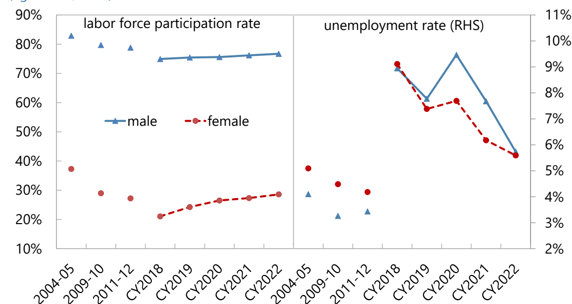
permitted female employment during night shifts. The PM MUDRA scheme, which extends collateral-free loans with a special focus on women's entrepreneurship has helped boost the number of women-owned MSMEs, which now stand at more than 2.8 million. To enhance employability of women, the Government is providing education, skills and vocational training under the National Education Policy and Skill India Mission. To enhance women's safety and convenience for commuting to jobs, funding has been provided to build working women hostels and in certain regions female-only public transportation or free public transportation is available.

5. Additional efforts are needed to address the barriers depressing female LFPR and to encourage women out of unpaid activities and into paid or higher productivity jobs. To ease time constraints due to unpaid domestic work, further widespread access to enabling services (such as child and elderly care services and facilities) and investment toward time-saving infrastructure is needed. Given the rapid progress of technologies and digitalization, strengthening female skilling through education and vocational training that matches needs of the labor market will enhance their employability. Policy actions also include raising awareness of the importance of female participation in the labor market, prohibiting any discriminatory employment practices, further addressing the safety concerns of females, developing road infrastructure, and enhancing public transportation. Promoting the development of non-agriculture sectors, especially in rural areas, by focusing on labor-intensive industries and creating service demand could improve female LFPR and productivity. Given the burden of household work for females, facilitating the creation of jobs with flexibility in working hours and location will make it easier for females to enter the labor force. In this respect, reducing any barriers to firms expanding in size could help increase suitable job opportunities for all, including females, as larger firms can offer greater flexibility as well as higher benefits. Narrowing gender gaps in LFPR should be a priority as it would bring positive spillovers such as boosting economic growth and male income (Ostry et al., 2018). The government's "Women-led development" initiative under the G-20 presidency provides a strong foundation for these efforts, which policy reforms should build on.

Figure 3. India: The Female LFP Landscape

Having recently narrowed, the gender LFPR gap remains large.

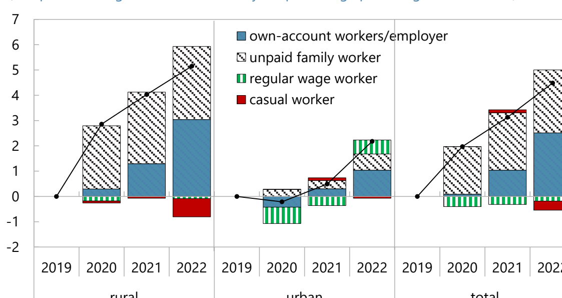
Labor Market Indicators
(aged 15+, CWS)



Note: 2004-05, 2009-10, and 2011-12 correspond to the survey period (July to June)
Sources: MoSPI and IMF staff estimates

Paid job opportunities seem to be limited for female workers, especially in rural areas.

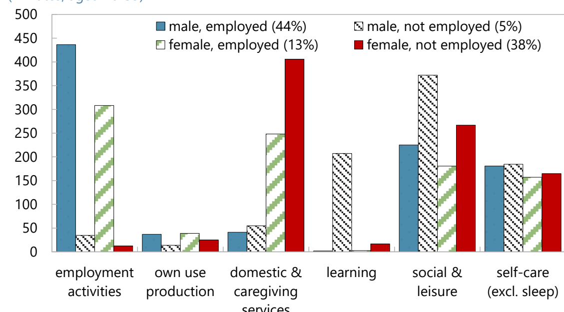
Cumulative Change in Female Employment Ratio 1/
(comparison using CY2019 as the base year, percentage points, aged 15 & above)



1/ Breakdown excludes self-employed who did not work during the reference week.
Sources: MoSPI and IMF staff estimates

Given the domestic and caregiving duties, creating flexible jobs is essential for females.

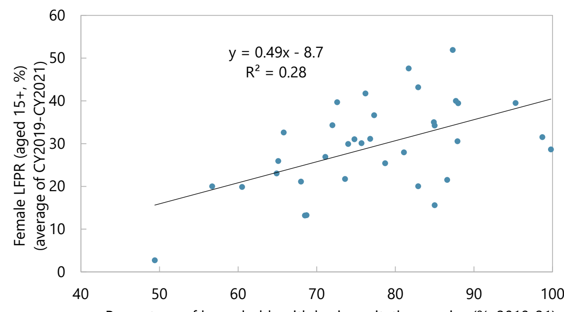
Average time spent in a normal day (2019)
(minutes, aged 20-59)



Note: The number inside the bracket indicates the share of the population..
Sources: Time Use Survey 2019 and IMF staff estimate.

Improving access to sanitation could ease time constraints on females and increase LFPR.

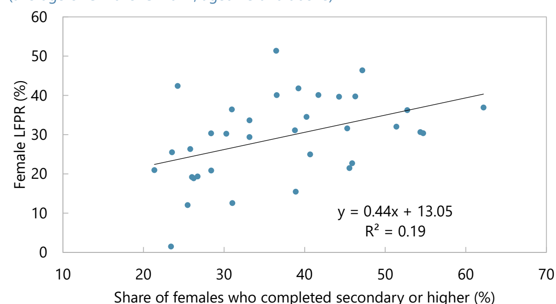
Female LFPR and Sanitation across States and UTs 1/



1/ The chart/regression has controlled for the share of females living in rural areas. The p-value for the coefficient of interest is 0.00.
Sources: PLFS, NFHS, and IMF staff estimates.

Higher female LFPR is correlated with a higher education level.

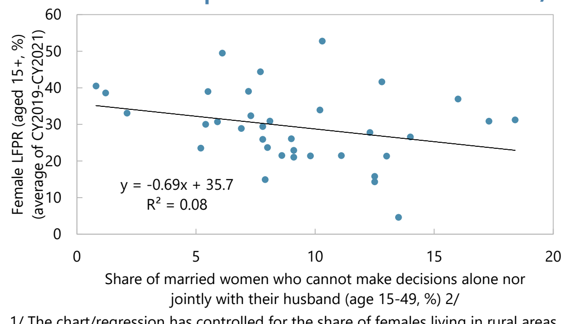
Female LFPR and Education across States and UTs 1/
(average of CY2019-CY2021, aged 15 and above)



1/ The chart/regression has controlled for the share of females living in rural areas. The p-value for the coefficient of interest is 0.07.
Sources: PLFS and IMF staff estimates.

Enhancing female empowerment is also essential for higher female LFPR.

Female LFPR and Empowerment across States and UTs 1/



1/ The chart/regression has controlled for the share of females living in rural areas. The p-value for the coefficient of interest is 0.10.
2/ Decisions about health care, major household purchases, and visits to relatives.
Sources: PLFS, NFHS, and IMF staff estimates.

Note: UTs = Union Territories.

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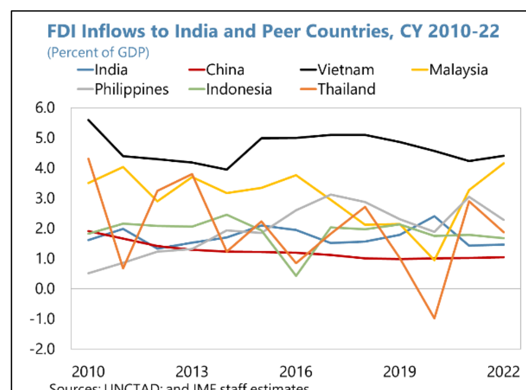
Annex XII. Factors Explaining Rising FDI Inflows to India

India has benefited from steady FDI inflows in recent years and has built a pipeline of new projects. This annex explores the factors that made certain Indian states an attractive destination for FDIs and can help sustain FDI inflows going forward.

1. FDI inflows into India increased since early 2010s in nominal terms and in proportion to GDP. According to RBI's BoP data, FDI inflows to India doubled from their post-GFC low of about US$27 billion in FY2012/13 to a peak of about US$56 billion in FY2021/22 (Figure 1). While FDI in many other countries suffered during the pandemic, in FY2020/21 India received record-large foreign investments in its computer services, which were uniquely positioned to meet demand for outsourcing IT and other business services from countries affected by the Covid lockdowns. In CY2020-22, cumulative FDIs received by India exceeded 5 percent of GDP, getting ahead of China (about 3 percent of GDP) but lagging some regional and global peers such as South Africa and Vietnam (about 13 percent of GDP each). In FY2022/23, FDI to India retreated from its peak level amid a negative shock from the war in Ukraine and associated deepening geoeconomic fragmentation. In early FY2023/24, high frequency data indicated that FDI began to recover gradually from the low level reached in the previous fiscal year, suggesting that the slowdown could be transitory and FDI could rebound to at least the average pre-pandemic level over the medium term.



2. A large pipeline of new projects confirms that India remains an attractive FDI destination, despite temporary setbacks. With the record-high "pipeline" of announced greenfield FDI projects of about US$78 billion and other 1,000 announced deals in CY 2022, India came ahead of its global and regional peers. India became the third country in the world by the number of announced deals (after the U.S. and U.K.) and second by the project finance deals (after the U.S.). Of course, announced deals do not always culminate in actual investments, as evidenced by cancellation of the Foxconn (Taiwan Province of China) and Vedanta Resources (India) plans (US$19 billion) to build a chip factory in India.[1]

3. Incoming FDIs are highly concentrated by receiving states, industries, and countries of origin.

- The two leading investment destinations, Maharashtra and Karnataka states, received more than half of all incoming equity FDIs in FY 2020/21 - 22/23. Together with the two next destinations in the ranking, Gujarat and Delhi, these top-4 destinations received more than

[1] Sources: UNCTAD, World Investment Report 2023, pages 12, 22; Reuters; Forbes.

80 percent of FDI. Among other things, it highlights the crucial importance of state policies in attracting FDI.

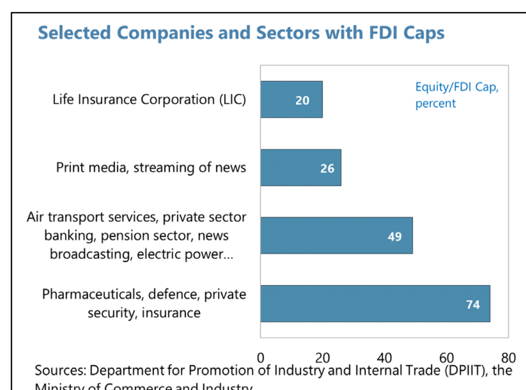
- Almost a third of FDIs into India in FY 2020/21 - 22/23 came from Singapore. The U.S. became the second leading source of FDI accounting for almost 1/5 of the total and sidelining the traditional # 2 source country, Mauritius. As financial hubs, both Singapore and Mauritius intermediate regional and global financial flows, which blurs the ultimate source of FDI coming from these two countries.

- Among industries, Manufacturing and Computer Services were the top destinations of FDI in FY 2020/21 - 22/23, each accounting for almost a quarter of the total. Each of four other industries took close to 1/10 of the inflows: Financial Services, Retail & Wholesale Trade, Communication Services, and Transport.

4. **A better business climate and proximity to political and financial centers explains the relative success of some Indian states in attracting FDIs**. The states that attract most FDIs take top positions in the 2022 edition of the Export Preparedness Index compiled by NITI Aayog and the Institute for Competitiveness (Figure 2). They also come at the top of individual components of the index, most notably its Business Ecosystem ranking (which covers business environment, infrastructure, and transport connectivity). Comparison of FDI performance with Business Reforms Action Plan (BRAP) ranking for 2020—compiled by the Ministry of Commerce & Industry—reveals that not only the business climate, but the advantage of being the political capital (Delhi) or the "financial capital" (Mumbai) helps attract FDI. Plotting Indian states' shares of attracted FDI on a logarithmic scale reveals striking correlation with various business climate indices (Figure 2, right-hand charts). This exponential relation between business climate indices and FDI indicates that improving business climate delivers highest gains to the leaders.

5. **Further improving business climate and removing barriers to FDIs can help sustain steady FDI inflows over the medium term**. After significant liberalization over the last two decades, many barriers and restrictions limiting FDI inflows to India remain in place. Investments in certain sectors of economy are capped or require government approval. For example, FDIs in print media and streaming of news are limited to 26 percent of total equity, and even these investments require government clearance. FDIs in air transport services, private sector banking, pension sector, news broadcasting, and electric power exchanges are capped at 49 percent of total equity. In the early 2022, the government has amended FDI rules by a special decision to allow FDI for up to 20 percent of equity in the Life Insurance Corporation (LIC) to allow foreign investors' participation in its IPO. Revisiting the remaining caps and restrictions can facilitate large FDI inflows to India, in particular to its aerospace industry that can capitalize on rising foreign interest after the successful landing of the India's Chandrayaan-3 spacecraft on the unexplored southern pole of the moon in August 2023. Moreover, improving the

Selected Companies and Sectors with FDI Caps



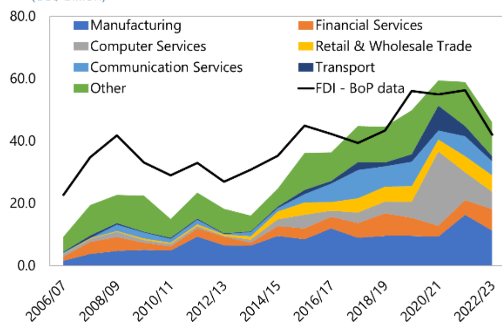
Sources: Department for Promotion of Industry and Internal Trade (DPIIT), the Ministry of Commerce and Industry.

business climate across the entire country, particularly in demographically rich states, to the level of the top states can greatly increase India's potential for attracting FDI. At the same time, imposing new or tightening existing export and import restrictions can discourage FDI inflows, in part because rising costs of imported intermediate inputs can undermine export competitiveness of products produced in India.

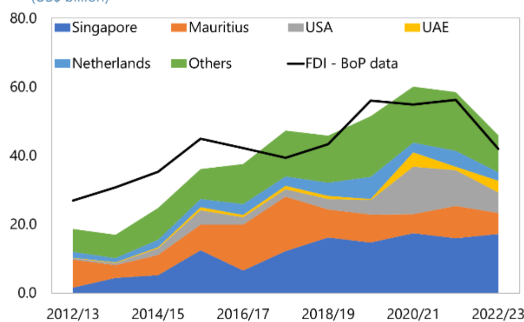
Figure 1. India: FDI Inflows and New Projects

FDI inflows to India's surged since early 2010s, but mostly concentrated in a few receiving industries. A strong pipeline of new projects augurs well for continued steady inflows.

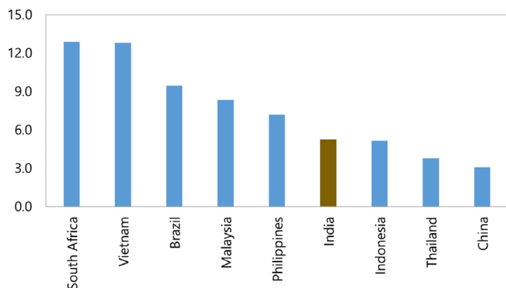
Surging FDIs concentrated in computer services, manufacturing, and a few other industries.



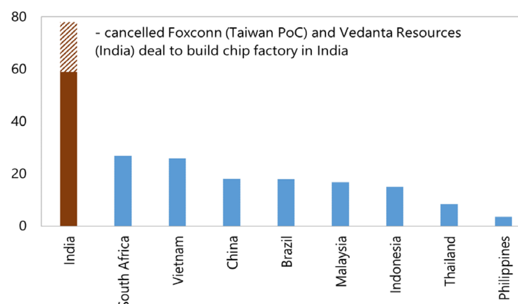
Most of FDIs came from just a few countries, with the US share rising recently



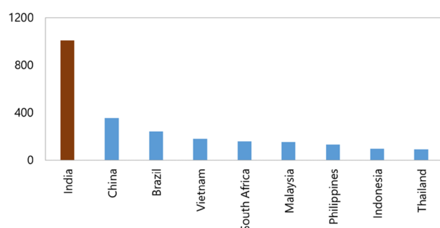
In proportion to economic size, however, FDIs to India still lag behind many peer countries.

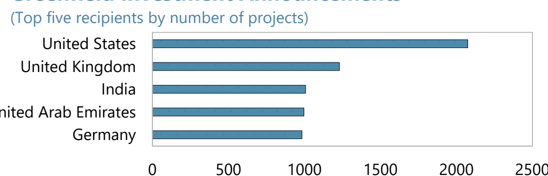


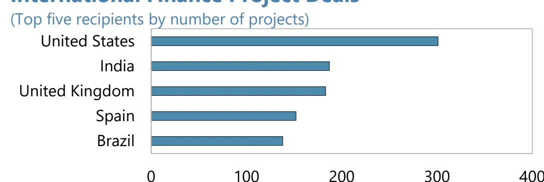
The pipeline of new projects looks strong in terms of announced investment amounts…



…And the number of deals, making India one of the leading FDI destinations worldwide.



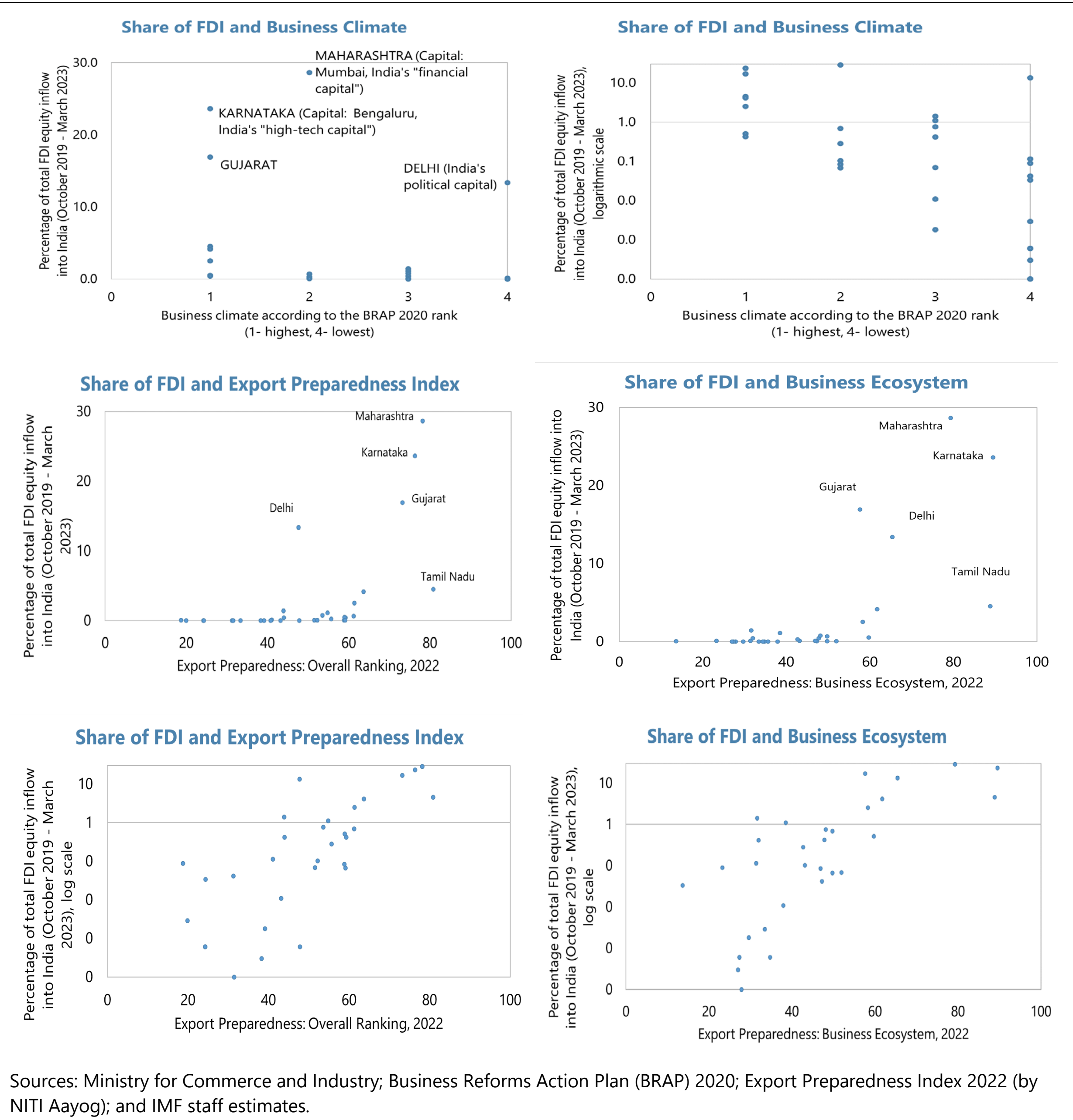




Sources: Ministry for Commerce and Industry; RBI; UNCTAD; Haver; and IMF staff estimates.

Figure 2. India: Indian States: FDI Inflows and Business Climate

Just a handful of India's states attracts most FDIs flowing into the country. Their success can be attributed to better business climate and proximity to capitals and investment hubs.



Sources: Ministry for Commerce and Industry; Business Reforms Action Plan (BRAP) 2020; Export Preparedness Index 2022 (by NITI Aayog); and IMF staff estimates.

INTERNATIONAL MONETARY FUND

INDIA

November 3, 2023

STAFF REPORT FOR THE 2023 ARTICLE IV CONSULTATION—INFORMATIONAL ANNEX

Prepared By | Asia and Pacific Department

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FUND RELATIONS

(As of September 30, 2023)

Membership Status:

Joined December 27, 1945; Article VIII.

General Resources Account

	SDR Million	% Quota
Quota	13,114.40	100.00
Fund Holdings of Currency (Holdings Rate)	9,309.44	70.99
Reserve Tranche Position	3,814.16	29.08
Lending to the Fund		
New Arrangements to Borrow	25.59	

SDR Department:

	SDR Million	% Allocation
Net cumulative allocation	16,547.82	100.00
Holdings	13,680.81	82.67

Outstanding Purchases and Loans: None

Financial Arrangements:

Type	Date of Arrangement	Expiration Date	Amount Approved (SDR Million)	Amount Drawn (SDR Million)
Stand-By	10/31/91	06/30/93	1,656.00	1,656.00
Stand-By	01/18/91	04/17/91	551.93	551.93
EFF	11/9/81	05/01/84	5,000.00	3,900.00

Projected Payments to Fund
(SDR million; based on existing use of resources and present holdings of SDRs):

	Forthcoming				
	2023	2024	2025	2026	2027
Principal	0.00	0.00	0.00	0.00	0.00
Charges/interest	29.57	118.65	118.54	118.60	118.60
Total	29.57	118.65	118.54	118.60	118.60

Exchange Rate Arrangement:

The currency of India is the Indian rupee. The exchange rate of the rupee is determined in the interbank market, where the Reserve Bank of India (RBI) intervenes frequently. RBI's stated intervention objective is to curb excessive volatility. The de jure exchange rate arrangement is classified as floating, while de facto exchange rate arrangement has been reclassified to stabilized arrangement for the period December 2022-October 2023. The reclassification is based on a statistical methodology that is implemented by staff evenhandedly across member countries. The methodology follows a backward-looking statistical approach that relies on past exchange rate movement and historical data. Therefore, this reclassification does not imply statements or views on future or intended policies nor does it imply a policy commitment on the part of the country authorities.

On August 20, 1994, India accepted the obligations of Article VIII, Sections 2, 3, and 4 of the IMF Articles of Agreement. India maintains the following restrictions on the making of payments and transfers for current international transactions, which are subject to Fund approval under Article VIII, Section 2(a): restrictions related to the non-transferability of balances under the India-Russia debt agreement; restrictions arising from unsettled balances under inoperative bilateral payments arrangements with two Eastern European countries; and a restriction on the transfer of amortization payments on loans by nonresident relatives. The Executive Board has not approved these restrictions.

In 2020 India introduced transfer taxes for personal remittances and payments for educational, medical and travel services under the Liberalized Remittance Scheme. Effective October 2023, the tax rates on personal payments and travel services were raised to discourage underreporting of income by high-net-worth individuals on their tax return. While the income tax law provides for the reimbursement of these taxes, they still give rise to exchange restrictions as they represent an additional burden/cost on making current international payments and transfers. The exchange restrictions arise from: (i) 20 percent tax on personal remittances above the annual Rs 700,000 threshold; (ii) 0.5 percent tax on remittances above the annual Rs 700,000 threshold for education payments where financed by loan; (iii) 5 percent tax on payments above the annual Rs 700,000 threshold for education and medical services, and (iv) 5 percent tax on payments for travel services (overseas packages) below the annual threshold of Rs 700,000 and 20 percent tax thereafter, to the extent that it applies to cross-border payments (i.e to nonresident seller).

Article IV Consultation:

The previous Article IV consultation discussions were held in September 2022. The Staff Report (IMF Country Report No. 22/386) was discussed by the Executive Board on November 28, 2022.

FSAP Participation:

Concluding meetings for the latest FSAP Update were held in Delhi and Mumbai in July 2017—the FSSA Update report was published in December 2017 (Country Report No. 17/390). A Detailed

Assessment of Observance of the Basel Core Principles for Effective Banking Supervision was issued in January 2018 and published as Country Reports No. 18/4. The upcoming FSAP discussions will begin in November 2023, with a concluding envisaged in late summer 2024.

Capacity Development (Technical Assistance and Training):

Recent and planned IMF capacity development and training activities with India are discussed in Appendix VI of the staff report.

Resident Representative:

A resident representative's office was opened in November 1991. Mr. Luis Breuer has been the Senior Resident Representative since July 2019.

INFORMATION ON THE ACTIVITIES OF OTHER IFIS

Information on the activities of other IFIs in India can be found at:

- World Bank: http://www.worldbank.org/en/country/india/overview
- Asian Development Bank: Asian Development Bank and India: Fact Sheet (adb.org)

STATISTICAL ISSUES

(As of October 1, 2023)

I. Assessment of Data Adequacy for Surveillance
General: Data provision is broadly adequate for surveillance. However, upgrading and expanding statistics particularly in the real sector (e.g., national accounts, employment, and prices), would help the monitoring of economic and labor market dynamics and policy design.
National Accounts and employment statistics: In January 2015 the Central Statistical Office (CSO) released a new series of national accounts, with base year 2011/12. In addition to the shift in the base year for measuring growth, the revisions reflected a review of source data and compilation methods, and implementation of the 2008 System of National Accounts. The current base year of 2011/12 is outdated, and GDP should be rebased as soon as feasible. For current price estimates, the data sources provide adequate coverage of economic activities, and the methodology is broadly consistent with international standards and best practices. Nonetheless, an indirect-tax-based extrapolation of trade turnover value from the base year does not provide an accurate gauge of growth of economy-wide value added from trade. The supply-side data are deemed to be of better quality than expenditure-side data. There are still some weaknesses in the deflation method used to derive value added. Also, the compilation of constant price GDP deviate from the conceptual requirements of the national accounts, in part due to the use of the Wholesale Price Index (WPI) as a deflator for many economic activities. The appropriate price to deflate GDP by type of activity is the Producer Price Index (PPI), which is under development. Large revisions to historical series, the relatively short time span of the revised series, major discrepancies between GDP by activity and GDP by expenditure, and the lack of official seasonally-adjusted quarterly GDP series complicate analysis. Together, these weaknesses make it challenging to monitor high frequency trends in India's economy through official statistics, particularly from the demand side. There are long-standing deficiencies in employment data. The Periodic Labour Force Survey questionnaire can be strengthened to reduce the role of self-clasification in capturing employment, though the authorities are working with the ILO on a pilot questionnaire to improve measurement. Quarterly employment data is only available for urban areas. Despite accounting for half of the labor market, employment data for rural areas is only available at an annual frequency. Both for rural and urban areas, data is available only with a substantial lag.
Price statistics: In early 2011, an all-India Consumer Price Index (CPI) with updated weights was released, which covered both rural and urban India, with 2009/10 as a base year. In addition, separate corresponding urban and rural CPI series were published. In early 2015, the CPI weights were updated again using 2011/12 expenditure data and the CPI series was revised from January 2015. The CPIs are published with a lag of about two weeks. Presently, there also remain four CPIs, each based on the consumption basket of a narrow category of consumers (namely industrial workers, urban and non-manual employees, agricultural laborers, and rural laborers). With the exception of the industrial workers' CPI, these other indices are based on weights that are over

ten years old. The authorities are conducting a new household survey and expect to use it to update the CPI basket over the medium term. The WPI base year is 2011/12. The authorities are in the process of developing a PPI to replace the WPI. An RBI series on residential property price indexes has helped surveillance in this area, though geographic coverage remains limited, and price data for commercial real estate are not available.

Government finance statistics: The Ministry of Finance (MoF) is responsible for compiling and disseminating the Government Finance Statistics (GFS). Data on the general government operations include state governments but exclude data on the operations of the extra-budgetary funds, local governments, and social security funds. There is scope to improve the timeliness and analytical usefulness of the presentation of the fiscal accounts from which GFS are derived, as data is not presented on a GFSM 2014 basis. The availability of timely consolidated data, particularly at the sub-natioal level, would help with the identification of fiscal risks.

The authorities published central government and general government operations data on the National Summary Data Page, under the Special Data Dissemination Standard (SDDS). In terms of submissions to the IMF Annual GFS database, in 2017 GFS data was disseminated for budget central government (BCG) and state government. In 2018 only data for BCG was disseminated. Authorities have not made submissions since 2019. Other sub sectors of general government have never been explicitly compiled, specifically extra-budgetary units (EBUs), local governments, and social security funds. For years since then no GFS data on general government operations have been disseminated.

The authorities have been working to address these shortcomings and to meet the G20 Data Gaps Initiative (DGI) Recommendation II.15 to produce GFS data on a GFSM 2014 basis and have now compiled for the last three years quarterly government operations data for budget central government though not yet published domestically. The authorities are now trying to expand coverage to include state government data to fully meet the DGI recommendation. The authorities are also keen to disaggregate the government operations data to meet the IMF annual GFS data request, which requires much more detailed data beyond the requirements of the DGI recommendation.

Monetary and financial statistics: The Reserve Bank of India (RBI) website and the RBI *Bulletin* publish a wide array of monetary and financial statistics, including reserve money and its components, the RBI's survey, the monetary survey, liquidity aggregates (outstanding amounts), interest rates, exchange rates, foreign reserves, foreign exchange interventions, and results of government securities auctions. The RBI reports data on some key series of the Financial Access Survey (FAS), including mobile and internet banking, mobile money, gender disaggregated data, and the two indicators (commercial bank branches per 100,000 adults and ATMs per 100,000 adults) adopted by the UN to monitor Target 8.10 of the Sustainable Development Goals (SDGs).

The RBI reports monetary data to STA in non-standard format. The RBI also provides "test" data using the standardized reporting forms. However, the test data do not contain sufficient details (e.g., instrument, currency and counterparty sector breakdowns) to construct a complete and analytically useful picture of India's financial sector that is also consistent with the guidelines provided in the Monetary and Financial Statistics Manual. In addition, data reported cover

<table>
<tr><td colspan="2">depository corporations only, and data on other financial corporations such as insurance corporations, pension funds, and investment funds are not covered.</td></tr>
<tr><td colspan="2">Financial sector data: As for reporting of financial soundness indicators (FSIs), 13 core and 9 encouraged FSIs for deposit takers as well as three FSIs for real estate markets are reported on a quarterly basis. FSIs for other financial corporations, nonfinancial corporations, and households are not reported.</td></tr>
<tr><td colspan="2">External sector statistics: The concepts and definitions used to compile balance of payments statistics are broadly in line with the sixth edition of the Balance of Payments and International Investment Position Manual (BPM6). However, trade data have valuation, timing, and coverage problems, which sometimes result in significant revisions of previously published statistics. Data on imports of goods in the balance of payments are registered in c.i.f. prices while the BPM6 requires the f.o.b. pricing. External debt statistics are available on a quarterly basis with a one quarter lag. Estimates of short-term external debt are presented both on an original maturity and a residual maturity basis (the latter is only available annually). The international investment position (IIP) statistics cover the sectors prescribed in the BPM6 and these data are disseminated within three months of the reference period in respect of quarterly data.[1] India disseminates monthly the Data Template on International Reserves and Foreign Currency Liquidity as prescribed under the SDDS. More up-to-date information on certain variables, such as total foreign reserve assets, foreign currency assets, gold, and SDRs, is available on a weekly basis and is disseminated as part of a weekly statistical supplement on the RBI web site.</td></tr>
<tr><th colspan="2">II. Data Standards and Quality</th></tr>
<tr><td>Subscriber to the Fund’s Special Data Dissemination Standard (SDDS) since December 1996. Uses SDDS flexibility option on the timeliness of employment, unemployment, and general government operations and periodicity of employment and unemployment. India’s latest SDDS Annual Observance Report is available on the DSBB.</td><td>A Report on Observance of Standards and Codes—Data Module; Response by the Authorities, and Detailed Assessments Using the Data Quality Assessment Framework was published on March 29, 2004.</td></tr>
</table>

[1] The IIP as published by the RBI values equity liabilities at acquisition cost, while the Fund uses market prices, resulting in substantial differences.

India. Table of Common Indicators Required for Surveillance

(As of October 16, 2023)

	Date of latest observation	Date received	Frequency of Data[7]	Frequency of Reporting[7]	Frequency of Publication[7]
Exchange Rates	10/16/23	10/16/23	D	D	D
International Reserve Assets and Reserve Liabilities of the Monetary Authorities[1]	10/06/23	10/13/23	W	W	W
Reserve/Base Money	10/06/23	10/11/23	W	W	W
Broad Money	09/22/23	10/13/23	BW	BW	BW
Central Bank Balance Sheet	10/06/23	10/13/23	W	W	W
Consolidated Balance Sheet of the Banking System	09/22/23	10/13/23	BW	BW	BW
Interest Rates[2]	10/16/23	10/16/23	D	D	D
Consumer Price Index	September 2023	10/12/23	M	M	M
Revenue, Expenditure, Balance and Composition of Financing[3] – General Government[4]	2021/22	January 2023	A	A	A
Revenue, Expenditure, Balance and Composition of Financing[3]– Central Government	August 2023	09/29/23	M	M	M
Stocks of Central Government and Central Government-Guaranteed Debt[5]	Apr-Jun 2023	09/27/23	Q	Q	Q
External Current Account Balance	Apr-Jun 2023	09/28/23	Q	Q	Q
Exports and Imports of Goods and Services	September 2023	10/13/23	M	M	M
GDP/GNP	Apr-Jun 2023	08/31/23	Q	Q	Q
Gross External Debt	Apr-Jun 2023	09/27/23	Q	Q	Q
International Investment Position[6]	Apr-Jun 2023	09/28/23	Q	Q	Q

[1] Any reserve assets that are pledged of otherwise encumbered should be specified separately. Also, data should comprise short-term liabilities linked to a foreign currency but settled by other means as well as the notional values of financial derivatives to pay and to receive foreign currency, including those linked to a foreign currency but settled by other means. [2] Both market-based and officially-determined, including discount rates, money market rates, rates on treasury bills, notes and bonds.

[3] Foreign, domestic bank, and domestic nonbank financing.

[4] The general government in India consists of the budgetary central government and state governments. It does not include Extrabudgetary Units, Social Security Funds, and local government.

[5] Including currency and maturity composition.

[6] Includes external gross financial asset and liability positions vis-à-vis nonresidents.

[7] Daily (D); weekly (W); bi-weekly (BW); monthly (M); quarterly (Q); annually (A); irregular (I); and not available (NA).

Statement by Krishnamurthy Venkata Subramanian, Executive Director for India, Sanjay Kumar Hansda, Senior Advisor to Executive Director and Anand Singh, Senior Advisor to Executive Director November 20, 2023

1. Indian Authorities thank staff for constructive discussions and express their appreciation to the Management and staff for their continued engagement. This BUFF statement focuses on providing a detailed and true picture of the Indian economy.

2. The Indian economy, being the fastest-growing major economy, is on its way to being a significant contributor to global growth in the coming years with its young population, improving physical and digital infrastructure and an enabling policy environment. Inflation has reverted to the tolerance band, moving closer to the target. While banks and corporates are profitable thanks to balance sheets whose health has been restored by various policy measures, the push to public investment has created favourable conditions for crowding in and sustaining private investment. As evident in multiple surveys, consumer confidence has been on a rising trajectory since the pandemic lows. India's external sector is stable, as evident in rising exports of services. The current account deficit (CAD) is low and manageable, and forex reserves stand bolstered to deal with eventualities.

3. In the 2022 Article IV report, staff had placed India's growth forecast at 6.8% for 2022-23, whereas the actual growth as per provisional estimates was 7.2% and is likely to be about 7.5% when the estimates are finally frozen in February 2026; **this under-estimation of growth was highlighted in the Buff statement issued by this office in November 2022.** This time, staff expect GDP to grow 6.3% in 2023-24 and 2024-25, while the Reserve Bank of India (RBI) projects it to grow 6.5% in both years. Contrary to staff assessment, private consumption is healthy and gathering momentum, supported by sustained buoyancy in services and pick-up in the informal sector and the Micro, Small and Medium Enterprises (MSMEs). With inflation moderating, private consumption is expected to gather further momentum. In Q1: 2023-24, actual growth at 7.8% was higher than the staff's projection. The Q2 growth is also expected to ‘‘surprise on the upside’’ given the discernible broad-based gaining of momentum in the high-frequency indicators. The ongoing structural reforms will also support the economy's momentum.

4. RBI projects headline consumer price inflation at 5.4% during 2023-24. It's expected to soften to 5.2% by Q4 of 2023-24 and remain at the same level in Q1:2024-25 (currently at 4.9% y-o-y in October 2023). Thus, after the surge in July-August 2023 due to weather shocks and supply disruptions and largely driven by food prices pressures, inflation is projected to decline to 5.6% in Q3:2022-23, *i.e.*, within the monetary policy target range of 4 (+/-2) %. Given the volatility in inflation, priority has been accorded to maintaining a disinflationary stance and the alignment of inflation outcomes with the target. The declining core inflation, also lower than the headline, has been a silver lining. Further, household inflation expectations have declined to single-digit numbers in September 2023 for the first time during the pandemic. **Here, we reiterate that India's lower inflation rate was not due to "extensive government intervention", as the staff have diagnosed, but due to India's *sui generis* economic policy during COVID-19 pandemic that anticipated that the pandemic also presented a significant supply-side shock, which led to India implementing a judicious mix of demand-side and supply-side measures.**

Structural Reforms

5. India's approach to structural reforms has been one of a steady and irreversible process, unleashing animal spirits and improving governance. Even amidst the once-in-a century COVID-19 pandemic, when most countries focused solely on tiding over the pandemic, India was among the rare countries that remained steadfast in its reform pursuits. The Central Government has been taking several measures to enhance the productivity and skills of people, including, among other things Skill India Mission, Pradhan Mantri Kaushal Vikas Yojana, National Apprenticeship Promotion Scheme, PM Vishwakarma Yojana, National Education Policy 2020, and online courses on SWAYAM portal. The National Career Service portal provides citizens with various employment and career-related services. In this context, the staff estimate of the need to create 145-330 million jobs by 2050 is likely an overestimate for several reasons. First, the staff estimate is based on the assumption of an unemployment rate of 5.7%. We strongly believe that using this rate significantly overestimates the number of jobs required because (i) this estimate of 5.7% was close to the rate of unemployment prevailing in 2017-18 when India was experiencing a growth slowdown due to the overhang created by problems in the financial sector; (ii) the unemployment rate has trended down over the last six years; and (iii) the latest unemployment

rate for 2022-23 is 3.2%, which is about half the estimate that has been used. Second, growth in the manufacturing sector – critical for job creation in the Indian economy – is showing encouraging signs. Third, the Indian labour market cannot be subjected to linear extrapolation from the recent past as (i) the ongoing transformational changes in the work environment, including work-from-home, remote work and the Gig economy, will change the nature of work and (ii) India being a service-oriented economy, the nature of work is likely to change far more than in many other economies. Fourth, there are many positive ongoings in the global economy, *e.g.*, green transition, de-risking of supply chains and a slew of frontier technologies, all generating tailwinds for growth and employment in India. Thus, lack of employment opportunities may not be the primary driver of unemployment.

6. India's female LFPR is widely perceived to be too low, using the ILO estimate of 19 per cent for 2020. However, this number is ILO's modelled estimate (not the actual estimate of India's official survey PLFS) and is subject to substantial uncertainty. According to the PLFS conducted annually by Ministry of Statistics and Programme Implementation (MoSPI), the FLFPR of India has increased from 23.3 % in 2017-18 to 32.8% in 2021-22 and further to 37% in 2022-23. ILO's latest (2013) standards exclude all unpaid work from the labour force. At the same time, ILO's standards also call for measuring work beyond "employment", including unpaid work for self-consumption, domestic duties, etc. MoSPI's standards are aligned with the older ILO standards of 1982 and consider unpaid work as part of the labour force in cases of subsistence farming and working as an unpaid helper in a household enterprise (which may be agricultural or non-agricultural). The categories of "attended domestic duties only" and "attended domestic duties and was also engaged in free collection of goods, tailoring, weaving, etc., for household use" remain out of the labour force even by MoSPI standards. As acknowledged by staff, the Government has, nevertheless, taken numerous steps to improve female's LFPR to ensure their economic security and the quality of their employment. Some labour code provisions on wages and social security have already come into force. Further, 29 States/Union Territories out of 31 have pre-published draft rules on new labour codes.

7. As per staff, India's tariff and non-tariff import barriers are high. However, this is selective and presents an incorrect picture. First, as the World Bank's World Integrated Trade Solution (WITS) database clearly shows, India's non-tariff measures (NTM) are significantly

lower than leading economies. This is reflected in the value of imports subject to NTMs relative to total imports captured in the *Coverage Ratio* and the percentage of traded products to which one or more NTMs are applied, as captured in the *Frequency Ratio*. As the Table below shows, **India's use of NTMs is almost half the level in leading economies on both metrics**. The significantly higher NTMs in leading economies particularly impact India's service sector, limiting the utilisation of India's comparative advantage to benefit the global economy. Second, in erecting trade barriers, countries face the trade-off between tariffs, which are transparent and objective, and NTMs, which are, by definition, non-transparent and subjective in interpretation. Thus, while most economies – including the leading ones – have chosen to resolve this trade-off through intensive use of the opaque and subjective NTMs, India uses tariffs as the only lever, which is transparent and objective. Finally, India's tariff structure needs to be seen in the context of trade barriers to global services *vis-à-vis* goods, the removal of which could help realise India's demographic dividend. Thus, **the selective characterisation of India's trade barriers is inconsistent with empirical evidence and economic optimality, which always advocates transparent and objective measures over opaque and subjective ones.**

Non-Tariff Measures (%)

		Coverage ratio	Frequency ratio
Leading Economies*			
	Maximum	94.3	95.5
	Average	82.9	74.8
	Minimum	76.2	61.2
India		45.5	43.7
*: US, European Union, Japan, Canada and Australia.			
Source: World Integrated Trade Solution, World Bank.			

8. A key structural reform India has undertaken is the creation of a digital marketplace for public-sector procurement. Towards enhanced transparency, efficiency and speed, the one-stop Government e-Marketplace (GeM) has revolutionised the public procurement system for the government departments and undertakings. The purchases through GeM were made mandatory in 2017. State Governments are also encouraged to purchase through GeM. GeM has led to average savings of around 10% on the median price, providing MSMEs and small businessmen access to sought-after government orders. GeM is catering to the diverse procurement needs of more than 67,000 government buyer organisations, which have saved about ₹40,000 crore by the

end of March 2023. Given the scale and complexities of realigning the old, deeply entrenched procurement processes, this is one of the largest global change-management exercises.

Fiscal Issues

9. The central government's gross fiscal deficit (GFD) is budgeted at 5.9% of GDP in 2023-24, down from 6.4% in 2022-23. The Authorities have achieved a fiscal consolidation of 3.3 percentage points in three years since 2021-22 and are strongly committed to reducing it to 4.5% of GDP by 2025-26. Immediately after COVID-19, the calibrated approach to fiscal consolidation – a *de facto* medium-term fiscal policy strategy – helped navigate, with a human face, back-to-back global crises while prioritising capital spending. In this context, publishing a fiscal strategy document ahead of the Budget in place of the current Macroeconomic Framework Statement and Medium-Term Fiscal Policy Statement may not enhance transparency but would distract the already streamlined budget-making process. Again, in a developing country context, accrual accounting may not be an unmixed blessing, particularly with respect to tax revenues, and can intensify non-transparencies.

10. As against the staff view in the 2022 Article IV report that India's fiscal space is at risk, the staff have now recognised that risk factors are mitigated, and risks of sovereign stress are moderate. Therefore, the staff assertion that the baseline carries the risk that debt would exceed 100% of GDP in the medium-term in the event of shocks that India has experienced historically sounds extreme. The same can be said of the staff prognosis that debt sustainability risks are high in the long term. The risks from sovereign debt are very limited as it is predominantly denominated in domestic currency. Despite the multitude of shocks, the global economy has faced in the past two decades, India's public debt to GDP ratio at the general government level has barely increased from 81% in 2005-06 to 84% in 2021-22 and back to 81% in 2022-23. Given the negative r-g differential and the secularly declining primary deficit, the debt-GDP ratio cannot exceed 100%. Further, in recent years, the quality of public expenditure has improved, tilting in favour of capital as against revenue. Furthermore, moderately high and sustained growth would go a long way in bringing down the debt-to-GDP ratio in the medium-term. Public debt has been on a downward trajectory since its rise during the pandemic. Finally, the staff scenario that the realisation of contingent liabilities of the centre and states, estimated at 6.7% of

GDP, would raise gross financing needs to over 20% of GDP implies an inexplicably high probability of realisation at 33%.

11. The Central Government's GFD at 37.3% of the annual target in the first half of 2023-24 is on track with the budget, backed by the growth in receipts at 17.7% against the annual target of 10.6%. GST collection jumped by 13% in October to ₹1.72 lakh crore, the highest-ever collection next to April 2023. The corporation tax growth has also turned around into a double-digit growth. India's tax-to-GDP ratio, direct tax-to-GDP ratio and indirect tax to- GDP ratios have all improved compared to the trends that prevailed from 2008 to 2015-16 (Subramanian, 2023). As these improvements are the outcome of several reforms launched in tax administration and the use of Artificial Intelligence and Machine Learning techniques to curb tax evasion, the positive trends are likely to continue and gather momentum. Therefore, the revenue situation will likely be much better than staff anticipation.

12. As regards the staff assessment of taxes on outward remittances as exchange restrictions, it may be noted that the practice is widespread across countries, including advanced ones. In the Indian context, however, the total tax collected at source is available for full credit or refund when filing the income tax return. Such taxes, in any case, do not limit the availability or use of foreign exchange by resident individuals in India. Certainly, the nominal cost involved in terms of cash flow does not amount to exchange restriction.

Monetary Policy

13. Amidst intermittent adverse weather events, reflected in food price spikes in July and August 2023, the policy repo rate has remained steady at 6.5% after a cumulative hike of 250 bps during May 2022-February 2023. The policy remains focused on withdrawing accommodation towards aligning inflation progressively to the target while supporting growth. The incremental cash reserve requirement was temporarily invoked in response to specific circumstances: the withdrawal of ₹2000/- banknotes from circulation. This has since been phased out.

14. There has been limited Rupee depreciation *vis-à-vis* USD in 2023 due to significant moderation in CAD, the revival of capital flows on the back of a comfortable foreign exchange reserves buffer and, above all, India's macroeconomic stability. The inclusion of India's

government bond in the Emerging Market Index is also around the corner. Further, the global uncertainty, which peaked from December 2019 to November 2022 in the wake of pandemic and the war in Europe, declined as the impact of the shocks was priced in. It is, therefore, not surprising that the Rupee-US Dollar exchange rate has moved in a narrow band in the recent period. However, staff have attributed the narrow movement to FXI and labelled the Rupee-US Dollar exchange rate regime as a 'stabilised arrangement'. This is, however, contrary to the Fund's classification requirement that ''…the exchange rate remains stable because of official action...'' (Annual Report on Exchange Arrangements and Exchange Restrictions). FXI has been relatively modest in 2023 so far. Further, the movement in the Rupee-US Dollar exchange rate exceeds the stipulated margin if the analysis period is extended, implying a subjective selection of the period by staff in their analysis. Given the foregoing, **staff characterisation of India's exchange rate as a 'stabilised arrangement' is incorrect and inconsistent with reality**. As in the past, exchange rate flexibility would continue to be the first line of defence in absorbing external shocks, with interventions limited to addressing disorderly market conditions.

15. As against the staff projection of 3.5%, India's CAD was 2% in 2022-23. While staff's projection for CAD stands at 1.8% for 2023-24, the first quarter CAD in 2023-24 has declined to 1.1% from 2.1% in Q1: 2022-23. India's external position remains sufficiently strong, with a turnaround in portfolio flows against the preceding two years. While FDI flows have moderated in line with the worldwide trend, external commercial borrowings have switched into positive territory, and that too, with the majority raised for capital expenditures. India's foreign exchange reserves stood at US$ 590.8 billion as of November 03, 2023. India remains confident of meeting its external financing requirements comfortably.

16. India is among the few countries to launch CBDC pilots in wholesale and retail segments in 2022. The pilots are being expanded to more banks, cities, segments of the population, and use cases, including linking the e-rupee to India's popular Unified Payments Interface (UPI). The empirical data that are being generated would go a long way in shaping the policies and future course of action. With its instant settlement feature, CBDCs can render cross-border payments cheaper, faster, and more secure.

Financial Sector

17. India's financial sector remains stable and resilient, as reflected in sustained growth in bank credit, low levels of non-performing assets and adequate capital and liquidity buffers. The financial indicators of non-banking financial companies (NBFCs) align with those of the banking system. The weaker tail of NBFCs vulnerable to liquidity risks are not systemically important. So, contrary to staff perception, there are no lingering vulnerabilities in NBFCs. Both banking and corporate sector balance sheets have been strengthened, leading to a **"twin balance sheet advantage" for growth**. Indeed, contrary to staff perception, subdued credit growth for the industrial sector reflects the fact that the corporate sector has ample internally generated resources. The reach and depth of financial intermediation in India are aided by technology and growing digitalization, which provide new opportunities for growth and financial inclusion.

18. A key distinguishing feature of India's Insolvency and Bankruptcy Code (IBC) has been its focus on resolution rather than liquidation. The significant reduction in gross NPAs over the past two years testifies to the success of the IBC ecosystem. The authorities constantly engage stakeholders to render the IBC ecosystem work more efficiently. Towards this direction, a discussion paper on further reforms was issued by the Government in January 2023.

19. The emergency credit line guarantee scheme (ECLGS), launched during COVID to help small businesses tide over losses due to lockdowns, saved at least 14.6 lakh MSMEs which benefited from ₹2.2 lakh crore in additional credit (SBI Research analysis, January 2023). The additional credit flow has saved around 12% of the outstanding MSME credit from slipping into NPAs. In terms of people, it saved the livelihood of at least 6.6 crore people.

20. Staff scenario that a sudden increase in sovereign risk premia could weigh on balance sheets and bank lending appetite appears far-fetched, given the strong macro fundamentals. The forthcoming inclusion in emerging government bond indices will broaden the investor base and diversify risks. The planned move to remove the limit on banks' Held to Maturity (HTM) portfolio from April 2024 would also add to banks' operational flexibility to decide on their investment portfolio. In any case, the pricing of bonds remains market-determined, and investment therein is driven by relative risk-return consideration. Therefore, staff concern about

the amplification of macro-financial risks arising from bank holding of government securities is not tenable.

21. Staff have expressed concern about the growth in unsecured retail loans. The growth is, however, due to the rapid digitalization of the economy, which has enabled the move from collateral-based lending to information-based lending. While collateral-based lending was necessary to mitigate the moral hazard problem in a primarily cash-driven economy, digitalization that has now touched the lowest common denominator, generates verifiable records of cash flows that can be used to mitigate the twin problems of adverse selection and moral hazard in lending. Thus, digitalization is enabling credit growth even while mitigating credit risk. Special Mention Account (SMA) 1 and SMA 2 accounts, which have higher proximity to default, have shown improvement with the total ratio of these two categories falling from 4.2% in March 2021 to 2.3% in March 2023. Unsecured retail loans formed only 7.9% of the total banking system credit. Moreover, their asset quality has improved, with GNPA ratio declining from 3.2% to 2.0% during this period. Thus, notwithstanding few signs of potential stress in retail loans, they do not pose an imminent risk to systemic stability.

22. Under the risk assessment matrix, the risk likelihood with respect to social discontent is judged to be medium by the staff. Here, we would like to indicate that there is no such evidence of inflation causing social discontent in India, especially as India has not experienced hyperinflation. Even during the pandemic, inflation has not increased abruptly, reflecting coordinated monetary-fiscal measures. Further, with the Indian economy remaining strong and resilient and the social fabric being strong, shocks have created headwinds but not instability.

23. We disagree with the staff assessment of financial sector vulnerabilities as ‘Medium’ under the risk assessment matrix. The Indian financial system remains strong and resilient. The banking system is in its best shape in more than a decade. There are no major vulnerabilities, and they are well capitalized. The ability of the financial system to absorb any shock depends on capital levels and strength of institutions’ balance sheets. Thus, even if an external or domestic shock occur, both banks and nonbanks are well positioned not to amplify those shocks and continue to provide financial services to the real economy.

Potential Growth

24. Staff have revised India's potential growth estimate from 6% to 6.3% in the baseline scenario, reflecting primarily larger-than-expected capital spending and higher employment. However, the staff estimate suffers from several infirmities. For estimating the growth in Total Factor Productivity (TFP), staff use the historical relationship between labour productivity growth and TFP growth during 1985-2019. This is problematic on several counts. First, the fundamental conceptual flaw here is that TFP is the *residual* after the effect of the contribution of capital and labour to potential growth has been accounted for. So, to correlate a measure that is a residual (after the effect of labour has already been accounted for) on labour has no economic justification as it resembles double-dipping on the contribution of labour. Second, Kotera and Xu (2023), which staff use as the primary source for their potential growth estimation, document that India's growth has primarily resulted from capital growth with minimal labour growth. In contrast to stagnant labour growth, TFP has been growing strongly, at 2.7% from 2014 to 2019 (the latest year when the data is available), as against 1.3% from 2002 to 2013. Correlating a variable that has grown strongly – TFP – with a variable that has been stagnant – labour – and using such a spurious correlation to estimate TFP runs against the basics of statistical estimation. Third, Kotera and Xu (2023, page 6) document that India's growth increased significantly from the early 2000s. Therefore, on top of the spurious correlation explained above, using a period starting from 1985 – when there has been a perceptible regime change in growth from the early 2000s – does not seem to reflect a realistic assessment. Fourth, given the high growth trajectory that India has obtained over the last several decades, every variable that is input into growth estimation – labour, capital, TFP – has been trending up in levels. For all these variables, staff use various methods to project the estimate for the future. The only variable where staff use the latest available value, which is also the highest in the entire sample, is depreciation. Of course, incorporating a higher value for depreciation lowers the potential growth estimate. So, the unconventional choice that staff make for depreciation – in contrast to all the other inputs – is symptomatic of their modelling approach. The cumulation of all these unconventional and unrealistic assumptions is reflected in the fact that staff have not provided any convincing explanation for the significant difference in the **baseline** growth estimate – assuming no reforms whatsoever, using the same Solow growth model as staff, the same Penn World Tables data as staff, and for the same period as staff – of 7.1% in Subramanian (2023) *vis-à-vis* their 6.3%.

25. Emerging Market Economies are evolving and more complex, and it requires greater analytical rigor to comprehend the economic dynamics and the underlying growth impulses, especially when key structural reforms are changing the economic path for such economies. We appreciate staff efforts and urge an approach where the different boundary conditions of such economies are incorporated into the standard paradigms primarily focused on describing advance economies.