



# **International Monetary and Financial Committee**

Twenty-Eighth Meeting  
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**Statement by P. Chidambaram,  
Minister of Finance, India**

On behalf of Bangladesh, Bhutan, India, Sri Lanka



**Statement by Finance Minister Mr. P. Chidambaram  
Leader of the Indian Delegation to the  
International Monetary and Financial Committee  
Washington DC, October 2013**

**(Representing the Constituency consisting of Bangladesh, Bhutan, India  
and Sri Lanka)**

Mr. Chairman,

We are meeting at a time when global growth prospects, have not only weakened, but global recovery has become uneven. Even as economic activity in the US is seen to be expanding and there appear to be some signs of economic activity stabilising in the Euro area, on the whole, global growth prospects have weakened since we last met in April 2013. This is both because of weakening of growth prospects in some emerging market economies (EMEs) and also a downward revision of growth in both the US and in the Euro area. We should, therefore, focus on policies that will not only help in achieving strong global growth going forward, but also foster resilience.

2. EMEs experienced significant capital outflows in the recent period on the first signs that the US Federal Reserve might be tapering its quantitative easing programme. The weakening in the EMEs growth prospects, since we last met, has not solely been an outcome of the responses needed to combat high volatility in the global financial markets and large capital outflows. Domestic factors have also played a part. Nevertheless, disruptive movements in exchange rates and other asset prices that arose on the back of tapering concerns have impacted confidence and hence growth prospects. When we met in April 2013, we agreed that eventual exit from monetary expansion will need to be carefully managed and clearly communicated. Recent financial market developments have raised serious concerns about an orderly exit from the unconventional monetary policies (UMP). We had also agreed to act decisively to nurture a sustainable recovery and to build resilience in the global economy. Even five years after the global financial crisis began, a strong and sustainable global recovery has eluded us so far. It is, therefore, imperative to review the progress made in achieving our objectives so that the challenges facing the global economy can be met effectively.

**A. The Global Economy and Financial Markets**

3. The global economy, which was showing some signs of stabilising in April 2013, is now facing a new set of challenges, even as old challenges remain. It is encouraging that economic activity in the US has been expanding, *albeit* at a moderate pace, on the back of strong private demand, but constrained by the budget sequestration. Economic activity is expected to pick up further as fiscal

consolidation eases, going forward, although immediate growth prospects in the US have become clouded due to the recent impasse in the US budget process. The Euro area remains constrained through low/negative growth, although economic activity is beginning to stabilise in the periphery. Emerging market economies, which have been the main drivers of global economic growth in the recent period, are now facing the prospects of slowing growth, in part, due to tightening of external financing conditions.

4. Global financial market conditions, which were showing signs of improvement in April 2013, have now become uncertain. The prospect of tapering of quantitative easing led to a sudden and significant increase in long-term yield of US treasuries. Equity markets both in advanced and emerging market economies declined significantly; market and liquidity risks have increased; and EMEs have experienced severe downward pressure on their exchange rates. Credit conditions in many advanced economies, especially in the Euro area, remain tight. Financial fragmentation in the Euro area persists. Although financial markets have since recovered somewhat as the US Fed decided to defer the tapering of its asset purchases, uncertainty continues to grip the financial markets as it is only a matter of time before the exit from the UMP begins.

5. High unemployment, financial fragmentation and tight credit conditions, and the necessary balance sheet adjustments in the public and private sectors will continue to weigh on economic activity in the Euro area, which is expected to pick up only gradually. Economic activity in Japan is also expected to slow down due to fiscal policy tightening.

### **Policy Challenges**

6. The current state of the global economy poses serious challenges to the policymakers, both in advanced and emerging market economies. A major challenge for major advanced economies is to ensure a smooth exit from the unconventional monetary policies. Recent developments suggest that if the exit from UMP is not orderly, it could threaten global financial stability both in advanced and emerging market economies. This, in turn, is likely to impact the fragile global recovery. There are no precedents to guide expectations relating to the consequences of unwinding. The policymakers in advanced economies, therefore, must clearly communicate the parameters that will guide the exit from the unconventional monetary policies. Central banks in advanced economies should take into account the spillover effects of their potential exit from the unconventional monetary policies.

7. The period ahead will be challenging for emerging market economies. Therefore, there is a need to be vigilant to the risk of sudden stops and reversal of capital flows and resultant volatility in their financial markets. EMEs should also take all the necessary steps to build resilience by strengthening domestic fundamentals, building up the required level of reserves and preparing contingency plans. They should not hesitate to respond with appropriate policies to preserve growth and financial stability.

8. A major challenge before the Euro area is to revive growth. Given the complex nature of the problem, with several factors reinforcing each other, the authorities need to move on several fronts at the same time. Measures must be taken to break the adverse bank-sovereign feedback loop and address financial market fragmentation. A faster progress is required towards banking union.

9. The Fund, with its almost universal membership, is in a unique position to ensure multilateral policy dialogue and cooperation on key policy challenges facing the global economy. In view of the likely bumpy exit from the unconventional monetary policies, the Fund needs to undertake an in-depth study as to how the unwinding will unfold, what impact it will have on different set of emerging market economies and how they should deal with the evolving situation. The Fund should foster multilateral dialogue on the likely impacts of the unwinding of UMP. It must play a role in better informing the spillover effects in a globally integrated world, so that advanced economies can take them into account while tailoring their policies.

## **B. The IMF's Role– Architecture for Global Cooperation**

10. I will now turn to some of the overarching issues relating to global cooperation that need to be addressed in the context of safeguarding global economic and financial stability in the period ahead.

### **Quota and Governance Reform**

11. The Board of Governors' resolution on the 2010 Quota and Governance Reform of the Fund had stated that each member would commit to use its best efforts to complete the required steps for ratification, no later than the Annual Meetings of 2012. However, this deadline could not be met by the time of the Tokyo Annual Meetings and there is still no clarity, even after the passage of a year, about when this will be finally done.

12. We have not succeeded yet in ratifying the 14th Quota Review despite the initial universal commitment to do so. We have not made any headway in moving towards the forward looking elements of the Review, namely the comprehensive review of the quota formula and the preparation of the 15th Review. Governance reforms are imperative to ensure the Fund's credibility, legitimacy and effectiveness.

13. We re-emphasize the urgent need, as agreed to earlier, to immediately conclude the 2010 IMF Quota and Governance Reform, as well as to complete the 15th General Review of Quotas and arrive at a new quota formula, by the agreed timeline of January 2014.

## **C. Developments in the Constituency**

14. I now turn to developments in my constituency.

### **Bangladesh**

15. The Bangladesh economy continues to achieve robust real GDP growth (6.03 per cent in FY13) and its macroeconomic fundamentals are among the best in the whole Asian region. The pace of growth is, however, slightly lower than anticipated due to depressed global growth and recent domestic political uncertainties. Resilient domestic demand, stable export performance and impressive remittance inflows, as usual, have been the main driving forces behind this impressive accomplishment. Moreover, Government's relentless efforts to remove supply side constraints by means of targeted investment in social and physical infrastructure and power and energy sector have bolstered the growth performance. Besides, prudent fiscal policy coupled with moderate monetary tightening has helped keep inflation below the 8 percent mark. In particular, point to point headline inflation decelerated to 7.39 per cent in August 2013 from the double digit level in March 2012 (10.1 per cent). While slower economic growth makes achieving revenue targets more challenging, on-going reforms and policy measures in the revenue administration together with strong revenue collection efforts have facilitated expected revenue mobilization. Under the 3-year ECF program with the IMF, the Government is implementing various reforms in the areas of tax policy and administration as well as public finance and debt management. At the same time, the Government reined in expenditure through prudent fiscal management and containment of subsidies. Moreover, persistent regulatory oversight led to improved outcome in annual development plan (ADP) implementation during FY13. On the whole, the overall budget deficit (excluding grants) stood at 4.4 per cent of GDP in FY13. The Government has been pursuing moderately restrained monetary policy to safeguard macroeconomic stability and keep inflation in check, while allowing adequate credit flows to the productive private sector. Most of the monetary aggregates remained in line with the monetary programs. The latest Monetary Policy Statement (July-December, 2013) is the continuation of the same policy stance. It also aims to preserve the country's external sector stability. In the external sector, current account balance (CAB) continues to be in surplus reflecting the increasing inflows of remittances coupled with sustained export expansion and declining imports. This also resulted in recent reserve build-up of more than US\$ 16 billion. The Bangladesh Bank is continuing to support a market based exchange rate while seeking to avoid excessive foreign exchange rate volatility.

### **Bhutan**

16. Real GDP growth in Bhutan remained strong in 2011-12, notwithstanding some moderation in growth to 8.5 percent from 11.7 percent during the previous year. Economic activity benefited from the support provided by the tertiary and secondary sectors, particularly construction, hotel and restaurants, and transport.

During 2012-13, the authorities continued to implement monetary policy, currency and prudential measures to rein in aggregate demand and tackle structural imbalances in the economy. The unemployment rate dropped from 3.1 percent to 2.1 percent in 2012. Per capita income rose to US\$ 2,590 in 2011 from US\$ 2,277 in 2010. Consumer price inflation moderated from 13.5 percent in the last quarter of the FY 2011-12 to 5.5 percent during the quarter ended June 2013. The fiscal deficit remains modest and decreased slightly from 1.1 percent of GDP in 2011-12 to 0.9 percent of GDP in 2012-13. The current account deficit was 20.5 percent of GDP in 2011-12 as compared with 25.7 percent of GDP in 2010-11. International reserves were US\$ 938 million in June 2013, sufficient to finance 12 months of total merchandise imports and 25 months of essential imports. The financial system remains safe, sound and resilient, with capital adequacy and liquidity well above the required prudential norms. In order to address the tight liquidity situation, the central bank reduced the CRR from 17 percent to 10 percent in March 2012 and further to five percent in June 2012. The Royal Monetary Authority (RMA) tightened prudential regulations on risk weights to reflect increasing loan exposure trends and risks in the case of sectors such as personal and housing loans while easing risk weights pertaining to productive sectors including agriculture. Going forward, the Bhutanese authorities expect economy activity to remain robust and real GDP growth is estimated to be 7.1 percent in 2013/14.

## **India**

17. Economic growth in India slowed down to 5.0 per cent in 2012-13. Although a part of the slowdown was due to weak and uncertain global macroeconomic environment, domestic constraints also played their part. Therefore, we have taken measures to ease supply constraints and improve investment climate. The Cabinet Committee on Investment (CCI), set up to remove blockages and fast-track large projects, has cleared projects amounting to more than US\$ 64 billion. Once these projects come into steam, which is expected in the next few months, they should have an all-round salutary effect. Growth is likely to pick up from the second quarter of 2013-14 onwards, facilitated, among others, by several projects cleared by the CCI. Financial markets in India came under pressure due to capital outflows triggered by the prospects of exit from the unconventional monetary policies. However, markets have since stabilised reflecting the various measures taken by the Government of India and the RBI.

18. Necessary measures have been initiated to contain the fiscal deficit and the current account deficit. The gross fiscal deficit has been budgeted at 4.8 per cent for 2013-14. The Government is committed to the path of fiscal consolidation and to contain the fiscal deficit at the budgeted level, and is prepared to take difficult decisions on this, should the need arise. We are taking steps to contain expenditure, particularly by better targeting the subsidies to the poorer sections of society. Going forward, commitment is to bring down the fiscal deficit to 3 percent by 2016-17. Public debt as a ratio of GDP continues on a downward trajectory. The current account deficit in the recent period has remained elevated mainly

due to large imports of gold, continued dependence on oil imports and production constraints in the coal and iron ore sectors. Efforts are being made to alleviate constraints in the coal and iron ore sectors. We have also taken steps to limit gold imports and they seem to be paying off. Growth of our exports has accelerated and net services exports have been growing strongly in recent months. The current account deficit is expected to be contained at US \$ 70 billion compared to US \$ 88 billion last year and this is expected to be fully financed by capital flows. Another major challenge facing the Indian economy is persistent inflation. While the WPI inflation has declined in recent months, the CPI inflation has continued to remain at elevated levels. Measures are being taken to bring down inflation through a mix of demand-side and supply-side policies.

### **Sri Lanka**

19. The Sri Lankan economy grew by 6.3 per cent during the first half of 2013, following an impressive growth averaging 7.5 per cent per year during the last three years. While subdued global economic activity had adversely affected external demand, the tight monetary policy adopted early 2012 and weather related production losses in the agriculture sector had a dampening effect on domestic demand in 2013. The industrial sector continued to post strong growth, largely driven by the thriving construction sector. The services sector continued to expand, supported by tourism, transport and financial services. Economic activity is expected to accelerate during the second half of the year with improved external demand, more accommodative monetary policy and favorable weather conditions. With growth moderating, the unemployment rate slightly increased to 4.4 percent in the second quarter of 2013.

20. The prudent demand management policies and moderation of commodity prices helped containing inflation within a single digit level in 2013, despite sizable adjustment in administered prices, including energy prices. Inflation moderated to 6.2 per cent in September 2013, from 9.2 percent at end 2012, enabling the Central Bank to further ease its monetary policy stance. Fiscal management remained challenging in 2013 with revenue continuing to fall below the targeted level, although public expenditure evolved in line with the budgetary targets. The slowdown in economic activity, including imports, mainly contributed to the decline in tax revenue. However, the government is committed to achieve the targeted fiscal deficit of 5.8 percent of GDP in 2013. Meanwhile, the bottom-line of the two major state owned enterprises, namely, the Ceylon Petroleum Corporation (CPC) and the Ceylon Electricity Board (CEB) have significantly improved with the revisions made to fuel and electricity prices and increased availability of hydropower in 2013.

21. The external sector further improved in 2013 with reduced trade deficit, increased services exports and higher workers' remittances resulting in the current account deficit to decline. With increased inflows to the capital and financial account, including FDI and portfolio investments, the balance of payments strengthened although valuation losses due to excessive currency movements and the sharp fall in the price of gold since May 2013 has had some



pressure on the international reserves. The gross official reserves slightly increased to US dollars 7.0 billion (equivalent to 4.3 months of imports) by end September 2013 from US dollars 6.9 billion at end 2012. The financial sector remained healthy with high capital adequacy, asset quality and improved profitability.

## **Conclusion**

22. The global economy is passing through a phase of many changes. Although the improving economic activity in the US is a good sign, a smooth exit from the unconventional monetary policies poses a major challenge for the policymakers in advanced and emerging economies. Given the risks involved in the exit from the unconventional monetary policies, there is a need to communicate clearly to market participants the parameters that will guide the exit. Emerging market economies also need to strengthen their domestic fundamentals and be prepared with appropriate policy responses in different scenarios, to meet the challenge arising out of exit from the unconventional monetary policies in advanced economies. The global recovery is as yet fragile. Hence, it needs to be ensured that it is nurtured and put on a sustainable path through appropriate policy actions, both in advanced and emerging market economies. Dialogue, cooperation and effective communication, on a multilateral basis, would be important in ensuring this.

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