



International Monetary and Financial Committee

Thirty-First Meeting
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**IMFC Statement by Arun Jaitley
Minister of Finance, India**

On behalf of Bangladesh, Bhutan, India, Sri Lanka

Statement by Mr. Arun Jaitley
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Leader of the Indian Delegation to the
International Monetary and Financial Committee
Washington DC, April 2015
(Representing the Constituency consisting of Bangladesh, Bhutan, India
and Sri Lanka)

Mr. Chairman,

1. The global recovery continues to be weak. Although recovery in the US has taken a firm hold, weak growth in the euro area and Japan and slowdown in growth in most major emerging market economies have impacted the overall global growth prospects. Deflationary pressures in the euro area continue to pose a challenge to macroeconomic management and debt sustainability. It is also worrisome that potential output growth has declined in recent years in both advanced and emerging market economies. Accommodative monetary policy practiced by central banks in the major advanced economies for a prolonged period of time as a response to deflationary pressures creates financial stability risks

2. When we met in October 2014, we committed to lifting potential growth and to creating a more robust, sustainable, balanced, and job-rich global economy. We also agreed that we would pursue bold and ambitious measures to: invigorate demand and remove supply constraints through appropriate macroeconomic policies and critical structural reforms; place government debt on a sustainable track; safeguard financial stability; reinforce cooperation to manage spillovers; and continue to rebalance global demand. However, the actual outcome, so far, has been somewhat disappointing.

3. At this juncture, the global economy is faced with some major challenges. First, potential growth has declined in both the advanced and emerging market economies and needs to be raised. Second, uncertainty continues about the smooth exit from the unconventional monetary policies (UMPs) by central banks in the major advanced economies. As a consequence, global financial stability risks have exacerbated in the wake of prolonged period of low interest rates. It is in this context that we need to review the evolving global macroeconomic situation and financial market conditions so that appropriate policy responses could be initiated by the policymakers in both the advanced economies and emerging market economies.

A. The Global Economy and Financial Markets

4. Despite being supported by a sharp decline in commodity prices, especially oil, and continuing accommodative monetary policy by central banks in the major advanced economies, global growth remains modest. Among the major advanced economies, recovery seems to have taken a firm hold in the US. The economic activity in the US is stronger than expected, and indicators point to robust growth in the short term.

5. The recovery, however, continues to be extremely weak in the euro area. Unemployment remains at an extraordinary high level. Private sector debt overhang and continuing credit contraction due to high Non Performing Loans (NPLs) of the banking sector continue to weigh on economic activity. Even as growth remains weak, negative inflation in the euro area has emerged as a major challenge as it could exacerbate debt dynamics. To deal with deflationary pressures, the ECB resorted to quantitative easing on a large scale.

6. Growth has also weakened in EMEs even as many oil importing emerging market economies have benefitted from a sharp decline in oil prices. Weakening of growth in emerging market economies is mainly due to country-specific factors. Despite slowdown in growth, emerging market and developing economies continue to be the main driver of global growth.

Policy Challenges

7. The current macroeconomic situation and financial market developments continue to pose several challenges for policymakers in both advanced economies and emerging market economies. Unconventional monetary policies by major advanced economies for a prolonged period raise some serious concerns. First, the effectiveness of such policies may be limited when other enabling conditions are absent. For instance, high private debt overhang and high NPLs of banks impair monetary transmission and reduce the effectiveness of the UMPs. Second, such policies create spillovers for other emerging and developing economies and make their macroeconomic management difficult. Third, UMPs create financial stability risks by encouraging excessive financial risk taking. Fourth, since UMPs are unprecedented, the exit from such policies creates its own challenges. The exit, when it commences, could create turbulence in global financial markets. Central banks in the major advanced economies, therefore, need to take into account the impact their policies may have on other emerging and developing economies. The IMF, which has been supporting such policies, also needs to reconsider whether UMPs militate against the core mandate of the Fund to maintain exchange rate stability

8. Many emerging market economies have benefitted from the sharp decline in oil prices. It provides a window to implement energy reforms, phase out subsidies and build fiscal buffers wherever macroeconomic conditions permit. A major challenge for emerging market economies is to raise growth by implementing growth critical structural reforms. The focus, in general, should be on encouraging infrastructure investment, strengthening the investment climate and improving human resource skills through education and training. EMEs also need to be prepared to deal with any shock that may arise on account of interest rate normalization by the US Fed and accommodative monetary policies in the euro area and Japan. In particular, EMEs need to build buffers and address corporate sector and banking vulnerabilities.

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

9. I now turn to a key overarching issue relating to global co-operation that needs to be addressed in the context of safeguarding global economic and financial stability in the period ahead.

Quota and Governance Reform

10. We are greatly disappointed that the 2010 Quota and Governance Reforms have not become effective in spite of the strong support of the global community for the reform. We are also concerned that we have not made any headway in the forward looking elements of the 15th Review, including the review of the quota formula and the initiation of the discussions on the Review.

11. Governance reforms are required to ensure the Fund's credibility, legitimacy and effectiveness. They are also most imperative to maintain its relevance. They, therefore, should not be deferred indefinitely. We urge the members who have not yet ratified the 2010 Quota and Governance Reforms to do so at the earliest. In the interregnum, as indicated in the Board of Governors' Resolution of February 2015, the Executive Board should work expeditiously to complete its work to make meaningful progress in the key areas covered by the 2010 Quota and Governance Reforms pending their full implementation. Among the options being considered, we believe that the delinking option remains the most desirable option since it is the nearest in form and substance to the 2010 reform package. The ad hoc option would reduce the incentive to implement the 2010 reforms in full. Further, it is important to begin work in earnest on the 15th Review so that it can be completed by December 15, 2015 as mandated under the Articles of Agreement. The continuance of such momentum in the IMF governance and quota reforms is essential to maintain the effectiveness, credibility and relevance of the IMF as a multilateral quota based institution, which reflects adequately changes in the global economy in a dynamic framework.

C. Developments in the Constituency

12. I now turn to developments in my constituency.

Bangladesh

13. The macroeconomic environment in Bangladesh continues to be stable. Despite the resurfacing of political agitations in January, the Government expects growth in financial year (FY) 15 (ending in June 2015) to be 6.7 per cent, higher than the IMF's estimate of 6.1 per cent. It also expects growth in FY 16 to be 6.7 per cent.

14. Headline inflation eased to 6.1 per cent in February 2015 driven mainly by a decline in food prices on the back of a good rice harvest and weak global commodity prices. The Bangladesh Bank has been maintaining a restrained monetary policy stance in order to attain the average inflation target of 6.5 per cent in FY15. Despite the fall in global oil prices, the current account balance is expected to decline in FY15 as oil import volume and non oil

import growth has been stronger than expected, and export growth has been subdued. The subdued export performance reflects the adjustment to higher labor and safety standards by the garment industry, disruptions caused by ongoing agitations, and possibly some impact from appreciation of the real effective exchange rate and some slowdown in external demand. Foreign exchange reserves continue to be comfortable at more than 6 months of imports. Despite weaker than expected revenues, the fiscal deficit is likely to remain controlled at about 4.0 per cent of GDP in FY15 because of contained expenditure, helped by lower fuel subsidies. However, the government has successfully protected poverty related spending. In the financial sector, lending by state owned commercial banks has remained contained. The banking sector is being carefully monitored after discovery of irregularities in some state owned banks.

15. The new VAT law, expected to raise fiscal revenues permanently, was planned for launch in July 2015. However, it has been delayed by a year due to complications in the finalization of a software tender and appointment of a project management consultancy. The government had also appointed a joint committee with business federations to look into the latter's concerns and recommend possible amendments to the law. The committee has submitted its report and after considering it, the Government does not intend to make any substantive change in the law except raising the threshold for businesses.

Bhutan

16. Real GDP growth in Bhutan is expected to recover to 6.8 percent in 2014-15 from 4.7 percent in 2013-14. This improvement in economic activity in 2014-15 will be underpinned by growth in construction, mining and quarrying, and manufacturing sub-sectors. The slowdown of growth to 4.7 percent in 2013-14 was partly the outcome of monetary and macro-prudential policy actions to rein in domestic demand to address external imbalances. With the introduction of fiscal measures by the Government, in particular new and increased taxes on the import of vehicles and fuel, the Royal Monetary Authority of Bhutan (RMA) phased out the temporary credit restrictions imposed on the housing and transport portfolios from September 2014. Consequently, credit growth is expected to pick up to meet pent-up as well as new demand, which is getting reflected in higher GDP growth in 2014-15. Going forward, the RMA will continue to monitor credit growth and review and revise its macro prudential regulations, as necessary, to counter prospective overheating.

17. Consumer price inflation (year-on-year) moderated to 6.7 per cent in the fourth quarter of 2014 from 11.3 per cent in the fourth quarter of 2013, driven by reduction in both food and non-food inflation. The fiscal deficit in 2013-2014 was contained at about 4.4 percent of GDP with the initiation of several expenditure rationalization measures by the Government as well as decrease in investment. The current account deficit, estimated at 26 per cent of GDP in 2013-14 was broadly unchanged from 2012-13, reflecting large imports associated with the construction of hydropower plants. Bhutan's international reserves were USD 1,184 million in December 2014, equivalent to 16 months of merchandise imports. The financial sector remains sound with the capital adequacy and liquidity ratios well above the required prudential norms. However, non-performing assets (12 per cent as of June 2014) remain a policy concern.

India

18. The Indian economy is now clearly on a recovery path. India's growth recovered to 7.4 per cent in the first three quarters (April-December) of 2014-15 as compared with 7.0 per cent during the same period of last year. Advance estimates have also placed the GDP growth for the full year of 2014-15 at 7.4 per cent. Medium-term growth prospects have also improved following recent policy initiatives towards unlocking coal and other mining activity, liberalization of foreign direct investment limits and a renewed thrust on public investment in infrastructure, which would help to improve the investment climate.

19. Inflation, which was a major concern for India during 2010-13, has moderated significantly. CPI inflation, which is now used as the main measure of headline inflation by the Reserve Bank of India (RBI), declined to 5.2 per cent in March 2015 from 11.2 per cent in November 2013. Reflecting softening of inflation, both near-term and longer-term inflation expectations of households have also moderated to single digits. In terms of the flexible inflation targeting framework adopted recently, going forward, the Reserve Bank of India will seek to bring the inflation rate to the mid-point of the band of 4 +/- 2 per cent, *i.e.*, to 4 per cent by the end of a two year period starting fiscal year 2016-17.

20. India has continued on the path of fiscal consolidation. The GFD of the central government, which was 5.7 per cent of GDP in 2011-12, declined to 4.1 per cent in 2014-15 and is budgeted to decline further to 3.9 per cent in 2015-16. India's current account deficit (CAD) declined sharply from 4.8 per cent of GDP in 2012-13 to 1.7 per cent in 2013-14 and is expected to decline further to 1.3 per cent in 2014-15. Reflecting the improved domestic macroeconomic situation as also the continued accommodative global monetary conditions, India has received large portfolio flows in the recent period - much higher than the current account deficit. This has enabled the Reserve Bank of India to build up its foreign exchange reserves, which are now at US\$ 343 billion (as of April 3, 2015), up by US\$ 67 billion from the level at end-August 2013. As such, India is now better prepared to deal with global financial market volatility that could arise in the context of US monetary policy normalization.

21. India has been placing a special emphasis on financial inclusion. In a short span of about eight months, a record number of 147 million bank accounts have been opened under a new scheme (*Pradhan Mantri Jan Dhan Yojana*). The opening of a large number of accounts should also facilitate direct benefit transfers to the beneficiaries and improve public expenditure management.

22. We are committed to maintain overall macroeconomic conditions on a sustained basis so that the Indian economy is able to achieve and sustain growth of 8 per cent and above.

Sri Lanka

23. The growth momentum of the Sri Lankan economy continues while inflation remains contained. The economy grew by 7.4 per cent in 2014, following 7.2 per cent in 2013. The strong performance in the industry and services sectors supported by recovering external

demand helped in maintaining the growth momentum. The year-on-year inflation declined to 2.1 per cent by end 2014. The inflation rate declined further to a very low level of 0.1 per cent in March 2015, largely reflecting adjustment of energy and other commodity prices in tandem with international prices and reduction of import duties on certain food items under the *100 day program* of the new administration in January 2015. Meanwhile, the unemployment rate continued to remain low at 4.3 per cent in the first three quarters of 2014.

24. In the absence of demand pressures and continued low credit growth, the Central Bank further eased its monetary policy stance during the year. With a significant improvement in services exports, including earnings from the thriving tourism sector, and increased workers' remittances, the current account deficit narrowed down to 2.7 percent of GDP in 2014, a notable improvement from 3.8 percent in 2013. Although some outflows were observed towards the end of the year in foreign investments in rupee denominated government securities, other financial inflows, including FDI and inflows to the government, helped the BOP to record a higher surplus in 2014. Accordingly, gross international reserves increased to US dollars 8.2 billion at end 2014, which was adequate to cover 5.1 months of imports, compared to 5.0 months at end 2013. With these developments, the Sri Lanka rupee, which remained broadly stable against the US dollar in the first nine months of the year, depreciated marginally during the last quarter of the year. From the fiscal front, despite the government's continued commitment to fiscal consolidation, the overall fiscal deficit increased to 6.0 per cent of GDP in 2014 from 5.9 per cent of GDP in the previous year, mainly as a result of the continued shortfall in revenue collection. Nevertheless, public debt as a percentage of GDP continued to decline by nearly 3 percentage points in 2014 to 75.5 percent. In the financial sector, the strengthened regulatory and supervisory framework, improved risk management and adequate buffers to mitigate risks, helped financial institutions to remain resilient during the year.

Conclusion

25. The global macroeconomic scenario remains a cause of concern. Even as the growth outlook remains modest, financial stability risks remain heightened. It is also worrying that potential growth in both advanced and emerging market economies has declined. The current global macroeconomic situation, therefore, poses several challenges to the policymakers. A major challenge is to put the global growth on a high sustainable path. The need is to use fiscal space, wherever available, and implement growth-critical structural reforms. In particular, structural reforms would boost confidence in the short run and help raise medium term growth potential. There is a need to avoid too much emphasis on the unconventional monetary policies in the major advanced economies. Both advanced and emerging market economies need to take measures to address financial stability risks. It is imperative that interest rate normalization by central banks in the major advanced economies is predictable and well communicated. We nevertheless need to remain prepared to deal with any challenge, should there be a disorderly exit from the UMPs in the major advanced economies.