International Monetary and Financial Committee

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IMFC Statement by Urjit R. Patel
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India

On behalf of
Bangladesh, Bhutan, India, and Sri Lanka

Statement by Dr. Urjit R. Patel, Governor, Reserve Bank of India (On behalf of Mr. Arun Jaitley, Member, IMFC representing the Constituency consisting of Bangladesh, Bhutan, India and Sri Lanka), Leader of the Indian Delegation to the International Monetary and Financial Committee

April 21, 2018

Mr. Chairman,

1. Since we met in October last year, global economic recovery has continued to strengthen and the outlook for the next two years is encouraging. The United States, Europe and Asia have benefited from buoyancy in global trade and investments. However, there are concerns that a durable recovery may remain constrained by factors such as the persistence of low productivity in advanced economies (AEs), debt overhang problems in AEs and some emerging market economies (EMEs), rising populism and protectionism, and slow pace of structural reforms, notably in infrastructure sector and labor laws. Measures that reduce structural impediments, strengthen policy buffers, and promote inclusive growth, will lay the basis for enduring recovery.

2. As called upon by the First G20 Meeting of Finance Ministers and Central Bank Governors of G20 leaders in March 2018 in Buenos Aires, we need to deploy all our policy tools to support strong, sustainable, balanced and inclusive growth. Their implementation should be coordinated with fiscal support that is flexible and focused on high quality investment to support growth and debt sustainability. As earlier called by G-20 Leaders at the Hamburg Summit in 2017, we also need to reaffirm our commitment to cooperative trade and investment framework, based on a principle of level playing field.

3. Growth in emerging market and developing economies (EMDEs) is improving although prospects in some countries are challenging due to the recent commodity price movements. We support a strengthening of structural policy adjustments based on sustainable fiscal and monetary policies to sustain global economic resilience. We also support the implementation of sound financial sector policies to mitigate risks within the international financial system.

The Role of IMF- Architecture of Global Cooperation

4. Although the quota increases under the 14^{th} General Review of Quotas (GRQ), renewal of New Arrangements to Borrow (NAB) and bilateral commitments have helped in maintaining the current lending capacity, the International Monetary Fund would continue to require sufficient resources to respond to actual, potential, or prospective financing needs going forward, in line with its mandate. A strong quota-based permanent resource base for the International Monetary Fund (IMF) would serve to strengthen the Global Financial Safety Net (GFSN) and mitigate risks to the international monetary system. We strongly support the shared multilateral commitment on completing the 15^{th} GRQ by the 2019 Spring Meetings and no later than the 2019 Annual Meetings as we call for the realignment of quota shares of EMDEs whose under-representation has increased further

by 0.5 percentage points in the last update, leading to under-representation of 7.5 per cent. We also lend our voice in favour of protecting the quota and voting share of the poorest members under the 15th GRQ.

5. The IMF should continue to strengthen its capacity for multilateral surveillance to identify evolving global vulnerabilities. We welcome the emphasis by the Fund on sharpening its toolkit to serve the membership, especially the low income countries (LICs) with meaningful and timely lending support and policy advice. We welcome the Fund's engagement and coherence with Regional Financing Arrangements (RFAs), which would strengthen the GFSN.

6. We call upon the IMF to develop credible policy advice for rebalancing of the global economy while drawing attention to the adverse implications of policy spillovers on other countries. The intensifying challenges to multilateralism call for unequivocal and forceful voice of the IMF and WTO in favour of rule-based international trading system and against protectionism.

DEVELOPMENTS IN THE CONSTITUENCY

A. BANGLADESH

7. The Bangladesh economy continues to perform well, supported by steady monetary policy management and fiscal discipline. The real GDP growth in FY18 (ending in June 2018) is projected to remain strong at around 7.7 per cent compared to 7.3 per cent in FY17. After picking up in mid-FY18 following higher flood-related food prices, inflation is expected to decline to below 6 per cent, which is the central bank's FY18 ceiling. In FY18 so far, point-to-point inflation has risen to 5.8 per cent (annual average CPI inflation is 5.7 per cent) in December 2017.

8. Monetary policy stance will continue to remain prudent, and the authorities remain vigilant against upside risks to inflation and in readiness for policy rate adjustments. Excess liquidity in the banking system has declined in recent months, as credit growth has picked up. The central bank is engaged in strengthening supervision and corporate governance in banks that can lead to lower credit and concentration risks and, subsequently, lower non-performing loans (NPLs).

9. On the external front, the current account balance recorded a deficit of US$ 1.48 billion during FY17 so far against a high surplus of US$ 4.3 billion in FY16, because of strong import growth (9.0 per cent) accompanying slight acceleration in exports (1.7 per cent) and a steep decline in remittance inflows (14.5 per cent) resulting in forex reserves depletion and Taka depreciation. The FY18 current account deficit (CAD) is projected at US$ 4.3 billion. Import coverage by reserves – currently at US$ 33.2 billion – is at 6 months in FY18 – slightly lower than in FY17. Bangladesh government is proactively engaging in bilateral and multilateral trade negotiations towards widening market access and diversifying the export basket.

10. Fiscal deficit (excluding grants) in FY18 is expected to remain at around 5.0 per cent. Budget financing is to be mainly done through National Savings Certificates (NSCs) and from bank and non-NSC sources. Gross investment as per cent of GDP has risen in FY17 to 30.5 per cent from 29.7 per cent in FY16.While donor support will continue to be essential in meeting additional spending pressures from the Rohingya crisis, the deferral of value added tax (VAT) is not likely to pose any major concern if the strong revenue growth momentum of FY17 continues and expenditures are kept in check. The government's reform initiatives to improve the business climate and ease infrastructure bottlenecks, including developing special economic zones (SEZs), should help crowd in both private domestic and foreign direct investments (FDI) that can create more jobs, raise productivity, and potential growth.

B. BHUTAN

11. Bhutan’s economic growth continued to accelerate in 2016 at 8 per cent, in line with the performance of the preceding three years where growth averaged a little over 6 per cent. The high growth continued to be driven by secondary and tertiary sectors. The medium-term outlook is also promising, with the commissioning of new hydropower projects expected to provide further impetus to output and exports, as well as to fiscal revenues.

12. CPI inflation has grown significantly in FY 2016-17 following the price movements in India and the global markets. The overall CPI inflation rose to 5.5 per cent in Q2, 2017 from 3.3 per cent during the same quarter in the previous year. Higher inflation was an outcome of both, an increase in domestic demand and temporary issues in the supply chain which led to higher food inflation.

13. Despite the government’s efforts to pursue sustainable fiscal path over the medium-term through expenditure rationalization and revenue enhancement measures, the revised budget for FY 2016-17 resulted in an overall fiscal deficit of Nu.6.49 billion (4.1 per cent of GDP) compared to Nu.1.56 billion in FY 2015-16. However, by the end of 12th five year plan (FYP, 2022-23) the fiscal deficit is projected to be in a surplus at 7.0 per cent of GDP. The improvement is mainly attributed to the commissioning of Mangdechhu, Punatsangchhu I & II hydropower projects in the medium-term.

14. On the external front, the trade deficit improved from 28.4 per cent of GDP to 20.9 per cent during FY 2016-17, resulting in a lower CAD of 24.4 per cent of GDP. The deficit is a result of the imports for the construction of hydropower projects. It is expected to decline after 2018-19 with the commissioning of 4 new power plants and the resultant export of power. In the longer run, the current account balance is likely to return to a surplus. Foreign currency reserves also remain at a comfortable level and sufficient to finance 12.5 months of merchandise imports.

15. Credit to private sector growth recorded at 15.4 per cent in June 2017 with a slight increase from 14.7 per cent in June 2016. The growth in credit was mainly contributed by the access to credit transmitted through financial inclusion initiatives.

C. INDIA

16. The Indian economy turned in resilient performance in 2017-18 (April - March). Although real GDP growth moderated to 6.6 per cent from 7.1 per cent a year ago, there was a strong rebound in the second half of the year on the back of a turnaround in investment demand, supported by an acceleration in manufacturing, rising sales growth, a pick-up in capacity utilisation, strong activity in the services sector and a record agricultural harvest.

17. Several factors are expected to accelerate the pace of growth in 2018-19. There are now clearer signs that the revival in investment activity will be sustained. Global demand has been improving, which should encourage exports and boost fresh investments. On the whole, real GDP growth is expected to expand at 7.4 per cent in 2018-19, with risks evenly balanced.

18. Since November 2016, headline consumer price inflation has remained generally below the medium-term target of 4 per cent. An unusual spike in vegetables prices pushed up inflation to a recent peak of 5.2 per cent in December, but it eased in subsequent months to reach 4.3 per cent in March. Several factors are likely to influence the inflation outlook, including a possible moderation in food prices if the monsoon turns out to be normal and is supported by effective food supply management. Countervailing this, upside risks emanate from the distinct hardening bias in crude oil prices, the steady firming up of inflation excluding food and fuel mirroring pick up in domestic demand, and spillovers from financial volatility as markets re-price the path of monetary policy normalisation by systemic central banks. Noting that risks to inflation are tilted to the upside, the monetary policy rate was kept unchanged at 6.0 per cent in April 2018 with a neutral stance.

19. The government is committed to fiscal prudence. Helped by buoyancy in tax revenues and rationalisation of subsidies, the gross fiscal deficit (GFD) of the central government has been steadily brought down since 2013-14 to 3.5 per cent of GDP in 2017-18 without compromising on public investment requirements and social sector spending. The GFD is budgeted lower at 3.3 per cent in 2018-19. The government has accepted a debt rule that will bring down the debt-to-GDP ratio to 40 per cent over a period of time by 2024-25. The goods and services tax (GST), which was implemented from July 2017 has reformed the system of indirect taxes by simplifying payments and credits, and improving the efficiency of movement of goods across the country. Automation of tax payments and ‘team based assessment with dynamic jurisdiction’ without direct interface with tax payers has improved overall efficiency and transparency of revenue administration.

20. Driven by the pace of import growth relative to that of exports, the current account deficit (CAD) expanded from 0.7 per cent in 2016-17 to 1.9 per cent for the first nine months of 2017-18. External financing conditions remain comfortable, boosted mainly by robust inflows of foreign direct investment (FDI). The UNCTAD’s survey of multinational enterprises ranked India as the third most favoured destination for FDI for 2017-19. Reflecting these developments, India’s foreign exchange reserves at US$ 424 billion were equivalent of 11 months of imports.

21. Meanwhile, India has persevered with structural reforms over a wide area ranging from a flexible inflation targeting framework for monetary policy; liberalization of FDI flows; a unique identification (Aadhaar) backed direct benefit transfers; an insolvency and bankruptcy code; the GST; realty reforms; and a swathe of measures for improvement in the ease of doing business more generally. These factors have improved India's global ranking in the World Bank's Ease of Doing Business.

D. SRI LANKA

Sri Lanka

22. Growth of the Sri Lankan economy moderated further in 2017, recording an annual growth of 3.1 per cent in 2017 compared to 4.5 per cent annual growth in 2016. Growth of all three sectors, namely Agriculture, Industry and Services, remained moderate, although the recovery of the agriculture sector, which was affected by adverse weather conditions, was visible towards the last quarter of the year. Growth in the industry sector was supported by the expansion in manufacturing, construction and mining and quarrying activities. The services sector growth was driven by financial services, wholesale and retail trade and other personal services activities. The economy is expected to grow by around 5 per cent in 2018 with the realization of foreign investment flows, improved domestic investment climate and the continued recovery in key global markets for Sri Lankan exports. With ongoing structural reforms, Sri Lanka's economy is expected to move to a higher growth path in the medium term.

23. Consumer price inflation, which accelerated during 2017 due to domestic supply side disruptions, rising international commodity prices and tax adjustments, moderated towards the desired mid-single digit levels in the first quarter 2017. Headline inflation as measured by the change in National Consumer Price Index (NCPI), which peaked at 8.8 per cent in October 2017, decelerated to 3.2 per cent by February 2018. Core inflation remained at the subdued level of 2.0 per cent by February 2018. The Central Bank maintained a tight monetary policy from end 2015 to maintain macroeconomic stability and to contain the buildup of adverse price and wage inflation expectations. Accordingly, the Central Bank tightened the monetary policy by raising the Statutory Reserve Ratio (SRR) by 1.5 percentage points to 7.5 per cent and raised policy interest rates by 100 basis points during 2016 and a further 25 basis points in 2017. Along with complementary macroprudential policies and tax adjustments, the growth of credit to the private sector as well as overall monetary expansion moderated to desired levels by end 2017. Considering the favorable developments in inflation and inflation outlook as well as lower than expected real GDP growth that further widened the prevailing gap between actual and potential GDP growth, the Central Bank eased the monetary policy by reducing the upper bound of its policy interest rate corridor by 25 basis points in early April 2018 with the view of addressing the near term tepid growth prospects. The tax revenue collection of the government improved in 2017 although there was some moderation in non-tax revenue. In spite of government's efforts, budget deficit expanded to around 5.5 per cent GDP in 2017, mainly as a result of expenditure incurred on natural disaster related expenditure. The 3-year extended arrangement under the Extended Fund Facility (EFF) of USD 1.5 billion with the IMF

continued, and this program is expected to strengthen the performance of the external and fiscal sectors of the economy, in particular.

24. Sri Lanka's external sector performance was mixed in 2017. Although earnings from exports grew at double digit rates with the reinstatement of the EU GSP+ facility, imports also increased mainly as a result of increased drought related imports as well as increased gold imports. Increased tourist arrivals as well as other services sector inflows supported the current account although there was a marginal moderation in workers' remittances. Higher inflows in terms of foreign direct investment were observed while inflows to the government were also considerable. Both the rupee denominated government securities market and the Colombo stock market recorded positive net inflows. These developments resulted in an overall surplus in the balance of payments in 2017, and the Central Bank built up official foreign reserves to US dollars 8.0 billion by end 2017 from US dollars 6.0 billion recorded at end 2016. The Sri Lanka rupee depreciated against the US dollar by 2.0 per cent against the US dollar during 2017.

25. Meanwhile the banking sector remained stable with improved soundness indicators, while firm action was taken to resolve issues with regard to some institutions in the non-bank financial sector. The financial sector resilience is expected to improve further with the ongoing transition to IFRS 9 and Basel III regulatory requirements.