

## South Asia: Strong Regional Growth, Tepid Global Growth

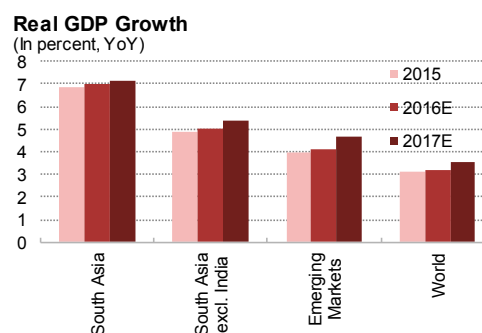
South Asia's economic performance remains resilient in the presence of volatile global financial markets. Real GDP growth in the region is likely to remain above 7 percent in 2016 and 2017, while inflation is projected to accelerate modestly. However, several macroeconomic balances point to potential sources of domestic and external vulnerability—particularly set against an increasingly diffuse global economic environment. With the exceptions of Bhutan and Afghanistan, fiscal imbalances remain wide. Persistent current account deficits (particularly in Bhutan and the Maldives) highlight downside risks to the balance of payments. Lower-for-longer commodity prices and the associated positive terms of trade shock have generally been supportive for South Asia. However, the negative effects of heightened global economic and financial volatility and tighter external financing conditions are prevalent in a number of countries.

### Global and Regional Economy

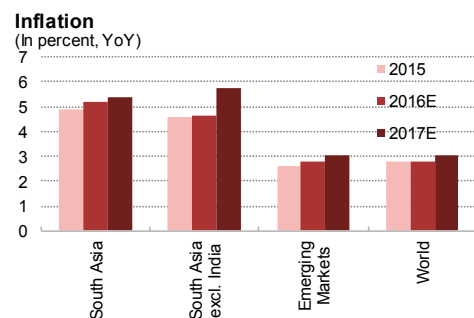
Global growth continues, but at a sluggish pace that increasingly leaves the world economy more susceptible to risks. The April 2016 *World Economic Outlook* forecasts global growth at 3.2 percent in 2016 and 3.5 percent in 2017, a fall of 0.2 percent and 0.1 percent, respectively, compared with the January 2016 WEO forecasts. This downward revision comes on the back of several previous downward revisions in global growth. This persistent slow growth has likely put a dent in global potential output, although prospects for different countries and country groups continue to be far from uniform.

Growth in advanced economies is expected to remain modest at about 2 percent in both 2016 and 2017. Growth will remain flat in the United States and the European Union—with real GDP growth projected at 2.5 and 1.5 percent, respectively, in both 2016 and 2017. In Asia, Japan's projected growth has been slashed to only 0.5 percent in 2016, down from 1.0 percent growth foreseen at the January 2016 WEO forecasts, reflecting a sharp fall in private consumption. Given the recent declines in global energy and commodity prices, growth prospects for major commodity exporters (such as Saudi Arabia) have been drastically reduced. For emerging market and developing economies, commodity price shocks are continuing to have strong macroeconomic effects. Growth in these economies was 4.0 percent in 2015 and is projected at 4.1 percent for 2016 (a downward revision of 0.2 percentage points compared to the January 2016 WEO forecast).

In the current fragile growth environment, risks to the outlook loom large. A key risk facing emerging market and low-income economies is a return of financial turmoil—associated with a new bout of exchange rate depreciation in emerging market economies that could further impair corporate balance sheets and engender a sudden stop in global capital flows—which would further damage investor and consumer confidence. While lower-for-longer global commodity prices constitute an upside risk for commodity-importing South Asian countries, risks to the outlook (including a sharper slowdown in China and rising geopolitical uncertainty) appear to be weighted to the downside, and could have large adverse spillovers on global economic activity.



Source: IMF, *World Economic Outlook*.



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India's strong economic growth—expected to accelerate modestly to about 7.5 percent in 2016 and 2017—has helped sustain the South Asian average growth at around 7 percent (India accounts for about 80 percent of regional GDP on a PPP basis). Most South Asian countries are expected to post higher growth rates in 2016 (the exception being Nepal) in the context of rising regional inflation. Projected fiscal and current account balances for 2016 are mixed. Fiscal consolidation is expected to be operative in India, Bhutan, Afghanistan, Pakistan and Sri Lanka, while external current account imbalances are expected to rise in the region, due largely to a modest widening of deficits in India and Bangladesh.

The outlook for 2017 and beyond continues to remain positive, but is subject to a rising level of uncertainty given increasingly diverse global and regional prospects. South Asian growth is expected to rise modestly in 2017, underpinned by the growth rebound in Nepal and growth acceleration in the Maldives. This baseline growth path could change depending on developments in key export markets (particularly the United States and Europe) and potential adverse spillover effects from future bouts of global financial market turbulence.

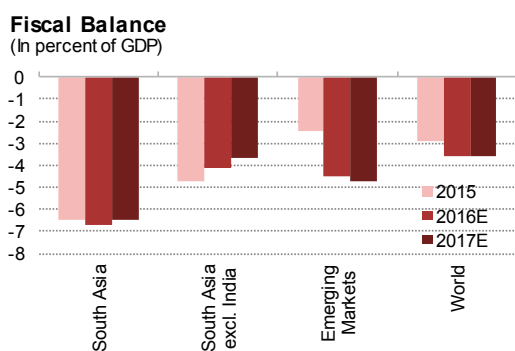
## India

The Indian economy is on a recovery path. After bottoming at 5.6 percent in FY2012/13, growth has risen steadily, reaching about 7.3 percent during FY2014/15-FY2015/16 and is projected to strengthen to 7.5 percent in FY2016/17. Since late 2014, a halving of global oil prices has boosted economic activity in India and underpinned a further improvement in its current account and fiscal positions, and engendered a sharp decline in inflation. As a result of further-reduced external vulnerabilities, improved growth prospects and continued monetary accommodation in advanced economies, India has experienced large FDI and portfolio capital inflows, a real appreciation of the rupee, and a robust rebound in foreign exchange reserves. Nonetheless, challenges remain as growth continues to be constrained by supply-side bottlenecks and weaknesses in the corporate and banking sectors.

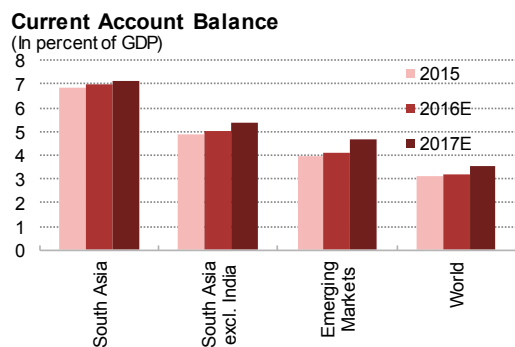
CPI inflation declined to 4.8 percent in March 2016 from an average of almost 10 percent during 2011–13, reflecting the tight monetary policy stance, lower global commodity prices, government efforts to contain food inflation and remaining economic slack. CPI inflation is projected at around 5 percent by end-2016/17 (close to the Reserve Bank of India's objective of 5 percent). The current account deficit has narrowed from a high of 4.8 percent of GDP in FY2012/13 to an average of around 1.4 percent of GDP during FY2013/14-2015/16 and is projected to be above 2 percent in FY2016/17. Sluggish global economic growth prospects, particularly in industrialized economies, as well as the recent rupee appreciation in real effective terms pose headwinds to export growth recovery. The FY2016/17 Budget envisages a welcome return to fiscal consolidation with an annual decline in the central government deficit from 3.9 to 3.5 percent of GDP (authorities' definition). Nonetheless, the quality of adjustment is second-best with the goods and services tax reform stalled in parliament, wages increasing and subsidies elevated, forcing a reduction in capital spending as a share of GDP to meet the fiscal target.

## Pakistan

While a very weak cotton harvest and the continued decline in exports are weighing on economic activity, real GDP growth is expected to reach about



Source: IMF, *World Economic Outlook*.



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4.5 percent in FY2015/16, supported by large-scale manufacturing, investment related to the China Pakistan Economic Corridor (CPEC), buoyant construction activity, a recovery in private sector credit growth, and gradual improvements in the supply of gas and electricity. International reserve buffers are increasing amid a broadly stable current account deficit as the lower oil import bill is partly offset by falling exports. Headline inflation has continued to gradually rebound (to 3.9 percent y-o-y in March 2016), as the favorable effect of past declines in international oil prices has continued to wane, and is expected to further increase to about 4.5 percent by June 2016.

Further progress will be needed to make the economy more resilient and competitive to generate strong and inclusive growth. Despite significant progress, slippages in policy implementation, political, legal, and security conditions, and further appreciation of the real exchange rate pose downside risks. Important priorities—critical to support private investment and exports which are needed for stronger, sustainable growth—include further widening the tax net, completing the energy sector reform, restructuring or privatizing loss-making public enterprises, improving the business climate and competitiveness, and fostering financial sector stability and development.

### Bangladesh

Activity and demand have shown mixed signals thus far in FY16. While exports and tax revenue have recorded robust growth during July-February, remittances, non-oil imports, and public investment have been weak. The decline in international oil prices since late 2014 has reduced Bangladesh's oil import costs significantly. International reserves are adequate at close to 6 months of prospective imports.

The three year IMF-supported program came to a successful completion in October 2015. The central government debt/GDP ratio has remained broadly stable at moderate levels (about 35 percent of GDP) with systematic tax revenue shortfalls offset by expenditure restraint and lower energy subsidies. Monetary policy has also remained prudent, helping to keep a lid on inflation. With the U.S. dollar strengthening and the taka/US\$ rate kept stable, the

taka has appreciated significantly against the euro over the past one year.

The outlook for Bangladesh remains broadly positive, but subject to considerable downside risks. Real GDP is expected to grow at around 6.6 percent in 2016 (6.3 percent in FY16 ending in June 2016, compared to the authorities preliminary estimate of 7.1 percent), a robust rate under current circumstances. Growth is expected to accelerate gradually to 7 percent over the medium term. Headline inflation is projected to remain stable, averaging 6½ percent, with nonfood inflation facing upward pressure from higher public sector wages. The fiscal deficit will widen on the back of the hike in public sector pay, but should remain sustainable as long as the new VAT comes into full effect in the near term. On the back of investment-led growth, the current account surplus may decline and turn into a slight deficit over the medium term, with international reserves remaining adequate.

### Sri Lanka

Real GDP rose 4.8 percent in 2015, on the basis of strong growth in services (particularly tourism), continued growth in agriculture, and positive (albeit declining) contributions from construction and manufacturing. The latter were indicative of the impact of a slowdown in public and private investment, as well as the negative effects of slowing world trade. Headline inflation dropped marginally to 2.0 percent as of March 2016, but core inflation continued to rise—reaching 4.5 percent. Despite strengthening terms of trade (from lower oil prices) a decline in exports and flat remittance inflows kept the external current account deficit unchanged from 2014 at 2.5 percent of GDP. Steady capital outflows have put significant pressure on the balance of payments, with gross foreign exchange reserves of the central bank declining by \$2 billion between end-2014 and end-March 2016.

The fiscal deficit expanded to 6.9 percent of GDP in 2015, compared with 6.2 percent in 2014. A revised budget was implemented in January 2015 following national elections, bringing a significant increase in wages, salaries, transfers and other categories of recurrent spending. The expanded deficit and depreciation of the rupee (which was allowed a

substantial downward adjustment in September) led to an increase in Sri Lanka's debt-to-GDP ratio from 70.7 percent in 2014 to 76 percent in 2015. As part of a three-year program to be supported by the IMF's Extended Fund Facility the government has committed to reduce the overall fiscal deficit to 5.4 percent of GDP in 2016, and to 3.5 percent by 2020—reflecting an underlying shift to a primary surplus of 1 percent of GDP to ensure a continued decline in debt-to-GDP over the medium term.

## Nepal

The promulgation of the new constitution on September 20, 2015 triggered unrest, a fuel crisis, and a change in government. Protests eased and trade and economic activity began to normalize only in early February, after the constitution was amended. The disruptions to trade at Nepal's southern border held back post-earthquake reconstruction activity and worsened the severe power shortages. As a result, growth is expected to decelerate sharply, to 0.5 percent in 2015/16 (mid-July 2015-mid-July 2016). Inflation rose to 12 percent (y/y) in January due to severe shortages of fuel and other essential goods before moderating to 11 percent (y/y) in February as imports picked up.

Budget under-implementation worsened in 2015/16. The significant under-execution of government expenditures more than offset the sharp fall in government revenue mobilization, resulting in an accumulation of government cash balance of about Rs. 76 billion (3.2 percent of GDP), in addition to a repayment of domestic debt of Rs. 20 billion (0.8 percent of GDP) as of end-February.

The external position has remained strong owing to the combination of severe import compression due to the trade disruption, and continued strong inflows of remittances. International reserves increased by 16 percent since end-2014/15 to US\$8.3 billion (10 months of prospective imports). However, the rapid buildup of reserves exposed weaknesses in the central bank's liquidity management framework and reserve money expanded by 47 percent (y/y) in February. The outlook is for a slow recovery and risks are skewed to the downside. Nepal's near-term challenges are to return economic activity to normalcy and recover from the earthquakes, including

by reconstructing damaged buildings and infrastructure, and to mitigate financial sector risks amplified by the earthquakes and economic disruption. The longer-term challenge is to boost the economy through well-coordinated fiscal policy to accommodate stepped-up efforts to implement post-earthquake reconstruction spending, monetary policy supporting the exchange rate peg and containing inflation, continued financial sector reforms, and structural policies to boost inclusive growth.

## Bhutan

The outlook for Bhutan remains generally favorable. Growth is on a recovery path, driven by a pick-up in services and on-going hydropower related construction. In the medium-term, commissioning of new hydropower projects will boost output and exports, as well as fiscal revenues. At the same time, inflation has eased—headline inflation fell to 3.5 percent in 2015Q4 from 6.7 percent in 2014Q4. Inflation is projected to pick up again somewhat from the 2015Q4 dip, but to remain on a declining trend following that of India (to which Bhutan's currency is pegged).

The fiscal deficit of 4.2 percent of GDP in FY2012/13 turned into a surplus of 3.8 percent of GDP in FY2013/14. Higher than expected project-tied grants and spending broadly in line with the original budget plan have contributed to the stronger fiscal outcome. In FY2014/15, as a result of lower grants and an increase in current spending reflecting mainly the public sector salary increase, the fiscal balance again turned into a moderate deficit of around 2 percent of GDP. Regarding the external sector, current account deficits are projected to remain high until 2017/18 as large hydropower projects remain in the construction phase. The deficits will continue to be financed by loans and grants from India. However, in the medium-term, a sharp increase in hydropower exports with the commissioning of new hydropower plants is projected to improve the current account balance. As a result, foreign exchange reserves, currently at about US\$1 billion (over 9 months of imports) are projected to increase further.

## Islamic Republic of Afghanistan

The outlook remains very difficult. GDP growth in 2015 is estimated at about 1.5 percent given the



deterioration in security conditions, delays in budget execution, and unfavorable weather lowering agricultural output. Inflation was negative through most of the year on account of low global food prices, subdued demand, and a depressed housing market, but has recently returned to positive territory partly due the Afghani's depreciation (17 percent year-to-year in December 2015), driven by the acceleration of emigration and the related capital outflows. The budget recorded a deficit in 2015 as a shortfall in grants more than offset higher-than-projected revenue and lower spending. The external current account was in surplus reflecting inflows of foreign aid, and resulting in a continued comfortable international reserves buffer reserves of more than 8 months of imports.

The growth projection for 2016 has been revised down to 2 percent, while average inflation is to pick up to 3 percent. The authorities continue to address fiscal and banking vulnerabilities by mobilizing revenue and strengthening financial sector supervision and enforcement. Substantial medium-term grant financing will be needed to finance development and security needs, facilitate the move toward fiscal sustainability, and enhance confidence in the Afghan economy.

### **Maldives**

Real GDP growth is estimated to have slowed sharply from 6.5 percent in 2014 to around 2 percent in 2015.

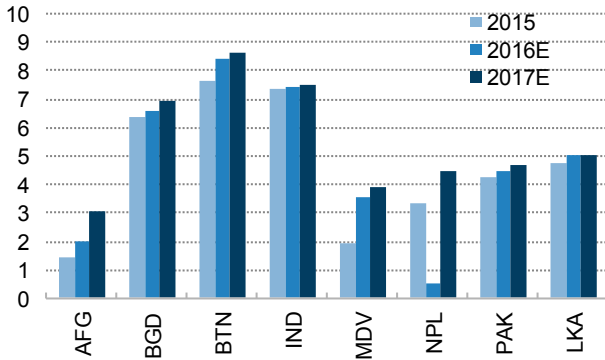
Tourist arrivals slowed following a collapse in arrivals from Russia and Ukraine, a plateau in arrivals from China and a temporary downward blip following November's state of emergency. Inflation is contained (1.3 percent y/y in February). But the current account deficit is estimated to have widened to 8 percent of GDP, despite lower oil prices, following a sharp pick up in non-oil imports possibly related to infrastructure scale up. A continued stronger than expected revenue performance resulted in a better than expected outcome for the fiscal deficit in 2015 (at around 9 percent of GDP). Notwithstanding higher revenues, sustained deficits have placed public debt on a rising path, reaching 73 percent of GDP in 2015.

Sizeable fiscal adjustment is needed to prevent a growing imbalance. The 2015 Budget took welcome steps through revenue raising measures, better targeting of subsidies, and a public employment freeze. However, the 2016 Budget reverses this progress with a large increase in infrastructure spending. Durable fiscal adjustment is needed. Capital expenditures should be prioritized and accommodated only where the benefits clearly outweigh the costs. A further adjustment effort focused on both revenue raising measures and expenditure restraint could help stabilize debt by 2020, and lower it further thereafter. This could be supported by strengthening public financial management. Such a fiscal adjustment would also help strengthen the external position.

## South Asia: Recent Economic Developments and Outlook

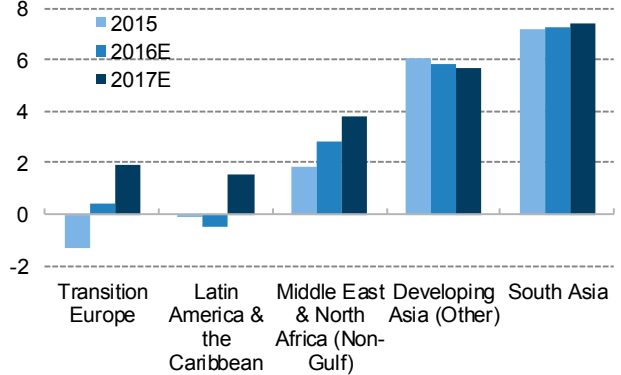
Economic growth is expected to accelerate in most countries

**Real GDP Growth**  
(In percent, YoY)



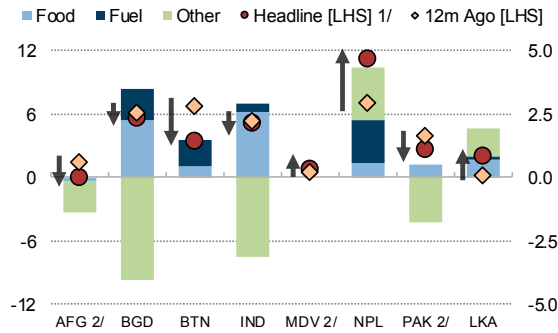
South Asian growth is a clear leader relative to comparator regions

**EM's Real GDP Growth by Region**  
(In percent, YoY)



Inflation remains anchored at low levels, with Nepal a notable exception

**Inflation: Headline and Contributions to Change**  
(In percent, YoY)

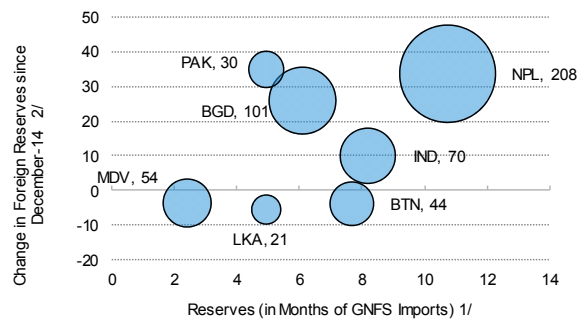


1/ LKA (Mar-16); BGD, IND, NPL (Feb-16); AFG, BTN, MDV (Dec-15); PAK (Nov-15).  
2/ Fuel series unavailable.

Foreign exchange reserves have grown rapidly, although there are several exceptions

**Foreign Reserves**

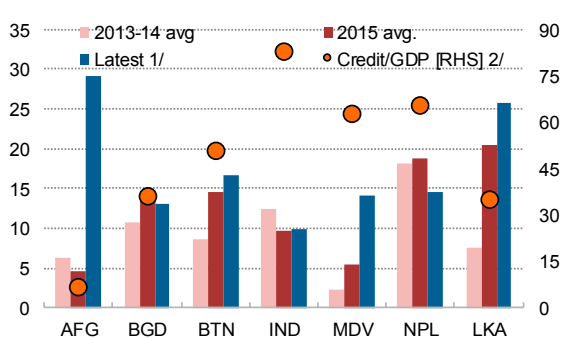
(In percent; bubble size: reserves as a % of external debt 1/)



1/ As of end-2015.  
2/ IND (Mar-16); BGD, NPL, PAK (Feb-16); MDV (Jan-16); BTN, LKA (Dec-15).

Credit growth has begun to recover in most South Asian economies, but remains tepid in India

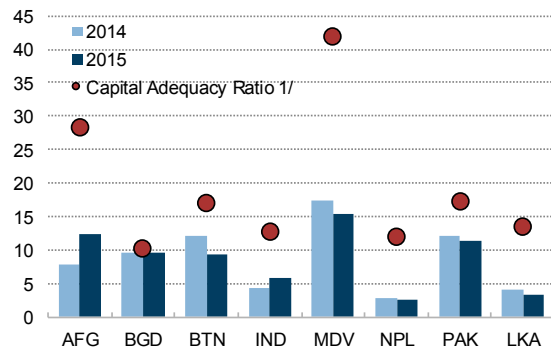
**Credit to the Economy**  
(In percent, 3mma, YoY)



1/ AFG, IND, NPL (Feb-16); MDV, LKA (Dec-15); BGD, BTN (Nov-15).  
2/ As of 2015 or latest available.

Impaired loans are large in some banking systems, but capital adequacy appears strong

**Nonperforming Loans Ratio**  
(In percent of total loans)



1/ Regulatory capital to risk-weighted assets. 2015Q4 or latest available.

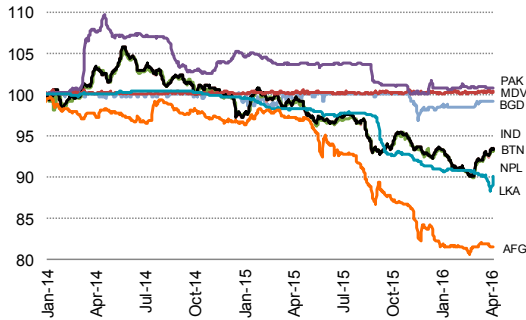
Sources: IMF, *International Financial Statistics*; IMF, *Financial Soundness Indicators*; IMF, *World Economic Outlook*; national monetary authorities; Haver Analytics; Bloomberg; and CEIC. Country acronyms denote: Islamic Republic of Afghanistan (AFG); Bangladesh (BGD); Bhutan (BTN); India (IND); Maldives (MDV); Nepal (NPL); Pakistan (PAK); and Sri Lanka (LKA). EM denotes emerging market economies.

## South Asia: Recent Economic Developments and Outlook, cont'd

### Nominal exchange rate flexibility is a policy feature in several South Asian economies

#### Exchange Rates

(USD/LCU, Index, Jan 1 2014 = 100, 5-day moving average) 1/2/

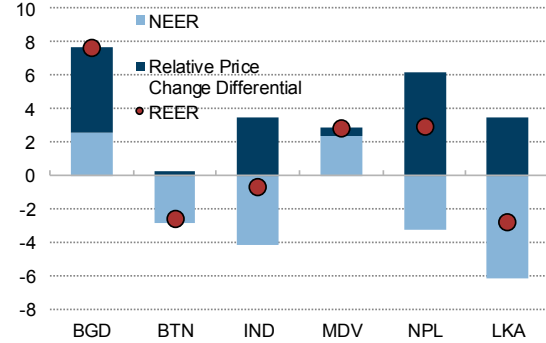


1/ LCU = Local currency unit.  
2/ BTN and NPL have pegs with the Indian rupee.

### Cross currency movements have been a prominent driver of real exchange rates

#### Contributions to changes in REER 1/

(In percent, YoY)

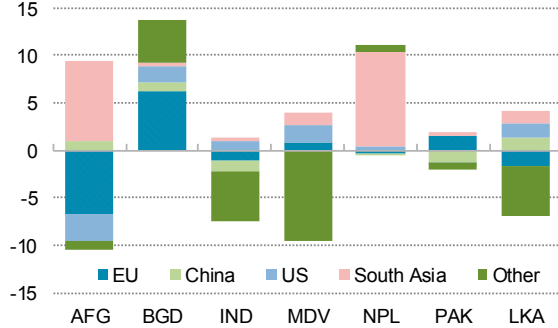


1/ As of March 2016 or latest.

### Intra-South Asian trade remains small—links to advanced economies and large EMs are key

#### Contributions to Export Growth 1/

(In percent, YoY)

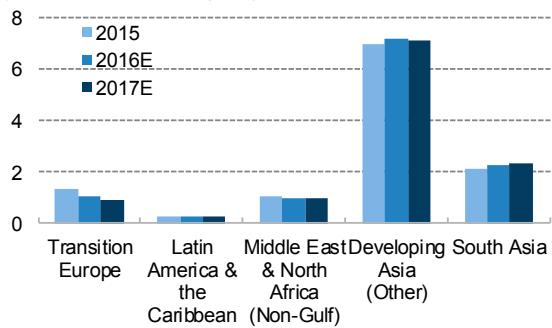


1/ As of November 2015.

### South Asia's share of world trade continues to grow, but is still relatively small

#### EM's Exports of Goods & Services by Region

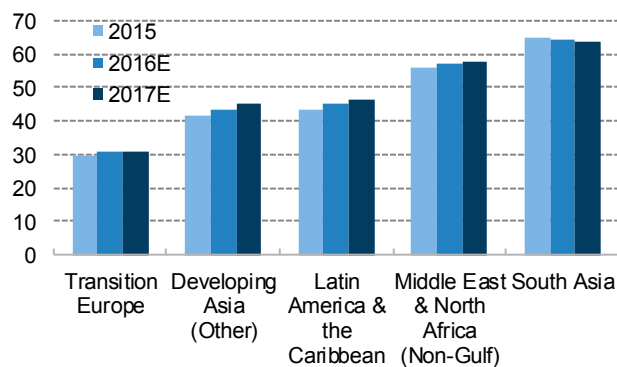
(As a share of world exports)



### South Asian regional public debt remains the highest among comparator regions

#### EM's Government Debt by Region

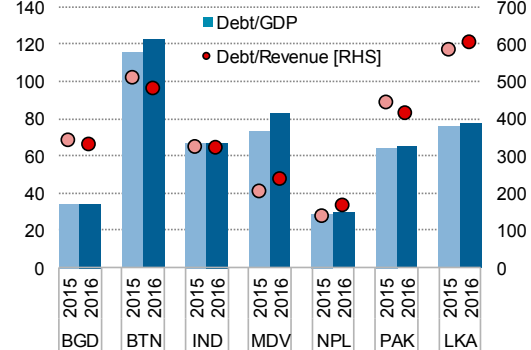
(In percent of GDP)



### Public debt-to-GDP ratios have increased in most countries

#### South Asia: Public Debt

(In percent)



Sources: IMF, *Direction of Trade Statistics*; IMF, *World Economic Outlook*; CEIC; Haver Analytics; and Bloomberg. Country acronyms denote: Islamic Republic of Afghanistan (AFG); Bangladesh (BGD); Bhutan (BTN); India (IND); Maldives (MDV); Nepal (NPL); Pakistan (PAK); and Sri Lanka (LKA). EM denotes emerging market economies.

## South Asia: Selected Economic Indicators

	Average						Projections	
	2001-10	2011	2012	2013	2014	2015	2016	2017
<b>Real GDP Growth</b>	<b>7.0</b>	<b>6.3</b>	<b>5.6</b>	<b>6.2</b>	<b>6.8</b>	<b>6.9</b>	<b>7.0</b>	<b>7.1</b>
<i>(Annual change; percent)</i>								
Afghanistan	9.1	6.5	14.0	3.9	1.3	1.5	2.0	3.0
Bangladesh	5.8	6.5	6.3	6.0	6.3	6.4	6.6	6.9
Bhutan	8.4	10.1	6.4	4.9	6.4	7.7	8.4	8.6
India	7.6	6.6	5.6	6.6	7.2	7.3	7.5	7.5
Maldives	8.5	8.7	2.5	4.7	6.5	1.9	3.5	3.9
Nepal	4.0	3.4	4.8	4.1	5.4	3.4	0.5	4.5
Pakistan	4.6	3.6	3.8	3.7	4.0	4.2	4.5	4.7
Sri Lanka	4.8	8.4	9.1	3.4	4.9	4.8	5.0	5.0
<b>Consumer Price Inflation</b>	<b>6.5</b>	<b>10.0</b>	<b>9.7</b>	<b>9.0</b>	<b>6.2</b>	<b>4.9</b>	<b>5.2</b>	<b>5.4</b>
<i>(Year average; percent)</i>								
Afghanistan	11.7	11.8	6.4	7.4	4.7	-1.5	3.0	4.5
Bangladesh	6.3	11.5	6.2	7.5	7.0	6.4	6.7	6.9
Bhutan	4.6	8.6	10.1	8.6	9.6	7.2	6.1	6.0
India	6.1	9.5	9.9	9.4	5.9	4.9	5.3	5.3
Maldives	4.1	11.3	10.9	4.0	2.5	1.4	2.1	2.6
Nepal	6.2	9.6	8.3	9.9	9.0	7.2	10.2	11.1
Pakistan	8.2	13.7	11.0	7.4	8.6	4.5	3.3	5.0
Sri Lanka	11.1	6.7	7.5	6.9	3.3	0.9	3.4	4.9
<b>General Gov. Overall Fiscal Balance</b>	<b>-7.3</b>	<b>-7.6</b>	<b>-7.2</b>	<b>-7.3</b>	<b>-6.5</b>	<b>-6.7</b>	<b>-6.5</b>	<b>-6.2</b>
<i>(Percent of GDP)</i>								
Afghanistan <sup>1</sup>	-1.3	-0.6	0.2	-0.6	-1.7	-1.4	0.8	0.2
Bangladesh <sup>1</sup>	-2.9	-3.6	-3.0	-3.4	-3.1	-3.9	-4.4	-4.3
Bhutan	-3.3	-2.1	-1.3	-4.0	-3.8	-2.4	-1.5	-0.7
India	-8.4	-8.2	-7.5	-7.7	-7.0	-7.2	-7.0	-6.7
Maldives	-7.5	-7.7	-7.9	-7.8	-9.4	-8.7	-13.6	-18.4
Nepal	-1.6	-1.3	-1.4	1.5	0.8	0.1	-2.1	-2.6
Pakistan	-3.8	-6.7	-8.6	-8.4	-4.9	-5.3	-4.1	-3.3
Sri Lanka <sup>1</sup>	-6.9	-6.2	-5.6	-5.4	-6.2	-6.9	-5.4	-4.7
<b>Current Account Balance</b>	<b>-0.7</b>	<b>-3.6</b>	<b>-4.1</b>	<b>-1.5</b>	<b>-1.2</b>	<b>-1.2</b>	<b>-1.4</b>	<b>-2.0</b>
<i>(Percent of GDP)</i>								
Afghanistan	17.0	6.0	5.9	7.9	7.8	4.5	3.3	0.2
Bangladesh	0.5	-1.0	0.7	1.2	-0.1	-1.1	-1.3	-1.5
Bhutan	-10.2	-23.5	-19.0	-22.7	-23.1	-26.7	-24.9	-26.1
India	-0.8	-4.3	-4.8	-1.7	-1.3	-1.3	-1.5	-2.1
Maldives	-13.3	-16.9	-7.4	-4.3	-4.1	-8.0	-7.8	-14.7
Nepal	2.5	-1.0	4.8	3.3	4.6	5.0	6.2	0.5
Pakistan	-1.5	0.1	-2.1	-1.1	-1.3	-1.0	-1.1	-1.6
Sri Lanka	-2.7	-7.1	-5.8	-3.4	-2.5	-2.5	-1.5	-2.8

Sources: IMF, *World Economic Outlook*; national monetary authorities; and IMF staff estimates and projections.

<sup>1</sup>Central government.

Notes: Regional aggregates weighted by PPP GDP. Variables reported on a fiscal year basis for India (April/March); Bhutan, Pakistan (July/June); Afghanistan (March 21/March 20 until 2011, and December 21/December 20 thereafter); Nepal (August/July); Bangladesh (Fiscal Balance only: July/June). Sri Lanka real GDP growth numbers reflect projections based on the revised (2010 base) national accounts data published by the authorities.