INTERNATIONAL MONETARY FUND

IMF Country Report No. 18/254

INDIA

August 2018

2018 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 2018 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 July 18, 2018 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 July 18, 2018, following discussions that ended May 22, 2018, 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 July 2, 2018.
- An **Informational Annex** prepared by the IMF staff.
- A **Statement by the Executive Director** for India.

The documents listed below have been or will be separately released

Selected Issues

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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August 7, 2018

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IMF Executive Board Concludes 2018 Article IV Consultation with India

On July 18, 2018, the Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation with India.[1]

Stability-oriented macroeconomic policies and progress on structural reforms continue to bear fruit. Following disruptions related to the November 2016 currency exchange initiative and the July 2017 goods and service tax (GST) rollout, growth slowed to 6.7 percent in FY2017/18, but a recovery is underway led by an investment pickup. Headline inflation averaged 3.6 percent in FY2017/18, a 17-year low, reflecting low food prices on a return to normal monsoon rainfall, agriculture sector reforms, subdued domestic demand, and currency appreciation. With demand recovering and rising oil prices, medium-term headline inflation has risen to 4.9 percent in May 2018, above the mid-point of the Reserve Bank of India (RBI)'s headline inflation target band of 4 percent ± 2 percent. External vulnerabilities remain contained but have risen. The current account deficit (CAD) widened to 1.9 percent of GDP in FY2017/18, on rising imports and oil prices. Gross international reserves rose to US$424.5 billion (about 8 months of prospective imports of goods and services) at the end of March 2018, but declined to US$407.8 billion in the third week of June 2018. Persistently-high household inflation expectations and large general government fiscal deficits and debt remain key macroeconomic challenges. Systemic macro-financial risks persist, as the weak credit cycle could impair growth and the sovereign-bank nexus has created vulnerabilities.

The near-term macroeconomic outlook is broadly favorable. Growth is forecast to rise to 7.3 percent in FY2018/19 and 7.5 percent in FY2019/20, on strengthening investment and robust private consumption. Headline inflation is projected to rise to 5.2 percent in FY2018/19, as demand conditions tighten, along with the recent depreciation of the rupee and higher oil prices, housing rent allowances, and agricultural minimum support prices. The current account deficit is projected to widen further to 2.6 percent of GDP on rising oil prices and strong demand for imports, offset by a slight increase in remittances. As inflation pressures have risen, monetary policy was tightened in early June 2018. Fiscal consolidation is expected to resume in

[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.

FY2018/19, with the FY2018/19 Union Budget deficit target of 3.3 percent of GDP (equivalent to 3.6 percent of GDP in IMF terms). Financial sector reforms have been undertaken to address the twin balance sheet problems, as well as to revive bank credit and enhance the efficiency of credit provision by accelerating the cleanup of bank and corporate balance sheets. Over the medium-term, the outlook will continue to improve with growth expected to rise to 7¾ percent, and macro-financial and structural policies are priorities to help boost inclusive growth and harness the demographic dividend.

Economic risks are tilted to the downside. On the external side, risks include a further increase in international oil prices, tighter global financial conditions, a retreat from cross-border integration including spillover risks from a global trade conflict, and rising regional geopolitical tensions. Domestic risks pertain to tax revenue shortfalls related to continued GST implementation issues and delays in addressing the twin balance sheet problems and other structural reforms.

Executive Board Assessment[2]

Executive Directors welcomed the strong economic growth and commended the authorities for the important and wide-ranging reforms. While noting the broadly positive outlook, Directors observed that risks are tilted to the downside from external factors, such as higher global oil prices and tighter global financial conditions, as well as domestic financial vulnerabilities. Against this background, they underscored the need for continued prudent macroeconomic policies and renewed emphasis on macro-financial and structural reforms.

Directors noted that continued fiscal consolidation is needed to reduce public debt. They stressed the need to take advantage of the projected acceleration of growth to achieve a public debt level of 60 percent of GDP by FY2022/23, as recommended by India's Fiscal Responsibility and Budget Management Review Committee. Directors also emphasized the need to reach this year's budget target and to take corrective actions if required. In this context, they encouraged the authorities to enhance goods and service tax compliance, while noting the scope for continuing to simplify the framework.

Directors supported the recent tightening of monetary policy. With upside inflation risks, further gradual tightening was likely needed to anchor expectations and maintain monetary policy credibility. Directors welcomed the authorities' commitment to a flexible exchange rate, noting that foreign exchange intervention should remain two-sided and limited to addressing disorderly market conditions.

Directors stressed the need to focus on macro-financial and structural policies, and welcomed a range of complementary initiatives taken to address high non-performing loans in public sector

[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 summings up can be found here: http://www.imf.org/external/np/sec/misc/qualifiers.htm.

banks and the large corporate sector leverage. They underscored the importance of accelerating the implementation of these initiatives, backed by a comprehensive plan to improve the governance, internal controls, and operations of public sector banks, including by considering more rapid withdrawal of public ownership.

Directors welcomed that the capital flow management framework was moving in the direction of greater liberalization, notably in the area of foreign direct investment. They stressed that India would benefit from further liberalization of trade and foreign investment, and welcomed the authorities' commitment to a multilateral rules-based trade system.

Directors emphasized the importance of modernizing labor laws and regulations and other measures to help increase formal employment, particularly the employment of women. They considered that these measures would lead to increased productivity growth and help India harness the demographic dividend from the large number of younger workers.

Directors welcomed the important progress that has been made in strengthening the supply side of the economy through large infrastructure investments. Land reforms remain essential to facilitate and expedite infrastructure development, to raise productivity in the agricultural sector, and to foster rapid inclusive growth.

India: Selected Social and Economic Indicators, 2014/15–2019/20 1/

I. Social Indicators

GDP (2017/18)		**Poverty (percent of population)**	
Nominal GDP (in billions of U.S. dollars):	2,602	Headcount ratio at $1.90 a day (2011):	21.2
GDP per capita (U.S. dollars) (IMF staff est.):	1,942	Undernourished (2015):	14.5
Population characteristics (2016/17)		**Income distribution (2011, WDI)**	
Total (in billions):	1.32	Richest 10 percent of households:	29.8
Urban population (percent of total):	33.1	Poorest 20 percent of households:	8.3
Life expectancy at birth (years, 2015/16):	68.3	Gini index (2011):	35.2

II. Economic Indicators

	2014/15	2015/16	2016/17	2017/18	2018/19	2019/20
				Est.	Projections	
Growth (in percent)						
Real GDP (at market prices)	7.4	8.2	7.1	6.7	7.3	7.5
Industrial production	4.0	3.3	4.6	4.4	...	...
Prices (percent change, period average)						
Consumer prices - Combined	5.8	4.9	4.5	3.6	5.2	4.8
Saving and investment (percent of GDP)						
Gross saving 2/	33.0	30.7	29.7	28.8	29.6	30.0
Gross investment 2/	34.2	31.8	30.3	30.6	32.2	32.2
Fiscal position (percent of GDP) 3/						
Central government overall balance	-4.5	-4.1	-3.7	-4.0	-3.6	-3.5
General government overall balance	-7.2	-7.0	-6.7	-7.0	-6.6	-6.5
General government debt 4/	67.8	69.6	68.9	70.4	68.7	67.2
Cyclically adjusted balance (% of potential GDP)	-7.1	-7.1	-6.7	-6.9	-6.6	-6.5
Cyclically adjusted primary balance (% of potential GDP)	-2.4	-2.4	-1.8	-1.9	-1.6	-1.6
Money and credit (y/y percent change, end-period)						
Broad money	10.9	10.1	10.1	9.5	11.4	11.8
Bank credit to the private sector	9.3	10.6	8.0	9.8	13.6	13.3
Financial indicators (percent, end-period)						
91-day treasury bill yield (end-period)	8.3	7.3	5.8	6.1	...	...
10-year government bond yield (end-period)	7.8	7.5	6.7	7.4	...	...
Stock market (y/y percent change, end-period)	24.9	-9.4	16.9	11.3	...	...
External trade (on balance of payments basis)						
Merchandise exports (in billions of U.S. dollars)	316.5	266.4	280.1	309.0	349.7	385.0
(Annual percent change)	-0.6	-15.9	5.2	10.3	13.2	10.1
Merchandise imports (in billions of U.S. dollars)	461.5	396.4	392.6	469.0	546.6	592.2
(Annual percent change)	-1.0	-14.1	-1.0	19.5	16.5	8.3
Terms of trade (G&S, annual percent change)	3.0	6.0	1.4	-2.8	-2.9	1.8
Balance of payments (in billions of U.S. dollars)						
Current account balance	-26.8	-22.1	-15.2	-48.7	-70.6	-68.3
(In percent of GDP)	-1.3	-1.1	-0.7	-1.9	-2.6	-2.2
Foreign direct investment, net ("-" signifies inflow)	-31.3	-36.0	-35.6	-30.3	-38.7	-47.1
Portfolio investment, net (equity and debt, "-" = inflow)	-42.2	4.1	-7.6	-22.1	-0.9	-7.3
Overall balance ("-" signifies balance of payments surplus)	-61.4	-17.9	-21.6	-43.6	4.2	-14.4
External indicators						
Gross reserves (in billions of U.S. dollars, end-period)	341.6	360.2	370.0	424.5	420.4	434.7
(In months of next year's imports (goods and services))	8.5	8.9	7.6	7.5	6.8	6.5
External debt (in billions of U.S. dollars, end-period)	474.7	485.0	471.8	514.4	559.3	609.5
External debt (percent of GDP, end-period)	23.3	23.1	20.8	19.8	20.2	20.0
Of which: Short-term debt 5/	9.1	9.1	9.1	8.4	9.0	9.2
Ratio of gross reserves to short-term debt (end-period)	1.8	1.9	1.8	1.9	1.7	1.5
Debt service ratio 6/	7.6	8.8	7.8	7.9	8.3	8.5
Real effective exchange rate (annual avg. percent change)	7.0	5.8	1.6	3.1	...	...
Exchange rate (rupee/U.S. dollar, end-period)	62.6	68.3	64.8	65.0	...	...
Memorandum item (in percent of GDP)						
Fiscal balance under authorities' definition	-4.1	-3.9	-3.5	-3.5	-3.3	-3.2

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.

5/ Short-term debt on residual maturity basis, including estimated short-term NRI deposits on residual maturity basis.

6/ In percent of current account receipts, excluding grants.

INTERNATIONAL MONETARY FUND

INDIA

STAFF REPORT FOR THE 2018 ARTICLE IV CONSULTATION

July 2, 2018

KEY ISSUES

Context: India has been among the fastest-growing economies in the world over the past few years, lifting millions out of poverty. The authorities have initiated important structural reforms to spur India's catch up with more advanced economies and to improve living standards for all. The main reforms include the inflation-targeting monetary policy framework, the Insolvency and Bankruptcy Code (IBC), the goods and services tax (GST), and steps to liberalize FDI flows and improve the business climate.

Outlook and Risks: Following transitory disruptions, growth is projected to recover in FY2018/19 and strengthen in FY2019/20 as stability-oriented macroeconomic policies and progress on structural reforms continue to bear fruit. High foreign reserve buffers and strong FDI inflows have helped contain external vulnerabilities. Risks to the outlook are tilted to the downside. Key external risks—higher global oil prices and tighter global financial conditions—have grown in recent months, placing a premium on prudent policies. Domestic risks include tax revenue shortfalls and delays in addressing the twin bank-corporate balance sheet problems.

Key Policy Recommendations: A key focus of this consultation is macro-financial and structural policies to boost inclusive growth, including to harness the demographic dividend. As the economy recovers and given limited policy space and growing risks, India would now be served best by supply-side measures.

- Continued fiscal consolidation is needed to lower elevated public debt levels, supported by simplifying and streamlining the GST structure.
- With the output gap closing and inflation rising, monetary policy will need further gradual tightening.
- India's external position remains broadly consistent with fundamentals. In the event of external pressures, India should continue to rely on exchange rate flexibility, and foreign exchange intervention should be two-way and limited to disorderly market conditions.
- Important steps have been taken to improve the recognition of non-performing assets (NPAs) and recapitalize public sector banks (PSBs), but more needs to be done. The IBC has the potential to improve significantly NPA resolution and corporate debtors' repayment discipline. A recent large fraud at a PSB highlights financial sector weaknesses and underscores the need for the government to take further steps to improve the PSBs' governance and operations, including by considering more aggressive disinvestment.
- While important progress has been made, key structural challenges remain. Needed policies include labor market, land, and product market reforms, which will raise investment, job growth, and productivity.

Approved By
Kenneth H. Kang (APD) and Seán Nolan (SPR)

Discussions took place in New Delhi and Mumbai during May 8–22, 2018. The team comprised Mr. Salgado (head), Mr. Almekinders, Mr. Blagrave, Mr. Mohommad, Ms. Moussa, Ms. Sodsriwiboon, Mr. Wimanda (all APD), Ms. Maslova (SPR), Ms. Ogawa (MCM), Mr. Bauer (Senior Resident Representative), and Mr. Mohapatra (Resident Representative Office). Messrs. Gokarn and Joshi (OED) also participated in the discussions. The mission met with Reserve Bank of India Governor Patel, Deputy Governor Acharya, Ministry of Finance Economic Affairs Secretary Garg, Chief Economic Advisor Subramanian, and other senior officials as well as representatives of the business and financial community, multilateral institutions, and nongovernment organizations. Ms. Inoue and Mr. Singh (both APD) assisted in the preparation of this report.

CONTENTS

TABLES

APPENDICES

Abbreviations and Acronyms

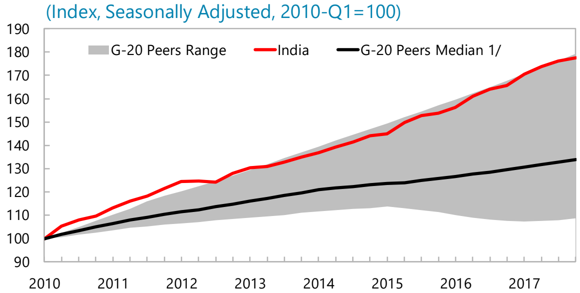
AQR	Asset Quality Review
CA	Current Account
CAD	Current Account Deficit
CIT	Corporate Income Tax
CPI	Consumer Price Index
DBT	Direct Benefit Transfers
EBA	External Balance Assessment
ES	External Sustainability
FDI	Foreign Direct Investment
FPI	Foreign Portfolio Investment
FRBM	Fiscal Responsibility and Budget Management
FX	Foreign Exchange
FY	Fiscal Year
FSAP	Financial Stability Assessment Program
FSGM	Flexible System of Global Models
GDP	Gross Domestic Product
GOI	Government of India
GrAM	Gramin Agricultural Markets
G-Secs	Government Securities
GST	Goods and Services Tax
HRA	Housing Rent Allowances
IBC	Insolvency and Bankruptcy Code
IRDA	Insurance Regulatory and Development Authority
INR	Indian Rupee
IMF	International Monetary Fund
LIC	Life Insurance Corporation
MCI	Monetary Conditions Index
MSME	Micro, Small, and Medium-sized Enterprise
MSP	Minimum Support Prices
e-NAM	Electronic National Agriculture Market
NCLT	National Company Law Tribunal
NDTL	Net Demand and Time Liabilities
NPA	Non-performing Asset
OECD	Organisation for Economic Co-operation and Development
PCA	Prompt Corrective Action
PDS	Public Distribution System
PFM	Public Financial Management
PIT	Personal Income Tax
PMG	Project Monitoring Group
PMI	Purchasing Manager’s Index
PSB	Public Sector Banks
PSL	Priority Sector Lending
RBI	Reserve Bank of India
SARTTAC	South Asia Regional Training and Technical Assistance Center
SDL	State Development Loan
SLR	Statutory Liquidity Requirement

TFP	Total Factor Productivity
UDAY	Ujwal Discom Assurance Yojana
US$	U.S. Dollar
WEO	World Economic Outlook
WTO	World Trade Organization
y/y	Year-on-year

OVERVIEW

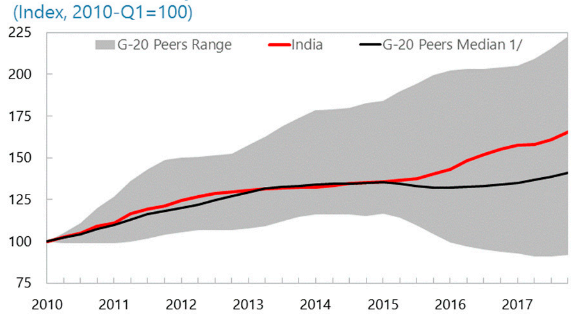
1. **A key focus of this consultation is macro-financial and structural policies to boost inclusive growth, including to harness the demographic dividend**.[1] While India has been one of the fastest-growing large economies in recent decades, investment growth has been comparatively modest and formal job growth insufficient. This creates challenges for creating jobs for a young and growing population and sustaining inclusive growth.

Real Growth: India and G20 Peers
(Index, Seasonally Adjusted, 2010-Q1=100)



Sources: Haver Analytics and IMF Staff Calculations
India's G-20 peers are Brazil, Russia, China, South Africa, Indonesia and Turkey

Real Gross Fixed Capital Formation: India and G-20 Peers
(Index, 2010-Q1=100)



Sources: Haver Analytics, WEO and IMF Staff Calculations
India's G-20 peers are Brazil, Russia, China, South Africa, Indonesia and Turkey

2. **Important reforms have been implemented in recent years**. This includes the inflation-targeting monetary policy framework, the Insolvency and Bankruptcy code (IBC), the goods and services tax (GST), and steps to liberalize foreign direct investment (FDI) flows and the ease of doing business (Appendix I). A further deepening and broadening of structural reforms is needed to raise investment, job growth, and productivity over the medium term, to spur India's catch up with advanced economies and create jobs needed for India's young and growing labor force. The priorities should be to enhance several important recently implemented reforms—e.g., further steps on financial sector reforms and simplifying and streamlining the GST—combined with a vigorous push for labor, land, and product market reforms.

3. **General elections will be held by May 2019**. Against this background, government policies have shifted mainly to accelerating implementation of ongoing reforms rather than initiating new ones. And budget pressures could increase in the coming months.

4. **Macroeconomic policies have been broadly consistent with past Fund advice**. The stance of monetary policy over much of FY2017/18 was appropriate and consistent with the Fund's call to aim monetary policy at durably lowering sticky inflation expectations, given the temporary weakness in growth and headline inflation at the lower end of the target range. Partly because of one-off factors, including the introduction of the GST, the government did not achieve its FY2017/18 fiscal consolidation target as advocated in previous Fund advice. Important steps are being taken to address the bank and corporate balance sheet problems and revive credit. Recent reforms to rigid labor laws, most notably through the extension of fixed-term contracts to sectors beyond textiles

[1] "Asia: At Risk of Growing Old before Becoming Rich? (Chapter 2 of the May 2017 IMF *Regional Economic Outlook: Asia and Pacific*) discusses the implications of demographic trends for the Asia and Pacific region, including India.

and leather, go in the direction of past Fund advice, but further reforms to labor laws, trade policies, infrastructure, and product markets are needed.

RECENT DEVELOPMENTS, OUTLOOK, AND RISKS

5. **Stability-oriented macroeconomic policies and progress on structural reforms continue to bear fruit, despite transitory disruptions to economic activity**. Key macroeconomic developments in FY2017/18 include (Figures 1–8, Tables 1–8):

- GDP growth slowed to a 4-year low of 6.7 percent, but a recovery is under way. Following a recovery from disruptions related to the November 2016 demonetization (Box 1) and the July 2017 GST rollout (Box 2), growth reached 7.7 percent in the quarter through March 2018 (y/y).

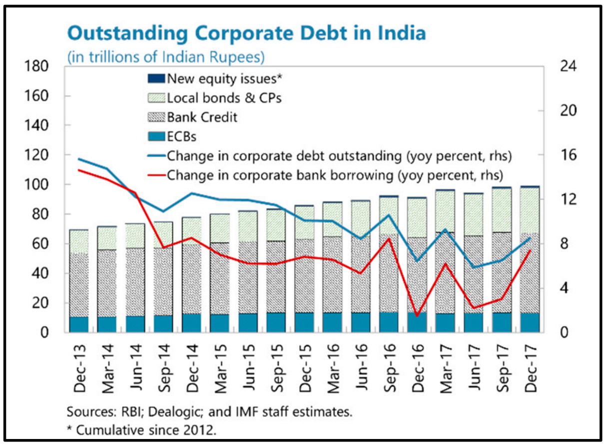
- Headline inflation averaged 3.6 percent, a 17-year low, reflecting low food prices on a return to normal monsoon rainfall and agriculture sector reforms (e.g., pulses buffer stock, national agriculture market, crop insurance, and irrigation), subdued domestic demand, and currency appreciation. However, with growth recovering and the output gap narrowing to -0.3 percent of potential GDP (staff estimate), inflation is now on the rise with core (6.2 percent in May, y/y) and headline (4.9 percent) inflation now above the mid-point of the target band for headline inflation of the Reserve Bank of India (RBI), and inflation expectations over the forecast horizon still elevated.

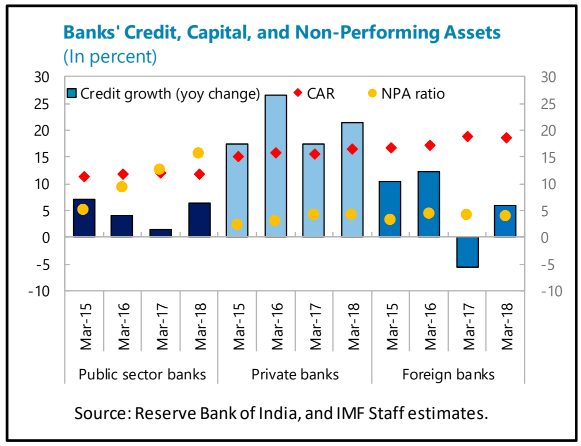
- External vulnerabilities remain contained but have risen. The current account deficit (CAD) widened to 1.9 percent of GDP, on rising imports and oil prices. But capital inflows have remained strong and helped finance the bulk of the CAD. In response to these inflows, the RBI intervened to limit the appreciation of the Indian rupee (INR) to about 3.1 and 1.4 percent on average during 2017/18 in real and nominal effective terms (according to the IMF's Information Notice System). Gross international reserves rose by US$54.6 billion during 2017/18 to US$424.5 billion (about 8 months of prospective imports of goods and services) in March 2018. The U.S. dollar value of India's non-oil merchandise exports expanded by 12 percent in calendar year 2017, a 6-year high, helping to raise India's global export market share somewhat. Nonetheless, India's export market share remains low, indicating a need to boost competitiveness through structural measures.

6. **Systemic macro-financial risks bear monitoring, nonetheless, as the weak credit cycle could impair growth and the sovereign-bank nexus has created vulnerabilities**.

- Bank credit growth recovered to 12.5 percent (y/y) in May. Incremental credit was mostly allocated to households and the services sector, with credit to industry remaining stagnant. The corporate sector has been deleveraging slowly and, while debt repayment capacity and profitability appear to have bottomed out, they remain weak in aggregate. The recent fraud at a large public sector bank (PSB) highlights governance weaknesses which have depressed bank share prices.

- The RBI's Asset Quality Review (AQR), initiated in 2015, improved recognition of non-performing assets (NPAs), especially in PSBs, which account for about 70 percent of the banking system's assets. So far, 11 PSBs have been put under the prompt corrective action (PCA) framework that became effective in April 2017. Meanwhile, system-wide capital adequacy has continued to improve and remains above the minimum requirements. Nevertheless, PSBs continue to report low profitability, high NPAs, and increased provisioning, related to the reclassification of their loan portfolios, which remains a constraint on credit expansion and investment. As a result, the NPA ratio for the total banking sector increased to 11.6 percent in March 2018 compared to 9.6 percent a year ago, in large part reflecting the migration of restructured loans to NPAs and in line with the RBI's new framework for the restructuring of stressed assets (see ¶31). A plan to recapitalize PSBs, announced in October 2017, will add at least 0.8 percent of GDP to public debt (financed through recapitalization bonds; Box 3). Depressed valuations may make it difficult to meet the government's expectation that PSBs raise an additional 0.3 percent of GDP from the market over two years.[2]





- Financial markets were generally robust through early 2018—especially equities. Market sentiment, however, has deteriorated in recent months, in line with increased global volatility. Moreover, 10-year bond yields rose by 130 basis points in the nine months through early-March, despite Moody's upgrade of India's government bond rating in November for the first time since 2004. This reflects concerns of higher global yields, that the center and state fiscal targets would be missed, and that some PSBs need to reduce holdings of government securities due to mark-to-market losses—further highlighting the bank-sovereign debt nexus. In recent months, yields have been particularly volatile given countervailing forces—announcements regarding the debt issuance calendar for the new fiscal year showing backloaded issuance and easing foreign investment limits for borrowings have been more than offset by global factors, including rising U.S. interest rates and higher oil prices.

7. **India has been affected by the emerging market turmoil since mid-April**. Portfolio outflows from India were relatively large, triggered by the runup in international oil prices and tighter global financial conditions, as well as domestic concerns over fiscal slippages and the

[2] PSBs raised INR 120 billion of the planned INR 580 billion in late FY2017/18 through the equity market and the sales of non-core assets.

banking system's exposure to the sovereign. In the ten weeks since April 13, net portfolio outflows amounted to US$9.3 billion or about 0.3 percent of GDP, and pressures from significant capital outflows were absorbed through the rupee depreciating by about four percent vis-à-vis the U.S. dollar. Nevertheless, this episode of capital reversal has been less intense than the 2013 Taper Tantrum, thanks to India's stability-oriented policies and progress with structural reforms in recent years. From mid-April to mid-June 2018, foreign exchange reserves fell by about US$16 billion (from US$426 billion), and the RBI accelerated the scaling back of its net forward foreign exchange position, which has been ongoing since September 2017. Following the sizeable purchases of foreign exchange in the spot and forward markets in 2017 to contain rupee appreciation, the recent declines in the central bank's reserves and net forward position underscore the two-way nature of India's exchange rate management.

8. **The macroeconomic outlook for FY2018/19 is broadly favorable**, even when considering the recent upward revision to global oil prices and tightening of global financial conditions (Text Table 1)[3].

- Real GDP growth is projected at 7.3 percent, on strengthening investment and robust private consumption. Compared to the Spring WEO projections, growth will be somewhat lower reflecting adverse terms of trade leading to real income losses to households and firms, and additional effects from an incremental further tightening of monetary policy.

- Headline inflation is projected to rise to 5.2 percent, above the mid-point of the RBI's medium-term inflation target band (4 percent CPI inflation ± 2 percent), as demand conditions tighten, along with higher oil prices, housing rent allowances (HRAs), and agricultural minimum support prices (MSPs), and the recent depreciation of the rupee. The effect of these factors was visible in recent inflation prints.

Text Table 1. India: Impacts of an Increase in Oil Prices

		2017/18	2018/19	2019/20
Oil price (US$/barrel)	Baseline	52.8	71.8	67.5
	April 2018 WEO	52.8	62.3	58.2
	Change from April 2018 WEO		9.5	9.3
Growth (percent)	Baseline	6.7	7.3	7.5
	April 2018 WEO	6.7	7.4	7.8
	Change from April 2018 WEO		-0.1	-0.3
Inflation (percent)	Baseline	3.6	5.2	4.8
	April 2018 WEO	3.6	5.0	5.0
	Change from April 2018 WEO		0.3	-0.1
Current account (percent of GDP)	Baseline	-1.9	-2.6	-2.2
	April 2018 WEO	-2.0	-2.3	-2.1
	Change from April 2018 WEO		-0.2	-0.1

Source: IMF Staff Projection.

- The CAD is projected to widen to 2.6 percent of GDP on rising oil prices and strong demand for imports, offset by a slight increase in remittances. The balance of payments would switch to a small deficit.

9. **Over the medium-term, the economic outlook is projected to continue to improve**. Real GDP growth is expected to rise to 7¾ percent reflecting continued robustness in private consumption and a recovery in investment, supplemented by progress in bank balance-sheet repair, improved credit growth, and on-going structural reforms, most notably the productivity-enhancing

[3] International oil prices are now projected to average US$72 per barrel in FY2018/19, up from US$62/barrel in the Spring 2018 IMF *World Economic Outlook* (WEO).

effects of GST. Beyond potential fiscal gains, the national GST lowered internal trade barriers and will help create a common domestic market. This potential growth rate is estimated to be 0.5 percentage points lower than in the last Article IV consultation, due to a somewhat slower-than-previously-envisaged impact of structural reform, along with a downward revision to the historical GDP times series (Box 4).

10. Beyond the risk of a further increase in international oil prices, other risks are also tilted to the downside (Appendix II)**.** Domestic risks pertain to tax revenue shortfalls related to continued GST implementation issues. Delays in addressing the twin balance sheet problems may lead to a further deterioration of the balance sheets of banks and corporates. Slow progress in implementing key structural reforms could weigh on investor sentiment, investment, and growth. On the external side, further tightening of global financial conditions could intensify the recent reversal of capital flows and add to external borrowing costs. A retreat from cross-border integration including spillover risks from a global trade conflict could affect exports. Nonetheless, given India's relatively low trade openness, spillover risks of a global trade conflict are likely contained, to the extent that it does not affect capital flows. India's outward spillovers are likely limited to its neighboring economies, namely Nepal and Bhutan, given trade ties and their currency pegs to the Indian rupee.

Authorities' Views

11. The authorities broadly agreed with the staff's assessment of the outlook and risks. They expected that the economic recovery would continue to strengthen and be broad-based, as agricultural output improves on the back of a predicted normal monsoon, industrial output expands in line with growing domestic and external demand, and services sector growth remains robust. The authorities observed a strong pickup in credit from banks and other financing sources to the commercial sector compared to last year. With improving capacity utilization and credit uptake, investment activity is expected to remain robust even as there has been some tightening of financing conditions in recent months. They also highlighted a significant rise in infrastructure investment, particularly in road construction, with the government's focus on demand and job creation through spending on rural and labor-intensive infrastructure likely to support rural demand. They underscored that risks to near-term growth persist, mainly arising from volatile oil prices and tightening global financial conditions. On inflation, the authorities indicated that their projections were lower than staff's. They also emphasized the need to look through the statistical impact of the HRA (0.35 percentage point on headline inflation) and cautioned that only the second-round impact would be relevant from a policy perspective. Moreover, they saw substantial uncertainty regarding the inflationary impact of higher MSPs, pending the operationalization of the mechanism to set and pay the higher prices.

KEY POLICY ISSUES

12. Policy mix. With limited policy space, growing risks (which places a premium on prudent policies), and the economy recovering, India would be served best by stepping up supply-side measures to revive credit growth (including to businesses) and promote inclusive growth. Fiscal consolidation should continue to lower elevated public debt levels and allow for easing of financial repression. The RBI will need to gradually tighten policy further, in response to inflation pressures, which will help to build monetary policy credibility. The staff's advice on financial sector reforms is anchored by the recommendations made in the recent FSAP (Appendix III).

13. Macro-financial and structural policies are medium-term priorities to boost inclusive growth and harness the demographic dividend. Immediate priorities are to revive bank credit and enhance the efficiency of credit provision by accelerating the cleanup of bank and corporate balance sheets and a decisive strengthening of PSB governance. Gains can also be made by simplifying and streamlining the GST structure and broadening the tax base. More broadly, over the longer term, greater labor market flexibility, land reforms, and product market liberalization are needed.

A. Fiscal Policy—Enhancing Sustainability

14. Fiscal consolidation paused in FY2017/18 as the planned reduction in the central government deficit target did not materialize, partly reflecting one-off factors (Text Table 2). The central government deficit remained at the FY2016/17 outturn of 3.5 percent of GDP (authorities' presentation; provisional accounts) and above the budget target of 3.2 percent of GDP. The deficit is estimated to have deteriorated by 0.3 percent of GDP relative to FY2016/17 in the IMF presentation.[4] Relative to the FY2016/17 outturn as a share of GDP, non-tax revenue declined sharply, offset partly by a small increase in tax revenue and a reduction in expenditures, mainly lower capital spending. Lower-than-budgeted telecom spectrum sales, dividends from public sector enterprises, and profit transfers from the RBI due to demonetization and intervention-related costs reduced non-tax revenue receipts, whereas base broadening efforts through heightened enforcement helped boost tax revenue.

Text Table 2. India: Summary Fiscal Operations, FY16/17-18/19
(In percent of GDP)

	FY 2016/17	FY2017/18		FY 2018/19
		Budget	Actual	Budget
Total revenues	**9.3**	**9.3**	**8.8**	**9.4**
Net tax revenues	7.3	7.4	7.4	7.9
Non-tax revenues	2.0	1.9	1.4	1.5
Total expenditure	**13.0**	**12.9**	**12.8**	**13.0**
Revenue expenditure	11.1	11.0	11.2	11.4
Capital expenditure	1.9	1.8	1.6	1.6
Central government balance	**-3.7**	**-3.5**	**-4.0**	**-3.6**
General government balance	**-6.7**	**-6.5**	**-7.0**	**-6.6**
Memo items				
Fiscal deficit (authorities' definition) 1/	3.5	3.2	3.5	3.3
Public debt	68.9	…	70.4	68.7

Source: Budget documents, RBI debt statistics, and IMF staff estimates.
1/ Includes asset sales in receipts, and excludes certain non-tax revenue items.

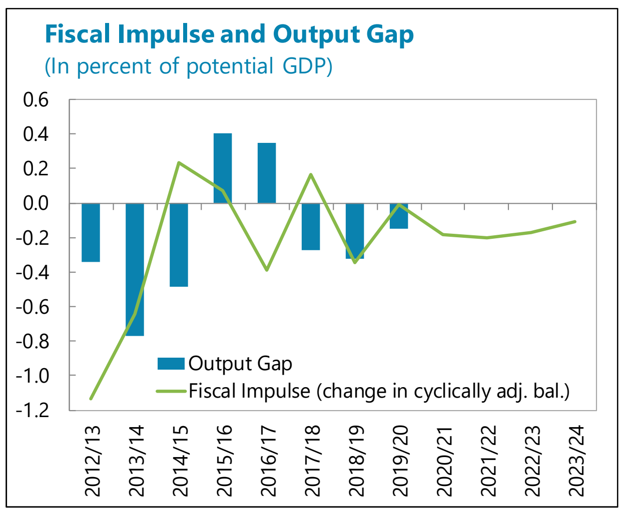
[4] The difference between the authorities' and IMF presentations primarily reflects higher-than-budgeted privatization proceeds, which are recorded below the line in the IMF presentation.

15. The central government's FY 2018/19 budget again envisages a reduction in the headline fiscal deficit.

- The authorities' presentation shows a reduction of about 0.2 percent of GDP, while the IMF projects a reduction of 0.4 percent of GDP (0.3 percent of potential GDP in cyclically-adjusted terms).

- Net revenues are budgeted to increase as a share of GDP, roughly half from an increase in direct tax collections. Continued base-broadening and enforcement measures would boost personal income taxes (PIT), offset by a slight fall in corporate income taxes (CIT) following a modest tax rate cut for micro, small, and medium-sized enterprises (MSMEs). Indirect tax revenue is budgeted to rise mainly on improved GST compliance. Non-tax revenue is projected to increase slightly, while other tax revenues are set for a small decline, with an increase in the states' share from gross revenues. The budget introduced a long-term capital gains tax on equities at a 10 percent rate, raised custom duties on several items, and lowered excise rates on petrol and diesel. Pressures may mount on cutting back excises on fuel as retail prices have risen recently.

- Expenditures are budgeted to increase as a share of GDP, primarily reflecting higher subsidy payments, offset by lower interest expenses. A key government initiative launched in the context of the budget remains unfunded, namely to offer farmers a MSP of 1.5 times production cost. The budget also announced the launch of a flagship national healthcare scheme to cover 500 million potential beneficiaries (about 100 million households), details of which are yet to be finalized, and the establishment of a dedicated Affordable Housing Fund (0.2 percent of GDP, financed mostly off-budget).



16. The government accepted the medium-term fiscal targets recommended by the Fiscal Responsibility and Budget Management (FRBM) Review Committee but with a delayed timetable. The recommendation to set-up a fiscal council was not approved.

- The fiscal deficit, adopted as the operational target, will be reduced to 3.0 percent of GDP (authorities' definition) by FY2020/21, two years later than the first year of meeting the target as recommended by the FRBM Review Committee.

- Central government debt will be brought down to 40 percent of GDP by FY2024/25, two years later than recommended.

17. Staff supports the FY2018/19 budget targets, and the authorities should stand ready to take corrective measures if there are any slippages.

- India has limited fiscal space as debt is close to thresholds that increase the likelihood of debt distress among emerging market economies (Appendix IV). High interest burden and risks from rising yields necessitate continued focus on debt reduction, to enable establishing policy credibility, building buffers, and further reducing the statutory liquidity requirement (SLR).

- The states' share in aggregate fiscal deficits and debt is large, and spending pressures pose risks, including from farm loan repayment waivers, the UDAY scheme under which states take over part of electricity distribution companies' debts and losses in return for reforms, and the recommendations of the Seventh Pay Commission. While states' fiscal deficits have generally been within 3 percent of GDP, stipulated under states' self-imposed fiscal rules, they have risen recently even as the center has consolidated.

- Against the backdrop of a narrowing output gap, the FY2018/19 budget targets imply a reduction of the cyclically-adjusted deficit as noted earlier (IMF presentation). However, revenue risks, mainly from GST, and expenditure risks may limit the adjustment.

- Vigilance is needed in view of the higher-than-usual uncertainty surrounding GST revenue projections, stemming mainly from the absence of historical data on which to base projections. In the context of GST adoption, the center has guaranteed states' annual revenue growth of 14 percent for a period of 5 years. Therefore, GST revenue slippages could exacerbate the central government deficit through additional transfers to states and necessitate further fiscal measures.

- Enhancing GST compliance, including by streamlining filing and refund mechanisms and simplifying the rate structure, along with strengthening tax administration, are key to relieve the burden on MSMEs and help deliver on the GST's promise of enhanced formalization of economic activity. Fewer rates and a broader base would limit opportunities for reclassification (to exploit rates differences between inputs and outputs) and simplify administration. In this context, consideration could be given to include petroleum products in the GST.

- On the expenditure side, the government primarily needs to limit the fiscal cost of the proposed increase in MSPs and avoid increasing fuel subsidies (or alternatively reducing fuel excise taxes). In addition, rising interest rates could put pressure on the government's interest burden.

18. Staff recommends a more ambitious medium-term fiscal consolidation path than currently envisaged by the authorities. The center has consolidated over the last few years from high deficit levels. The expected acceleration of growth provides room for a more rapid reduction in the deficit and would allow the authorities to adopt a consolidation path consistent with the FRBM Review Committee's recommendation to reduce general government debt to 60 percent of GDP by FY2022/23, underpinned by further reforms to subsidies and continued measures to raise tax buoyancy (Text Table 3; the footnotes therein provide details on the measures underpinning the alternative scenario). This entails a cumulative improvement in the cyclically-adjusted primary balance of about 1.3 percent of potential GDP over 4 years, well below consolidations achieved by other countries (the top quartile of achieved adjustments is 3 percent over 3 years). A faster pace of consolidation would help cap the rise in long-term bond yields, reduce external and banking vulnerabilities, and improve market confidence.

19. Staff assessed the growth impact of a more ambitious fiscal-consolidation scenario using the IMF's Flexible System of Global Models (FSGM). This was done for the two components of the consolidation—a reduction in government expenditure (subsidies) and an increase in tax revenues. The limited growth impact reflects the gradual nature of the consolidation, the use of relatively less distortionary fiscal instruments, and monetary policy being assumed to ease relative to the baseline to moderate the impact on domestic demand—such a scenario represents a relatively growth-friendly consolidation.

Text Table 3. India: Medium Term Macro-Fiscal Outlook

(In percent of GDP)

	Actuals		Budget	Baseline 1/				Consolidation scenario 3/			
	FY17	FY18	FY19	FY20	FY21	FY22	FY23	FY20	FY21	FY22	FY23
Revenue	**20.9**	**20.5**	**21.3**	**21.3**	**21.3**	**21.3**	**21.4**	**21.4**	**21.6**	**21.8**	**22.0**
o/w tax revenue	17.7	17.9	18.6	18.6	18.6	18.7	18.7	18.8	19.0	19.2	19.4
Expenditure	**27.5**	**27.5**	**27.9**	**27.8**	**27.7**	**27.5**	**27.4**	**27.5**	**27.3**	**26.9**	**26.8**
o/w central subsidies	1.3	1.1	1.4	1.4	1.4	1.4	1.4	1.1	1.0	0.9	0.9
General govt overall balance	**-6.7**	**-7.0**	**-6.6**	**-6.5**	**-6.4**	**-6.2**	**-6.0**	**-6.1**	**-5.6**	**-5.1**	**-4.7**
Cyclically Adj. Primary Balance 2/	-1.8	-1.9	-1.6	-1.6	-1.6	-1.5	-1.5	-1.1	-0.9	-0.6	-0.3
General govt debt ratio	**68.9**	**70.4**	**68.7**	**67.2**	**65.7**	**64.4**	**63.1**	**66.7**	**64.5**	**62.3**	**60.0**
GDP growth	7.1	6.7	7.3	7.5	7.7	7.7	7.7	7.4	7.7	7.6	7.7
Inflation	4.5	3.6	5.2	4.8	4.5	4.2	4.1	4.8	4.4	4.1	4.0

1/ Buoyancy assumptions: Central CIT = 1.1, PIT = 1.05, GST = 1.00.
2/ In percent of potential GDP.
3/This scenario illustrates achieving the FRBM committee's recommendation that general government debt be reduced to 60 percent of GDP by FY2022/23. This is achieved with a combination of greater tax buoyancy and subsidy cuts. (A) Tax buoyancy assumptions are: CIT = 1.1, PIT = 1.1, GST = 1.15 (relative to broadly neutral buoyancy in the baseline), assuming continued base-broadening measures. GST is assumed to achieve buoyancy sufficient to raise GST to GDP ratio by around 0.5 percentage points over 5 years (in line with the median increase in central government Value Added Tax over 5 years in cross-country panel of 69 countries). (B) Subsidies are reduced gradually by 0.5 percent of GDP over 4 years, with a 0.3 percent of GDP cut in fertilizer subsidies, elimination of fuel subsidies, and a modest cut to food

20. Staff encourages the authorities to upgrade the fiscal-reporting framework. With states responsible for an increasing share of spending, maintaining fiscal discipline and strengthening macro-fiscal capacity at the state level is essential. This includes harmonizing state budgetary processes and decreasing the more-than-one-year lag in reporting fiscal data. The recently appointed 15th Finance Commission will address several state issues, for which IMF staff is providing background on international experiences and best practices related to subnational governments, including through SARTTAC (Appendix V). Additionally, to capture risks stemming from off-budget spending (which appear to have risen), coverage of expenditures should be broadened. These improvements would allow enhanced coverage of the general government's fiscal position.

Authorities' Views

21. The authorities agreed on the need to take corrective measures in the event of slippages to the FY2018/19 budget targets. With the economy improving, they believed that any fresh slippages are likely to be moderate. They were confident that the GST would be buoyant over the near term, adding up to ½ percent of GDP in revenues in each of the next two years. The GST was also expected to help boost direct taxes, through improved compliance and record-keeping. The recently introduced e-way bill, an electronically-generated document which is required to be generated for inter-state goods transactions above INR 50,000 (approximately US$750) in value would significantly help improve GST compliance. Further reforms to the GST would first focus on base broadening before considering further rationalization of the rate structure, although the pruning of the list of items subject to the top 28 percent tax rate had already effectively led to some rationalization. Regarding base broadening, the authorities noted that taxing certain fuels such as aviation fuel and natural gas under the GST would be relatively easy, but including other products such as petrol, diesel, and immovable property would be more challenging as they were key revenue sources for states. In the Indian context, pruning exemptions would also be difficult. On the expenditure side, the recent public financial management (PFM) reforms including advancing the budget calendar, reducing subsidy leakages through Direct Benefit Transfers (DBTs), and reducing project cost overruns had helped improve expenditure control. The PFM System developed by the Ministry of Finance is being implemented. It needs to be strengthened to improve the quality of expenditure and fiscal data reporting.

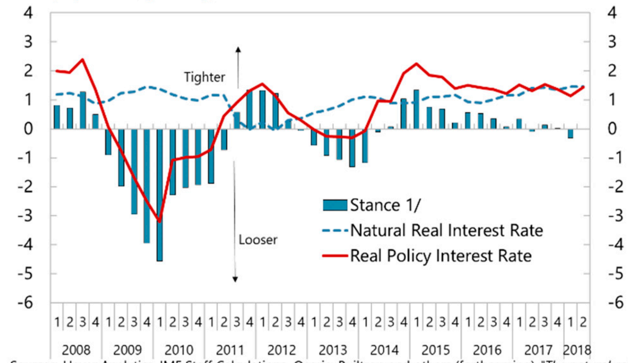
22. The authorities noted that the recommendations of the FRBM committee including a formal debt anchor had been accepted by the government and amendments to the FRBM Act had been passed through the Finance Act of 2018. While underscoring the importance of medium-term fiscal consolidation, they felt that a gradual pace was called for because of the need to support growth and development. A gradual pace was also deemed to be more feasible and would avoid disappointments relative to a more ambitious path.

23. Regarding the recording of bank recapitalization costs in the fiscal accounts, the authorities noted that they had followed international best practice in pricing the government's bond-financed equity stakes in the PSBs. Market prices, as per the applicable formula mandated by the Securities and Exchange Board of India regulations, were paid. Being consistent with a preferred shareholder acquiring a large allotment of equity, the recapitalization was recorded below the line as a financing transaction.

B. Monetary and Exchange Rate Policy—Consolidating Credibility

24. Monetary policy tightening in early June was appropriate and further gradual tightening will be needed. The policy rate had been on hold since August 2017 (6 percent). Staff's assessment is that after the June rate hike (to 6.25 percent), monetary policy conditions are broadly neutral based on staff estimates of the natural rate of interest (about 1.45 percent) and one-year ahead inflation expectations (4.8 percent). Headline and core inflation are rising and forecasted to be above the mid-point of the headline inflation target band in the near and medium term, raising the probability that adverse shocks could push headline inflation above the RBI's target range and calling for a tighter stance. Persistently elevated inflation could also lead expectations to become entrenched—household expectations were revised higher in the RBI's latest survey. Inflation risks are tilted to the upside—including from higher oil prices, potential changes to MSPs, exchange rate depreciation, possible fiscal slippages, second-round effects from state-level increases in HRAs, and recently-announced increased import duties. Tighter monetary policy will, however, make it more challenging to revive the credit cycle.

Monetary Policy Stance and Real Interest Rates
(In percent, quarterly)



Sources: Haver Analytics, IMF Staff Calculations, Osorio-Builtron and others (forthcoming) "*The natural rate of interest and its drivers: A cross-country analysis*".
1/ Stance = Natrural Real Interest Rate - Real Policy Interest Rate

25. To enable the RBI to achieve the medium-term inflation target on a sustained basis continued action to improve the monetary transmission mechanism is needed. Having established a robust institutional framework for monetary policy, key next steps include enhancing competition in the banking system, encouraging banks to streamline credit pricing, addressing fragmentation of interbank markets, and continuing to enhance communication. Accordingly, PSB governance reform and reducing the government's footprint in the banking system would play an important role in leveling the playing field, thereby promoting competition and market efficiency. Important gains can be expected from addressing banks' NPAs, operationalizing corporate debt restructuring processes, and agriculture sector reforms to help stabilize food prices and contain households' inflation expectations.

26. India's external position is assessed to be broadly consistent with fundamentals and desirable policy settings (Appendix VI). External debt at around 20 percent of GDP is moderate compared to other emerging market economies. External financing looks sustainable, but could be affected by domestic and external volatility. In the past year, a number of changes affecting FDI and portfolio flows were implemented, largely moving in the general direction of capital account liberalization. Further liberalization of portfolio inflows should be considered, while considering risks of capital flows volatility. Gross reserves, at more than 160 percent and about 210 percent of the standard and capital flow measures-adjusted IMF metrics at end FY2017/18, respectively, appear adequate for precautionary purposes.

27. India should continue to rely on exchange rate flexibility.

- Experience in other fast-growing emerging market economies suggests that the real effective appreciation of the rupee is mostly inevitable over the longer term. Overly restricting currency appreciation would lead to opportunity and sterilization costs from foreign exchange interventions and slow the development of the foreign exchange market, including for hedging instruments. Accordingly, interventions should be two-way and limited to disorderly market conditions.

- In the event of severe external pressures or further increases in oil prices, continued exchange rate flexibility complemented by tighter fiscal and monetary policies would help ease the shock. Based on the Debt Sustainability Analysis and FSAP stress tests, negative balance sheet effects from a rupee depreciation would likely be contained.

Authorities' Views

28. The authorities indicated that forward-looking monetary policy will continue to be calibrated to achieve the medium-term inflation target. Considering inflation data available through April 2018, at the time of the consultation mission, their forecast of headline inflation in FY2018/19 was 4.6 percent, below that of staff, partly because the authorities had not yet factored in the upside risks from higher MSPs, state HRAs, and possible fiscal slippages. The authorities noted that monetary policy would look through the direct effect of the HRA, were confident that food inflation in the medium term would remain subdued, and emphasized that headline inflation is the official target. Although there was broad agreement with staff's assessment of the output gap, the authorities emphasized significant uncertainty around these estimates. The authorities agreed with staff on the importance of continued supply-side reforms to contain food inflation and the need for stability-oriented macroeconomic policies to help anchor inflation expectations.

29. The authorities concurred that the external position is broadly consistent with fundamentals and desirable policy settings. They agreed with the assessment of a CA norm of -2.5 percent of GDP and felt strongly that a CAD above 3 percent of GDP may pose financing difficulties. A more negative CA norm would also give the wrong signal for macroeconomic management. The authorities confirmed that exchange rate flexibility would continue, but argued for proactive rather than reactive intervention to prevent disorderly market conditions and noted that intervention should be assessed across a full capital inflow-outflow cycle. They planned to continue using foreign exchange interventions to smooth rupee movements and augment external buffers during episodes of sustained inflows to be used during outflows, which tended to occur in spurts.

C. Financial and Corporate Sector—Addressing the Twin Balance Sheet Problem

30. A range of complementary initiatives has been taken to address India's twin balance sheet problem and resurrect PSB's financial intermediation. In addition to the AQR, recognition of NPAs, implementation of the new PCA framework, and PSB recapitalization, the RBI directed banks to refer two batches of large corporate accounts in July and December 2017, representing about 40 percent of PSBs' outstanding NPAs by value, to the time-bound resolution process under the IBC. Importantly, there is a sense that the implementation of the IBC could shift the power balance between debtors and creditors and improve corporate repayment discipline. Five of the 12 accounts from the first batch are now resolved or nearing the final stages of resolution. Ongoing efforts to build institutional capacity for the effective functioning of the IBC are welcome and could be complemented with designing an out-of-court regime that offers a flexible, speedy, and low-cost alternative to the in-court process under the IBC.

31. In recent months, the RBI introduced a new, simplified framework for the resolution of stressed assets. The new framework involves a more proactive approach in identification, monitoring, and supervision of problem assets and their reference to the IBC process. Accordingly, banks have begun to reclassify a large share of restructured loans (e.g., PSBs reduced these loans from 2.7 percent in September 2017 to 1.1 percent of total loans in March 2018) as NPAs, pushing up the NPA ratio further. The higher provisioning coverage (40 percent required for NPAs compared to 5 percent for restructured loans) will cause weaker PSBs to continue to report losses in the coming quarters.

32. Staff welcomes the various initiatives but urges the authorities to further strengthen governance and accelerate implementation as part of a broader package of financial reforms. In addition to speeding up NPA resolution and completing PSB recapitalization, this includes improving bank governance, reducing the role of the public sector in the financial system, and enhancing bank lending capacity and practices, thereby reducing the fiscal contingency risks arising from PSBs in the future.[5] The Banking Reforms Roadmap, announced by the government in January 2018, indicates that the recapitalization will be contingent on measures to strengthen governance and operations. However, the plans remain vague, and staff recommends that the authorities pursue more far-reaching governance reforms, for instance removing the RBI representatives from banks' boards and defining better the terms of reference for board members, including the Ministry of Finance representative, to strengthen the quality and independence of banks' boards. More aggressive PSB disinvestment and privatization would address some of the structural issues in governance, such as incentives and efficiency of PSBs.

33. Promoting private-sector based alternatives to PSBs is needed over the medium term. The recent successful IPO of a private bank that had started out as a microfinance institution, the vibrancy of India's non-bank financial corporations, and the rapidly-developing fintech space illustrate the viability of market-based solutions to India's access-to-finance and financial-inclusion challenges. The government should also continue to gradually reduce the SLR to help deepen markets and encourage lending and reexamine priority sector lending (PSL) targets, which apply equally to private banks. These targets distort resource allocation, result in contingent and actual fiscal liabilities that have repeatedly been associated with PSBs, and lead to financial repression.

34. Staff encourages the authorities to follow up on the FSAP recommendations, including to amend the legal framework to provide the RBI full regulatory and supervisory powers over PSBs

[5] A panel was set up to study asset management companies to resolve the NPAs. The FSAP advised focusing on further promoting private asset reconstruction companies, and recommended against establishing public ones given the heterogeneity of cases, difficulties in setting transfer prices, challenges related to governance and expertise, and the fact that the largest cases are already being addressed under the IBC.

to make banking regulation and supervision ownership-neutral. The recent large fraud at Punjab National Bank—the second largest PSB—underscores the importance of steps needed to improve PSB governance and internal controls. At the same time, the strong growth of credit to households from private banks and non-bank finance companies calls for vigilance on the part of RBI supervisors, to make sure that these institutions uphold underwriting standards.

Authorities' Views

35. The authorities agreed on the importance of focusing on the implementation of the reforms. While acknowledging some initial teething problems in its operationalization, the authorities expected the implementation of the IBC to contribute to the speeding up NPA resolution. Accordingly, the banking sector's NPA ratio was expected to peak within a year. Banks' provisioning is improving, and early indications from some of the large cases subject to the IBC process suggest that the provisioning requirements may be sufficient. For instance, lower-than-provisioned haircuts in the steel industry—the largest contributor to overall NPAs—are expected to release capital and support further credit growth. The authorities recognized the importance of the PSB governance reform and reiterated that it is an integral part of the recapitalization plan with a reporting framework in place to monitor progress. The RBI was reviewing supervisory processes and frameworks to strengthen fraud prevention and assessment of operational risk.

36. The authorities stressed the key role played by PSBs in the economy and argued for a gradual pace of reducing the government's presence in the financial sector. Although the PSL requirements apply equally to private sector banks, PSBs are critical in providing financial access more directly to underserved populations. The authorities are encouraging PSBs to diversify and differentiate their business models, while improving risk management. The RBI has been progressively reducing the SLR and it was noted that: (i) the ratio was currently not binding, with banks maintaining SLRs well in excess of the requirement; and (ii) banks were allowed to use part of their qualifying assets to satisfy the liquidity coverage ratio.

D. Structural Reforms—Boosting Investment and Inclusive Growth

37. To support inclusive growth, key structural challenges need to be resolved. Since the 1980s, wide-ranging structural reforms to deregulate, open, and make the economy more competitive have contributed to vastly improved living standards, with the share of the population in poverty decreasing significantly. However, income per capita remains relatively low, and income disparities are widening. Moreover, unlike some other emerging market economies, India's manufacturing sector remains relatively small, reflecting major rigidities in labor, land, and product markets.

38. Comprehensive reforms will help raise productivity and reduce vulnerabilities, setting the stage for higher and more sustainable growth. Labor market reforms could complement the GST in terms of promoting the formal economy and creating fiscal space for needed social and infrastructure spending. Improving the business climate combined with trade liberalization would also complement the GST in creating a more integrated, domestic market for goods and services, linking India's states also to the rest of the world. This, in turn, would reduce external vulnerabilities and generate more stable sources of financing, supporting the fiscal position.

39. The government continues to pursue growth-friendly policies, but the recent focus has shifted to implementation of reforms that have been already initiated. Steps taken in recent years continue to bear fruit. For example, on FDI liberalization, caps on foreign investments in different sectors have been largely relaxed. The Foreign Investment Promotion Board, which was responsible for clearing FDI proposals in cases where government approval was required, has recently been abolished. Most foreign investments are now allowed to enter sectors of the Indian economy under the automatic route. As a result, FDI inflows to India have been strong. Nevertheless, progress in other areas has been more limited, particularly on further deregulating labor markets and agricultural reforms.

Trade Policy Issues

40. Further trade liberalization and reforms to facilitate trade and investment will ultimately benefit India, and expand its role in the world trade system. Trade barriers remain significant.[6] Trade documentation and procedures are cumbersome, and lengthy processing times are burdensome. India's average most favored nation applied tariff rate (at 13.4 percent as of 2016) is higher than in some peer countries, though with relatively large differentiation between agricultural and non-agricultural products. In addition, tariffs are being changed frequently, including in the FY2018/19 budget. Trade in services is also restricted. Restrictions on foreign entry, barriers to competition, and lack of regulatory transparency are reportedly the main obstacles. Reducing non-tariff barriers, stabilizing and then subsequently decreasing tariffs, and implementing supply-side reforms to improve the business climate would help increase India's integration in global markets. The recent liberalization of FDI policies is a positive step in this direction.

41. Several trade-related issues concerning India are currently being considered at the WTO.

- The United States has challenged India's export subsidy schemes at the WTO, as creating an uneven playing field. India has recently crossed the income threshold, above which a country becomes subject to the prohibition on export subsidies.

- The United States questioned India's methodology related to calculations of the market price support for wheat and rice at the WTO Committee on Agriculture, raising concerns on possible underreporting of the support's size.

- Following the announcement of the imposition of large steel and aluminum tariffs by the United States on several countries' imports, including for India, the Indian authorities sought consultations on their consistency with the WTO norms. While a direct impact on India's exports

[6] Trade barriers are documented in IMF WP 18/32 "A Multidimensional Approach to Trade Policy Indicators."

from the tariffs is likely to be relatively small, the authorities are concerned about their possible impact on the global trade system.

Labor Market Reforms

42. An important priority is modernizing labor regulations and other measures to help increase formal employment and employment of women. Analytical work on structural reform priorities and sequencing, featured in the 2017 Article IV consultation, found that labor market reforms are the top priority since they maximize gains while minimizing short-run costs, given India's large informal sector. With growth recovering and greater progress in product market reforms, now is the time to shift attention to labor market reforms. Notwithstanding the recent extension of fixed-term labor contracts to all sectors, labor laws remain numerous, outdated, and restrictive, including at the sub-national level. Staff's analytical work highlights the linkage between labor market rigidities and misallocation of resources in manufacturing. By providing disincentives for firms to hire more and expand, these rigidities stifle productivity growth and formal sector job creation.

43. Further labor reforms will help reap the full benefits of the demographic dividend and economies of scale from the national GST. Reforms to the Industrial Disputes Act of 1947 and restrictive clauses under the Factories Act of 1948, including reforms to job protection for permanent workers, are key to enhance labor market flexibility and allow firms to expand and reach economies of scale. Labor laws, which currently number around 250 including both the center and states, need to be streamlined and reduced, building on current efforts to rationalize the various laws into four Labor Codes. Labor market rigidities push down female labor force participation, which is among the lowest in peer countries.[7]

Infrastructure and Product Market Reforms

44. More emphasis could be put on addressing delays in infrastructure investment. In recent years, the supply side of the economy has been strengthened through large investments in airports, roads, telecom, and power generation. Nevertheless, there is a general recognition that sustainably higher growth will require more action on addressing infrastructure bottlenecks. India's Project Monitoring Group (PMG) has been empowered to speed up investment approvals, but many projects are still pending PMG approval. The most common delays include environmental clearances and land acquisition issues.

45. Land reforms remain essential to facilitate and expedite infrastructure development. Staff welcomes recent initiatives and schemes to overcome project delays (e.g., Engineering, Procurement, and Construction schemes and the setting up of Special Purpose Vehicles to acquire land and obtain relevant permits and licenses) and transfer risks to the entity that is most capable of handling it (e.g., procedural and administrative risks related to land acquisition to the government and construction and commercial risks to the private sector). Nevertheless, efforts should be

[7] See the Selected Issues Paper prepared for the 2017 Article IV Consultation.

enhanced on land reforms to streamline and expedite land acquisition and simplification of procedures.

46. Continued actions to strengthen further the business climate are important. Despite recent simplification efforts, business regulations remain very complex, litigation lengthy, and corruption and bureaucracy reportedly major obstacles for doing business. Further steps could include contract enforcement and judicial reform. In addition, measures to reduce administrative and regulatory burdens, improve governance, shorten regulatory approval timelines, and widen implementation of single-window clearance can support foreign and domestic investments.

47. Sustained inclusive growth requires agricultural sector reforms, as productivity in the sector remains low. The staff's analytical work highlights the importance of reducing supply-side constraints, building more integrated markets, boosting productivity, and addressing market distortions. As MSPs could skew farmers' production decisions, add to inflation, and enlarge the fiscal burden, their use (backed by assured procurement) should only be temporary and limited to correcting market failures. Farmers should be supported through other reforms. Despite gradual implementation, recent agricultural policy initiatives such as the assured irrigation system, the introduction of common electronic trading platform for the National Agriculture Market (e-NAM) and the development of Gramin Agricultural Markets (GrAM) are welcome and promise to reduce production risk, increase competitiveness, and improve transparency in state agricultural markets. Building on recent progress, more needs to be done to revamp government procurement processes and the public distribution system (PDS) for food, including to restructure the role of the Food Corporation of India via outsourcing of cereal procurement and stocking operations as well as checking leakages in the PDS. Various agricultural subsidies are being streamlined especially through DBTs, and should be further reduced going forward.

Authorities' Views

48. The authorities generally recognized the need for further comprehensive structural reforms to make the Indian economy more competitive. They underscored the strong pick-up in infrastructure investment activities through the National Investment and Infrastructure Fund in recent years, which should also help attract more FDI flows into India's infrastructure sector. While acknowledging that steps need to be taken to further improve the business climate, the authorities pointed at India's substantial advances in recent years in cross-country rankings regarding the ease of doing business, thanks to the government's sustained efforts on regulatory reforms. They pointed to ongoing reform efforts at the state level to improve the ease of doing business, thus generating reform momentum through competition among states and setting best practices. On labor reform, the authorities argued that the recent extension of fixed-term labor contracts to all sectors should bring sufficient flexibility. They were also hopeful that recently-announced plans to increase the coverage of healthcare and new welfare provisions which cover the informal sector and enhanced paid maternity leave should improve female labor force participation. The authorities noted that the agricultural sector reforms are underway, including to streamline agricultural subsidies through the application of DBT and to build nationally-integrated agricultural markets through e-NAM and GrAM.

49. The authorities expressed strong support for the multilateral rules-based trade system but had some reservations on staff's call for trade reforms. The authorities noted their strong support for the WTO dispute resolution mechanism and were concerned about a possible reversal of global trade integration. On trade tariffs, rates have been gradually decreasing on average, and recent increases for some goods were consistent with India's WTO commitments and were effected in response to developments in the domestic economy. In this context, the authorities noted that India's tariff rates were not substantially higher than in peer countries with similar income levels. They also objected to the OECD's services trade restrictiveness indicator on methodology and results. Regarding export subsidy schemes, the authorities believe that an eight-year transition period should be applied for unwinding those schemes.

STAFF APPRAISAL

50. Following transitory disruptions, India is again one of the world's fastest-growing economies. Cash shortages in the aftermath of demonetization and transitional costs related to the introduction of the national GST exacerbated a growth slowdown in FY2017/18 that had started earlier. But activity picked up in recent quarters with robust contributions from private consumption and gross fixed capital formation. As a result, inflation is now on the rise after moderating to a multi-year low earlier on subdued demand, low food prices, and currency appreciation.

51. Growth is projected to recover in FY2018/19 and strengthen in FY2019/20 as stability-oriented macroeconomic policies and progress on structural reforms continue to bear fruit. India stands to benefit from further implementation of key structural reforms to spur the country's catch up with advanced economies, including the inflation-targeting monetary policy framework, the IBC, the GST, and steps to liberalize FDI flows and improve the ease of doing business.

52. Risks to the outlook are tilted to the downside. Rising international oil prices will hold back activity. Beyond further oil price increases, other risks derive from tighter global financial conditions, a retreat from cross-border integration including spillover risks from a global trade conflict, and rising regional geopolitical tensions. Domestic risks pertain to tax revenue shortfalls related to continued GST implementation issues and delays in addressing the twin balance sheet problems and other structural reforms.

53. The policy mix should be geared to supply-side measures to promote inclusive growth. With the economy recovering, the output gap closing, and inflation rising, policy space is limited, suggesting a premium on prudent macroeconomic policies.

54. Continued fiscal consolidation is needed to lower elevated public debt levels and allow for easing of financial repression. India has limited fiscal space as debt is close to thresholds that increase the likelihood of debt distress among emerging market economies. Accordingly, the immediate focus should be on achieving the ambitious revenue targets which underlie the FY2018/19 budget targets, while standing ready to take corrective measures if risks to revenues, mainly from the GST, and expenditures materialize. Enhancing GST compliance, including by streamlining filing and refund mechanisms and simplifying the rate structure, are key to relieve the burden on smaller businesses and help deliver on the GST's promise of formalizing economic activity.

55. The authorities should adopt a more ambitious medium-term fiscal consolidation path and look to upgrade the fiscal reporting framework. The expected acceleration of growth provides room for faster deficit reduction, allowing the authorities to adopt a consolidation path consistent with the FRBM Review Committee's 60 percent of GDP general government debt target by FY2022/23. In the context of efforts to strengthen macro-fiscal capacity at the state level as well as the work of the recently appointed 15th Finance Commission, state budgetary processes should be harmonized and fiscal-data reporting made timelier. In addition, coverage of expenditures should be broadened to allow for enhanced reporting on the general government's fiscal position and capture risks stemming from off-budget spending.

56. The recent tightening of monetary policy was appropriate and further gradual tightening will be needed. With the output gap closing, inflation rising and forecasted to be above the mid-point of the target band in the near and medium term, and inflation risks on the upside, further tightening would anchor expectations and build monetary policy credibility. To enable the RBI to achieve the medium-term inflation target on a sustained basis, continued action is needed to improve the monetary transmission mechanism. In this regard, PSB governance reform and reducing the government's footprint in the banking system can be expected to help promote competition and market efficiency.

57. A key focus of the authorities should be on macro-financial and structural policies to boost investment, jobs, and productivity, and thus inclusive growth over the medium term to harness India's demographic dividend. Despite wide-ranging reforms in recent decades, income per capita remains relatively low, and income disparities are widening including among the states.

58. More progress is needed in tackling the twin balance sheet problem and resurrecting PSBs' effective financial intermediation. The simplified framework for the resolution of stressed assets announced by the RBI in February rounds off earlier steps to recognize NPAs, promote a time-bound resolution process under the IBC, and recapitalize the PSBs. Implementation of these pillars needs to be accelerated and backed by a comprehensive plan to improve PSB governance, internal controls, and operations to reduce fiscal contingency risk, including by considering more aggressive disinvestment and privatization. The authorities are also encouraged to follow up on the FSAP recommendations, including to amend the legal framework to provide the RBI full regulatory and supervisory powers over PSBs and make banking regulation and supervision ownership-neutral.

59. India would benefit from further liberalization of trade and reforms to facilitate trade and investment. India's capital flow management framework is moving in the general direction of capital account liberalization. Most FDI is now allowed to enter sectors of the Indian economy under the automatic route, but there is scope to reduce administrative and regulatory burdens and improve governance. Further liberalization in portfolio flows could be considered, while remaining vigilant to risks of capital flow reversals. As a strong advocate of the multilateral rules-based trade system, India is encouraged to play a bigger role in the world trade system.

60. India's external position is assessed to be broadly consistent with fundamentals and desirable policy settings, with international reserves adequate for precautionary purposes. Exchange rate flexibility should continue, with foreign exchange intervention being two-way and limited to disorderly market conditions.

61. Modernizing labor regulations and other measures to help increase formal employment and employment of women is a priority. In view also of India's low female labor force participation, further modernizing labor laws would encourage productivity growth and formal sector job creation, as well as reduce labor market rigidities that push down labor force participation, and allow India to reap the full benefits from the new national GST.

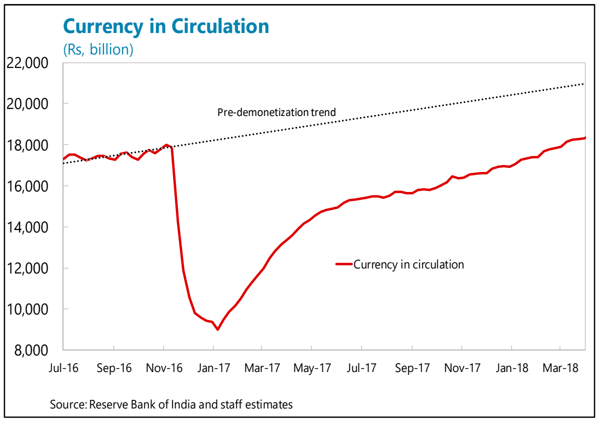
62. Achieving sustainably higher inclusive growth will require addressing infrastructure bottlenecks and agricultural sector reforms. In recent years, important progress has been made in strengthening the supply side of the economy through large infrastructure investments. Notwithstanding new initiatives and schemes to overcome project delays, land reforms remain essential to facilitate and expedite infrastructure development. Similarly, the initiatives to build more integrated markets and address market distortions will raise productivity in the agricultural sector by reducing production risk, increase competitiveness, and improve transparency in state agricultural markets.

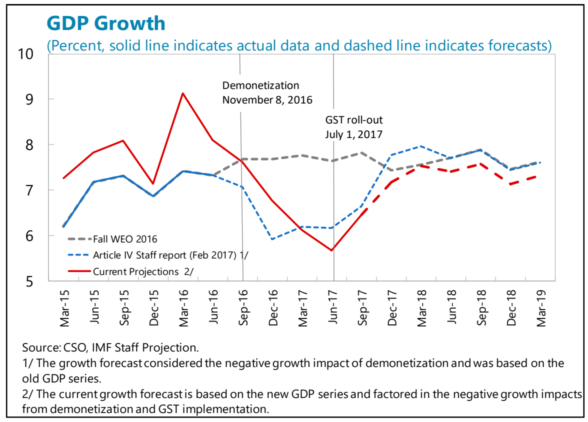
63. It is recommended that the next Article IV consultation take place on the standard 12-month cycle.

Box 1. Demonetization and its Aftermath

A surprise announcement in November 2016 to withdraw 87 percent of currency in circulation introduced an acute monetary shock, exacerbating the growth slowdown that had started earlier. To date, remonetization is largely complete and growth is recovering. Despite increased digitization, more needs to be done to make sustained gains in reducing the informal economy. Tax compliance has improved somewhat, also aided by GST implementation.

Remonetization is largely completed. The RBI collected 99 percent of the cancelled notes. Currency in circulation has risen above pre-demonetization level and appears to be growing slightly faster than the pre-demonetization trend.

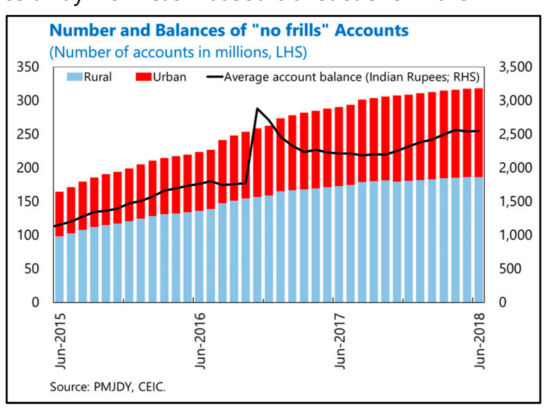




The abrupt money supply shock due to cash shortages exacerbated the growth slowdown:

- Uncertainty and disruptive cash shortages put a damper on consumer and business sentiment. As a result, high-frequency indicators for consumption (e.g., sales of two-wheelers) and production (e.g., industrial production, manufacturing and services PMI, and production of cement) saw strong declines. These indicators suggest that the effect of demonetization largely ended by May 2017.
- The impact on growth appears to have been more severe and longer-lasting than anticipated at the time of the 2017 Article IV consultation with a disproportionate impact on the informal sector. Considering the national accounts revisions starting in the first quarter of 2017/18, growth slowed steadily by about 180 basis points from the announcement of demonetization to May 2017, compared to about 100 basis points projected in the previous Article IV staff report. The uncertainty created by the implementation of the GST likely prolonged the growth slowdown.

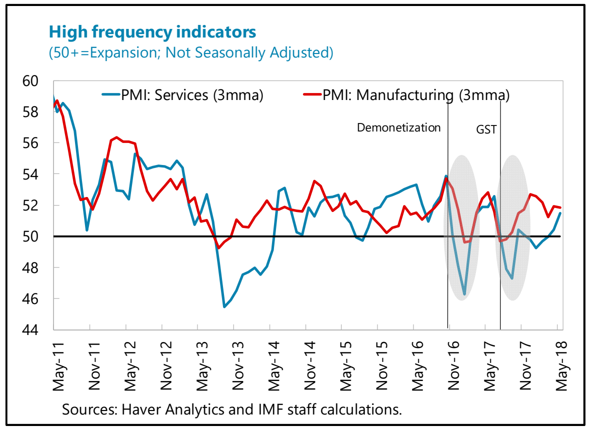
Demonetization's digitalization and formalization objectives remain a work in progress. One objective of the demonetization exercise was to drive consumers and businesses away from cash-based transactions in the informal economy. Digital and formal channels of transactions did rise and should help raise tax compliance and formalize the economy:



- *Digitization*. Electronic payments rose considerably in the immediate aftermath of demonetization and then fell somewhat but appear to be on an increasing trend.
- *Tax compliance*. Efforts are being made to identify and legitimize the source of deposits made in the months after demonetization, complemented by a campaign against tax evasion. As a result, the Indian Ministry of Finance estimates that the growth of new taxpayers reached 45.3 percent in FY2016/17, compared to 25.1 percent in the previous fiscal year.

Box 2. The Short-term Economic Impact of GST Implementation

Transitional costs related to the national GST introduction led to a sharp slowdown of economic activity. The Parliament passed the GST Constitutional Amendment Bill in August 2016, enabling replacement of a plethora of cascading center, state, inter-state, and local taxes with a single, nationwide, value-added tax on goods and services. The GST came into effect on July 1, 2017. Late decisions on the GST rate structure and exemptions created uncertainty and confusion among businesses and caused consumers to delay spending. Transitional effects of GST implementation contributed to a slowdown in growth to 6 percent (y/y) in the first half of FY2017/18.



While the GST sets a uniform tax rate across states, other elements of the GST structure are less streamlined than recommended. Uniform tax rates across states is a major achievement. Nevertheless, the GST in India includes four non-zero tax rate tiers (and additional rates and cesses for specific goods) and a broad array of exemptions such as on alcohol and petroleum, which goes against Fund advice of having as few tax rate tiers as possible and minimal exemptions.

As the new regime normalizes, high frequency indicators point to a recovery from the third quarter of FY2017/18. With GST implementation issues being addressed and businesses and consumers adjusting to the new system, short-term supply- and demand-side indicators rebounded strongly, and growth recovered to 7.2 percent (y/y) in the third quarter of FY2017/18. Medium-term growth is expected to improve owing to efficiency gains from the GST that improve intra-Indian trade in goods and services.

GST Implementation Issues and Support Measures

Issues	Descriptions	Support Measures Taken
Supply-chain disruptions	Uncertainty related to the rate structure of the GST led to de-stocking in the run-up of the GST rollout. Implementation glitches such as regarding IT systems and invoice matching caused delays and increased businesses' compliance costs.	Deadlines for the submission of tax returns were extended. All businesses with a turnover of Rs 15 million or less a year, can opt into a composition scheme where a flat rate is paid on turnover, no input credit is claimed, and taxes are filed and paid on a quarterly basis instead of a monthly basis.
Liquidity shortages	Exporting firms faced delays in receiving their input tax credit from states, causing liquidity and working capital shortages. One reason for the delay was the division of responsibility between the state and the center in issuing the returns. The use of duty credit scrips was limited under the GST.	An e-wallet, which would include an advance refund for input tax credits, has been set up and was rolled out from April 1, 2018. The issuance of GST refunds to exporters was also streamlined to a single authority. The validity period of duty credit scrips increased to 24 months from 18 months and the GST on their sale and purchase declined to 0 percent.
Tax efficiency and compliance	The multiple rate structure of the GST remains complicated.	To be addressed.

Box 3. PSB Recapitalization Plan

The Government of India (GOI) is undertaking a significant recapitalization of PSBs to enhance regulatory capital and provide "growth capital" to boost lending to the economy. The two-year recapitalization plan of INR 2.1 trillion (1.3 percent of GDP) was initially announced in October 2017. A subsequent announcement in January 2018 detailed the allocation of 0.5 percent of GDP to 20 PSBs during FY17/18, 59 percent of which was slated for 11 weak PSBs currently under the RBI's PCA framework. The bulk of the recapitalization in the first year was financed by recapitalization bonds. The total capital injection envisaged is broadly in line with the capital needs estimated by the 2017 FSAP, which ranged from 0.75 to 1.5 percent of GDP.

India: Bank Recapitalization Plan
(percent of GDP)

	FY17/18	Total
Recapitalization bonds	0.5	0.8
Budget transfer	0.0	0.1
Capital-raising from the market	0.1	0.3
Total	0.6	1.3

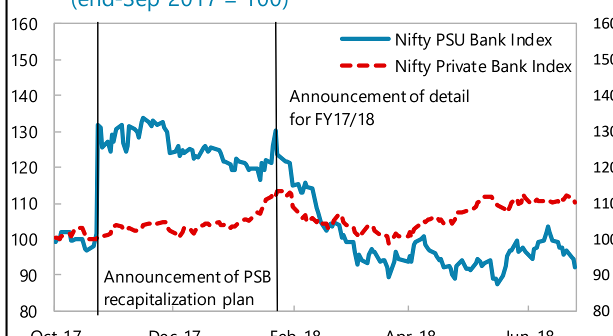
Source: Government of India.

The Banking Reforms Roadmap, announced alongside the recapitalization, lacked details on measures to improve PSB governance and operations. The roadmap lists six "reform themes", including strengthening PSBs; increasing credit supply; and deepening financial inclusion and digitalization. Measures to strengthen PSBs include more rigorous underwriting and loan loss recovery practices and rationalization of non-core assets and overseas operations. Bank boards are tasked with approving the plans for implementing the reform agenda and monitoring their progress. The government indicated that the recapitalization will be contingent on reform progress, without specifying the milestones to be met for each tranche.

The plan's impact on banks' credit provision is unclear and implementation delays have been costly.

- The sizable recapitalization is a positive development, but further analysis is needed to assess how much capital could be directed to increasing lending. Much will depend on the capital needs from the ongoing NPA resolution proceedings and their implications for the sufficiency of provisioning. Other uncertainties pertain to other stresses on asset quality including from a recent fraud case; and pressures on banks' profitability from mark-to-market losses on holdings of government bonds.

Nifty Bank Index[1/]
(end-Sep 2017 = 100)



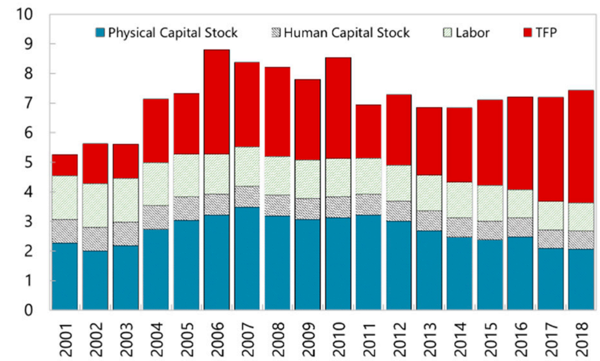
Source: National Stock Exchange of India.
1/ Nifty PSU Bank index consists of 12 PSBs. and Nifty Private Bank index consists of 10 private banks.

- The market initially reacted positively to the October 2017 recapitalization announcement, but PSBs' share prices have fallen to pre-announcement levels with the majority of PSB shares trading at a discount to book value and some well below 0.5.

Box 4. Potential Output

Potential growth for India is increasing gradually, and is estimated at 7.3 percent in FY 2017/18. Estimates are derived from a combination of statistical and multivariate filters. A production-function decomposition of the potential-growth estimates indicates that much of the recent acceleration is due to improvements in total factor productivity (TFP) growth, which have more than offset a dwindling contribution from the physical capital-stock, attributable to the prolonged period of subdued investment growth.

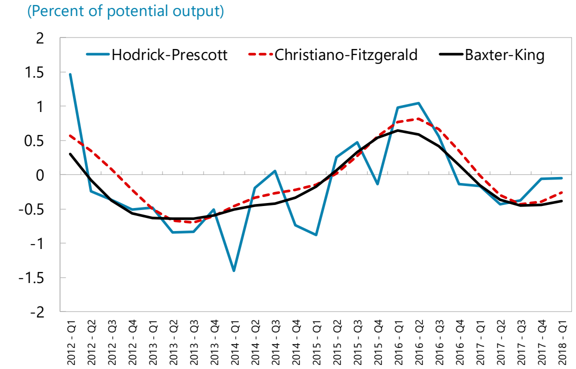
Contribution to Potential Growth



Sources: CSO, UN, and staff calculations

Positive impacts of ongoing reforms will likely boost potential growth to around 7¾ percent over the medium-term.[1/] The most notable contribution comes from the introduction of the GST. Despite its complicated structure, efficiency gains are anticipated to increase internal trade and boost growth in coming years.[2/] There remains considerable scope for potential output to increase even further—above 8 percent—though important additional reforms in the areas of land and labor, which could generate a rebound in investment, would be needed, along with simplifying and streamlining the GST. To date, progress on such reforms has been limited and weak credit growth is holding back investment growth.

Output Gap
(Percent of potential output)



Sources: IMF staff estimates based on CSO data

The output gap is small and closing. The estimated output gap for FY 2017/18 is about -0.3 percent. Following last year's demonetization economic slack was assessed to have increased somewhat, though recent indicators, including elevated core inflation and expectations, suggest only limited slack remains.

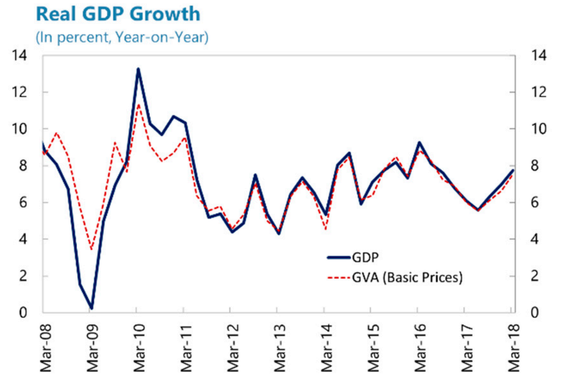
1/ To be revisited, once the authority publishes the back-cast GDP series in November 2018.

2/ Drawing on the experiences of countries implementing GST and the estimates from Van Leemput, E. and E. Wiencek, "The Effect of the GST on Indian Growth," Board of Governors of the Federal Reserve System, International Finance Discussion Paper Note, March 2017.

Figure 1. India: Growth and Activity

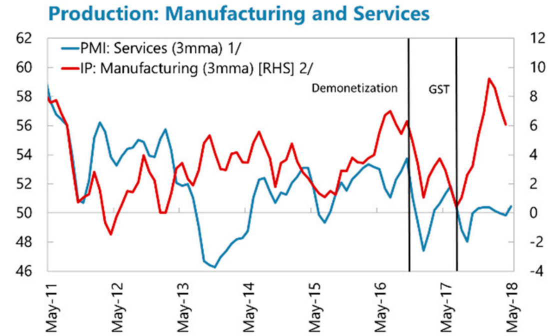
A broad-based recovery is underway.

Growth has turned the corner…



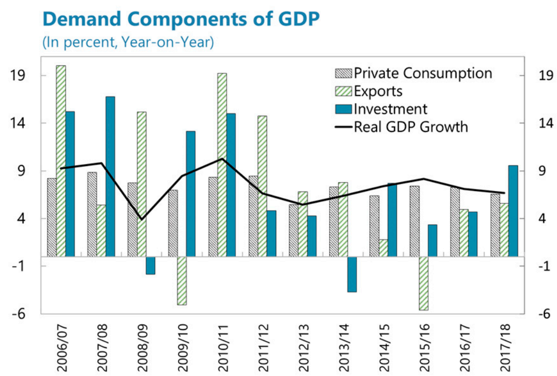
Sources: CEIC, and IMF staff calculations.

…as the economy recovered from temporary disruptions.



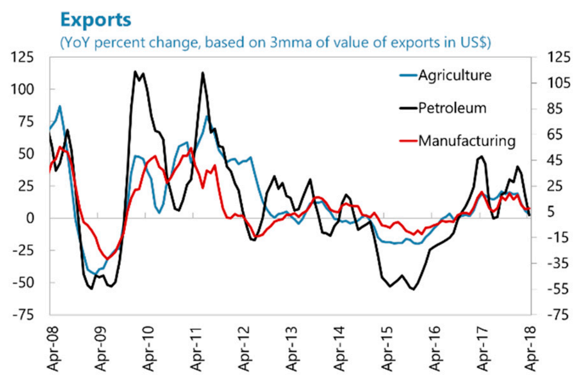
Sources: Haver Analytics; and IMF staff calculations.
1/ SA, 50+ = Expansion.
2/ YoY percent change.

Consumption remains a key driver of growth.



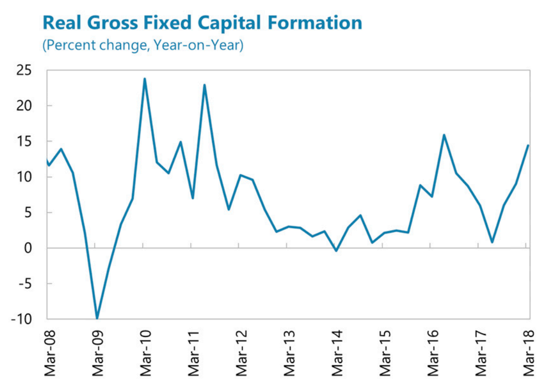
Sources: CEIC, and IMF staff calculations.

Export performance is improving gradually.



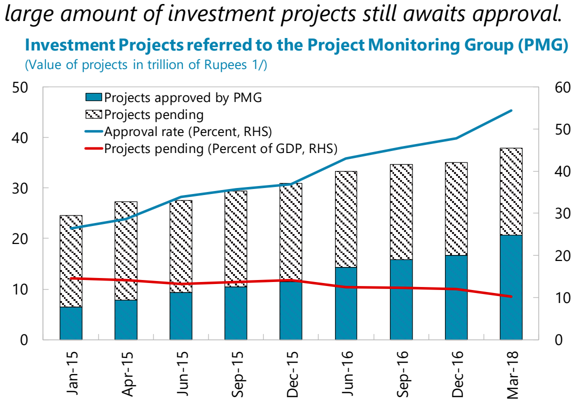
Sources: Haver Analytics, and IMF staff calculations.

Investment has also seen an important reversal.



Source: Haver Analytics.

Efforts are being made to accelerate investment, but a large amount of investment projects still awaits approval.



Sources: PMG and IMF Staff Calculations
1/ Stock data at the end of reference period

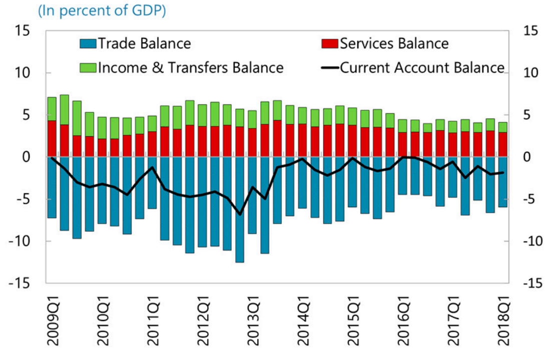
Figure 2. India: External Vulnerabilities

India's external position remains strong.

The current account deficit is gradually widening but from a low base…

Current Account Balance

(In percent of GDP)

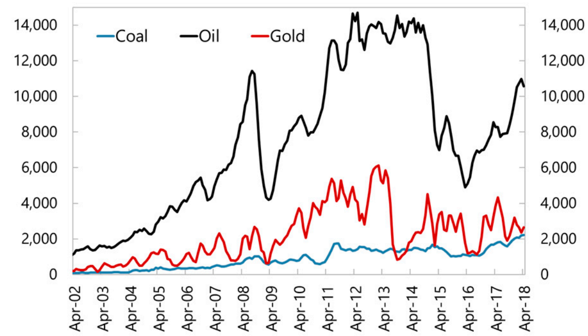


Sources: Haver Analytics; and IMF staff calculations.

…on the back of a deterioration of the trade balance driven by oil and other goods imports.

Imports: Principle Commodities

(In millions of U.S. dollars, 3mma)

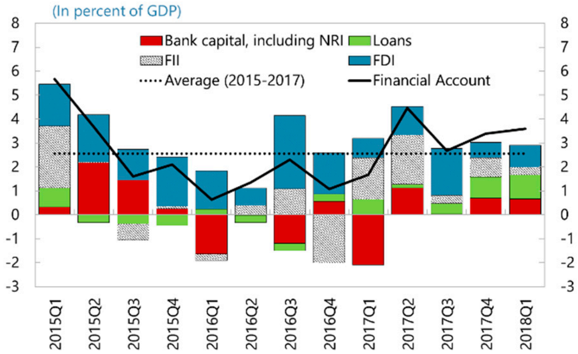


Sources: Haver Analytics; and IMF staff calculations.

Financial flows, led by FDI, have been sufficient to finance the current account deficits.

Financial Account

(In percent of GDP)

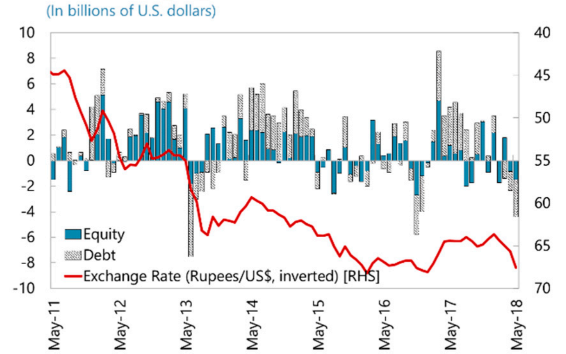


Sources: Haver Analytics; and IMF staff calculations.

However, like in other emerging market economies, capital started flowing out of India in recent months.

FII Flows - Equity and Debt

(In billions of U.S. dollars)

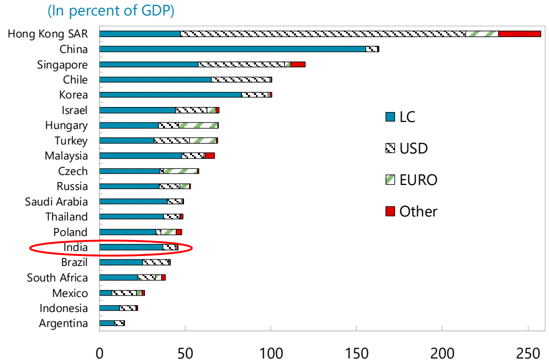


Source: CEIC.

Foreign exchange (FX) exposures of corporates are limited.

Non-Financial Corporate Debt, 2017 Q3

(In percent of GDP)

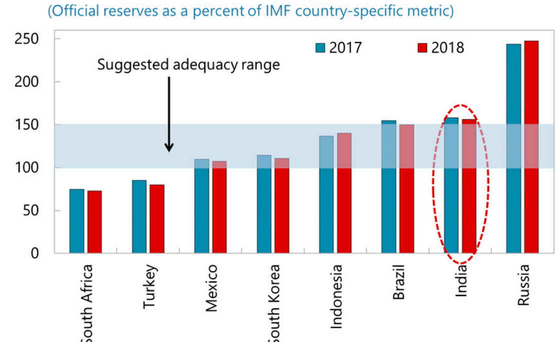


Sources: BIS, IIF EM Global Debt Monitor.

International reserves remain adequate.

Estimated Reserve Adequacy

(Official reserves as a percent of IMF country-specific metric)

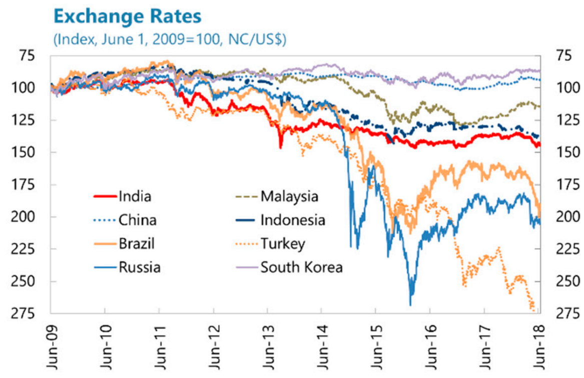


Sources: IMF, *International Financial Statistics*; and IMF staff calculations.

Figure 3. India: Financial Markets

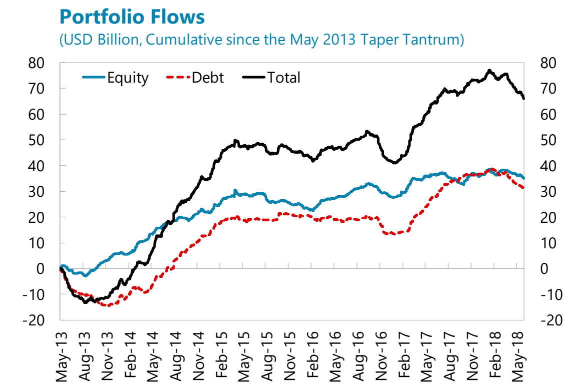
Indian financial market conditions were generally favorable, but volatility has recently increased.

The Indian rupee appreciated somewhat during 2017 but has recently faced depreciation pressures…



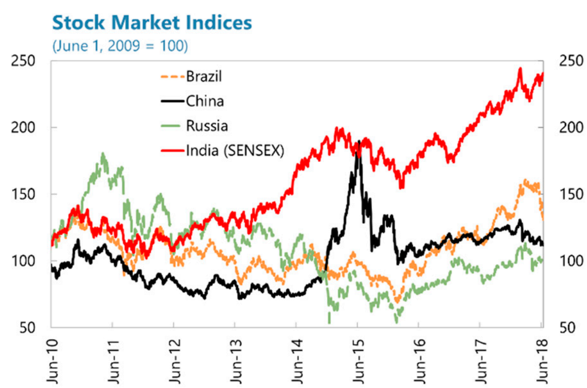
Sources: Bloomberg Financial Markets L.P.; and IMF staff calculations.

…as portfolio flows to India have become more volatile, in line with trends in other emerging market economies.



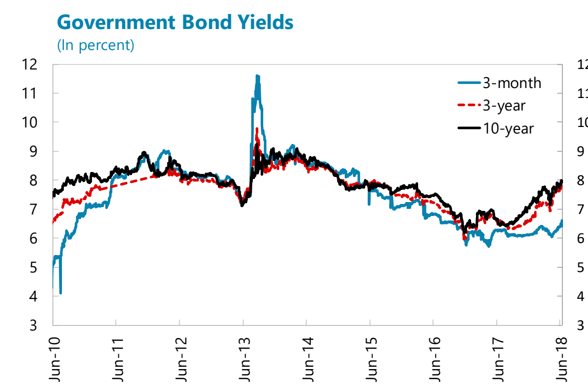
Sources: Bloomberg Financial Markets L.P., and IMF staff calculations.

The stock market rallied in 2017, and has maintained upward momentum in recent months.



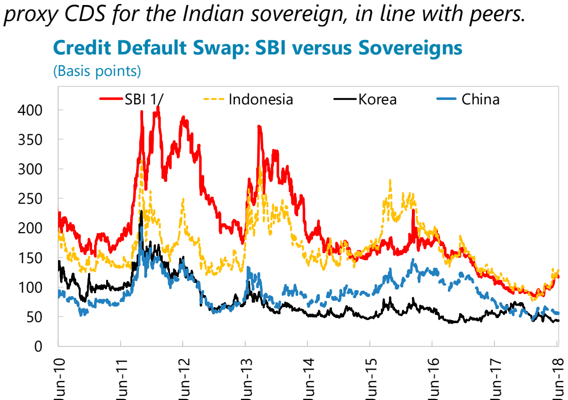
Source: Bloomberg Financial Markets L.P.

Long-term government bond yields have risen since mid-2017 to a 3-year high.



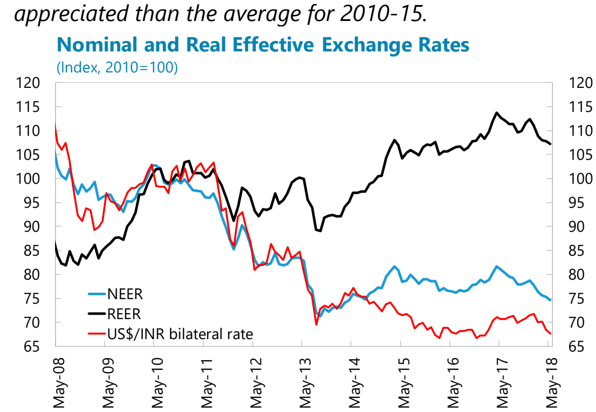
Source: Bloomberg Financial Markets LP.

Recent months saw a modest widening of spreads on the proxy CDS for the Indian sovereign, in line with peers.



Source: Bloomberg Financial Markets LP.
1/ SBI is used as proxy for Government of India.

Over the past 12 months, India's REER was 12 percent more appreciated than the average for 2010-15.



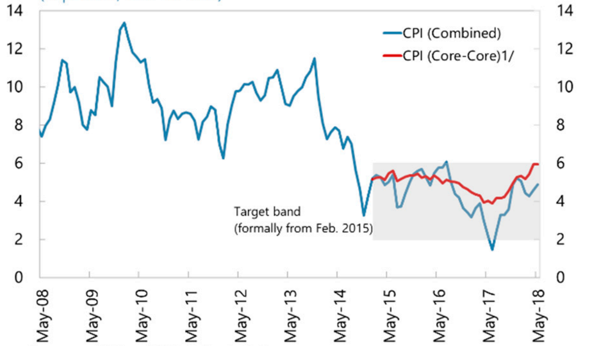
Sources: IMF, *Information Notice System*; and IMF staff estimates.

Figure 4. India: Monetary Developments

Inflation has remained within the RBI's target band but household expectations remain elevated.

Despite volatility, inflation has mostly remained within the target band. Core inflation has been in the band's upper half.

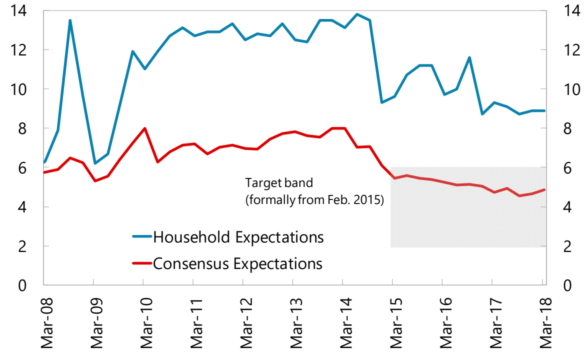
Inflation
(In percent, Year-on-Year)



Sources: CEIC; and IMF staff calculations.
1/ Core-Core measure excludes food, energy, petrol and diesel

The RBI's monetary policy has gained credibility in financial markets but household inflation expectations remain high.

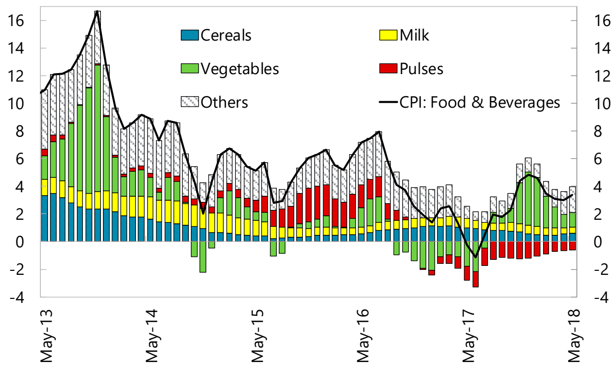
Inflation Expectations, 1-Year Ahead
(In percent)



Sources: Haver Analytics; and Consensus Economics.

Prices of food items, which comprise 43 percent of the CPI basket, remain quite volatile, especially vegetables and pulses.

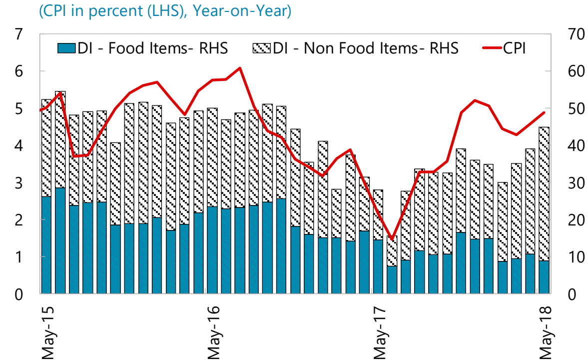
CPI Food Inflation Contributions
(In percent, Year-on-Year)



Sources: CEIC, and IMF staff calculations.

And the share of items in the CPI basket that displays high year-on-year price increases is on the rise again.

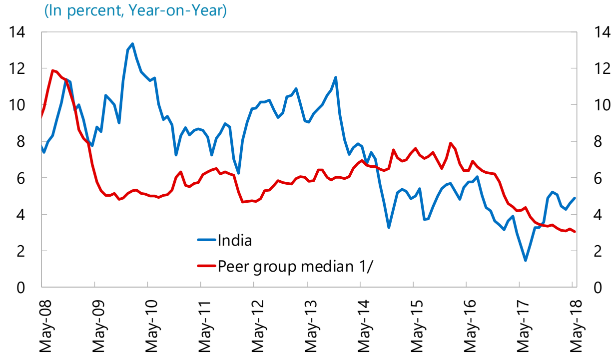
Inflation Diffusion Index (DI) 1/
(CPI in percent (LHS), Year-on-Year)



Sources: Haver Analytics, IMF Staff Calculations
1/ Share of items in the CPI basket for which inflation exceeds 5 percent.

The strengthening of monetary policy and low oil and food prices led to important disinflation gains in 2015-2017.

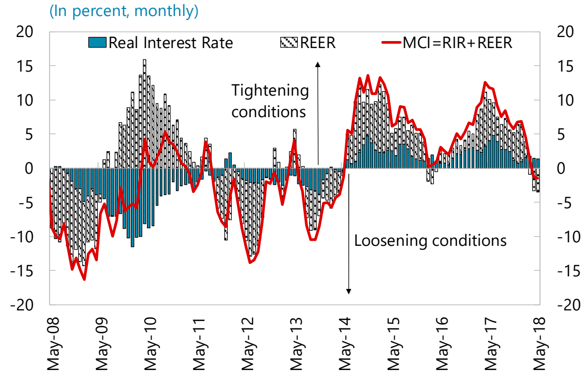
Inflation in India and its G20 Peers
(In percent, Year-on-Year)



1/ G20 peer group includes Brazil, Russia, China, South Africa, Indonesia, and Turkey.
Sources: Haver Analytics and IMF Staff Calculations

The recent weakening of the rupee has contributed to a loosening of overall monetary conditions.

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



Sources: Haver Analytics, IMF Staff Calculations

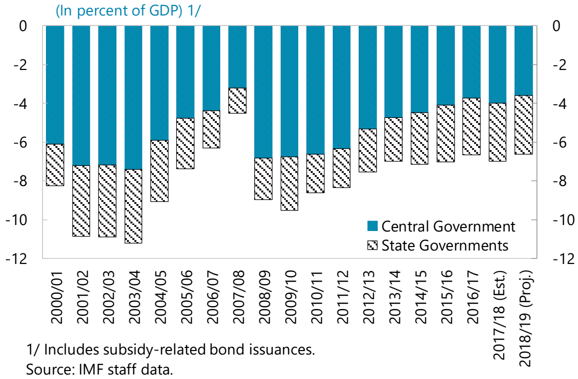
Figure 5. India: Fiscal Developments

The government balance deteriorated in 2017/18, but the authorities plan to resume fiscal consolidation in 2018/19.

The general government deficit widened somewhat in 2017/18 due to one-off factors.

Government Balance

(In percent of GDP) 1/

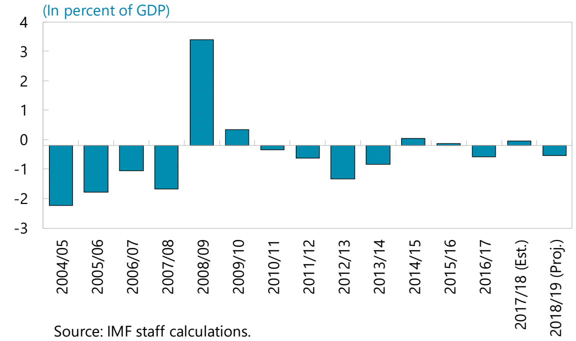


1/ Includes subsidy-related bond issuances.
Source: IMF staff data.

The FY2018/19 budget implies a small negative fiscal impulse.

General Government Fiscal Impulse 1/

(In percent of GDP)

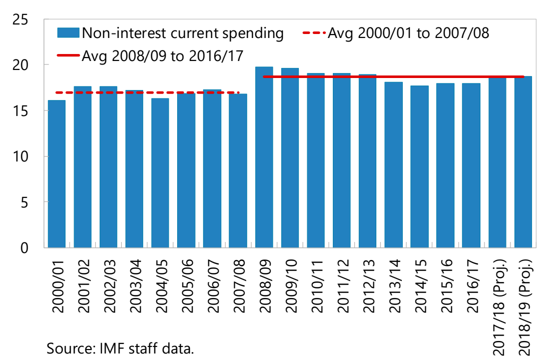


Source: IMF staff calculations.
1/ Defined as difference between current and previous year budget deficits, using business cycle-adjusted revenues.

Current spending has been inching up and remains above the pre-crisis average.

General Government Non-interest Current Spending

(In percent of GDP)

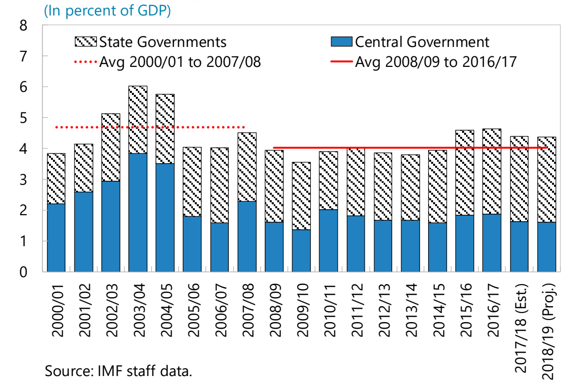


Source: IMF staff data.

Capital spending remains above the post-crisis average.

Capital Spending

(In percent of GDP)

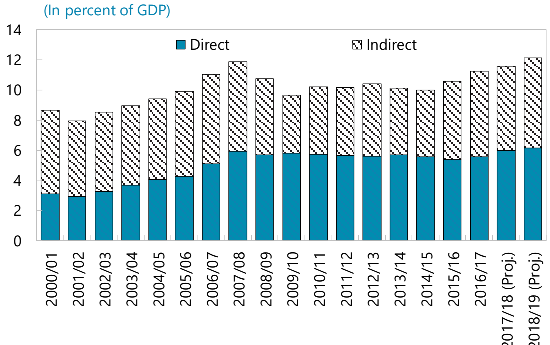


Source: IMF staff data.

Efforts are being made to raise direct and indirect taxes.

Central Government Revenue

(In percent of GDP)

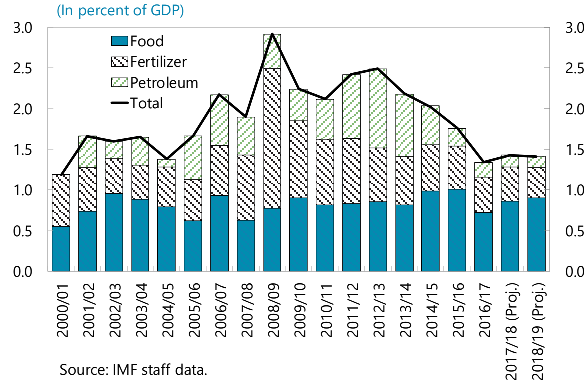


Source: IMF staff data.

Food and fertilizer subsidies remain considerable. Fuel subsidies have been contained.

Government Subsidies

(In percent of GDP)



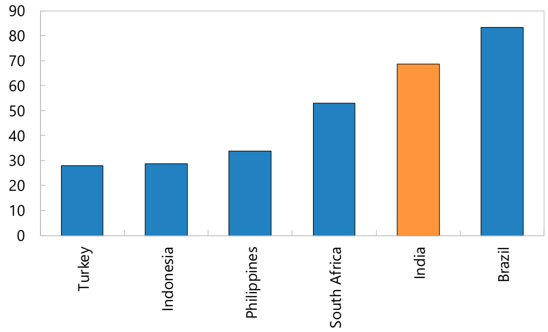
Source: IMF staff data.

Figure 6. India: Fiscal Vulnerability Indicators

India's public debt is large compared to emerging market peers but the debt profile is favorable.

India's public debt is relatively large in comparison with other major emerging market economies.

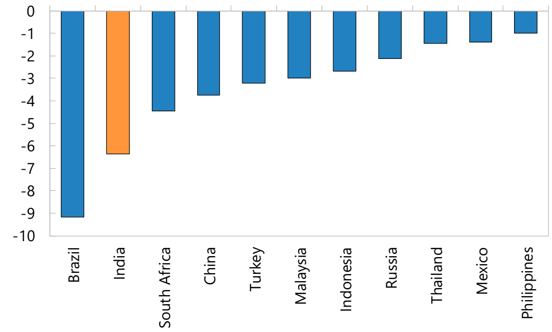
General government gross public debt, 2017
(In percent of GDP)



Source: IMF, *World Economic Outlook*.

The same holds for the general government fiscal deficit.

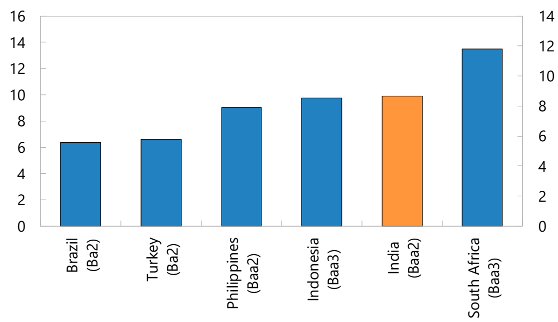
General government fiscal balance, 2017
(In percent of GDP)



Source: IMF, *World Economic Outlook*.

But debt roll-over risks are mitigated by the long average maturity of Indian debt…

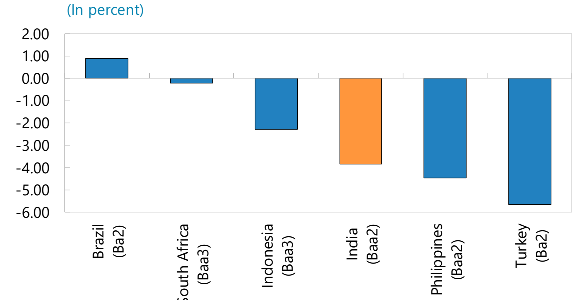
Average government debt maturity 1/
(Years)



Source: Bloomberg Financial Markets LP.
1/ As of March 20, 2018.

…and India's debt dynamics are favorable.

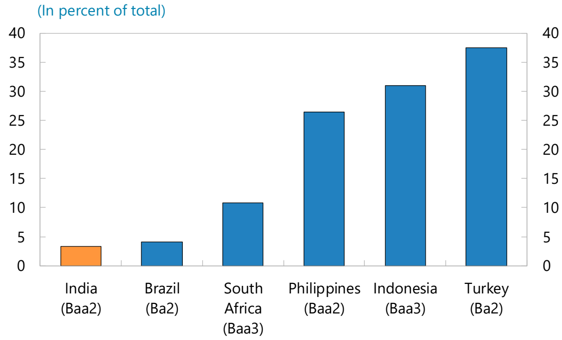
Projected interest-growth differential, 2017-22 1/
(In percent)



Sources: IMF *World Economic Outlook* and Bloomberg Financial Markets LP.
1/ Calculated as the weighted average coupon rate on government debt less the average nominal GDP growth forecast over six years.

Currency risks affecting Indian public debt are minimal…

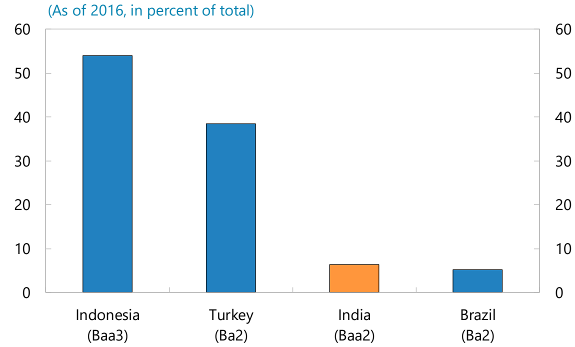
Government Debt in Foreign Currency 1/
(In percent of total)



Source: Bloomberg Financial Markets LP.
1/ As of March, 2018

…and exposure to non-resident investors is limited.

Government Debt held by Non-Residents
(As of 2016, in percent of total)



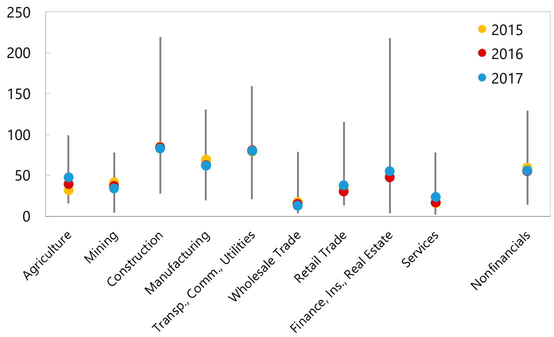
Source: Bloomberg Financial Markets LP, and IMF staff estimates.

Figure 7. India: Corporate and Banking Sectors

The twin balance sheet problem in the corporate and banking sectors continues to play out.

The corporate sector has been deleveraging slowly.

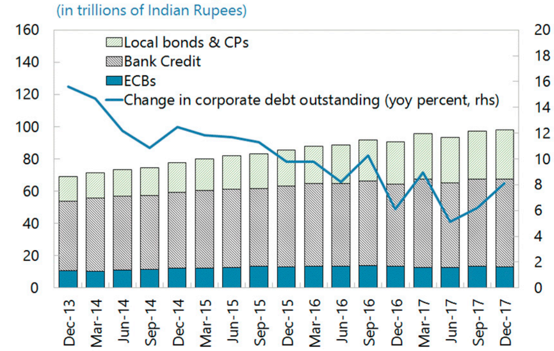
Corporate Leverage Ratios, by Sector
(Debt to Equity Ratio - Median, 25th and 75th percentiles)



Sources: IMF, Corporate Vulnerability Utility; and IMF staff calculations.

Decelerating growth of corporate sector debt suggests that the deleveraging continued in 2017.

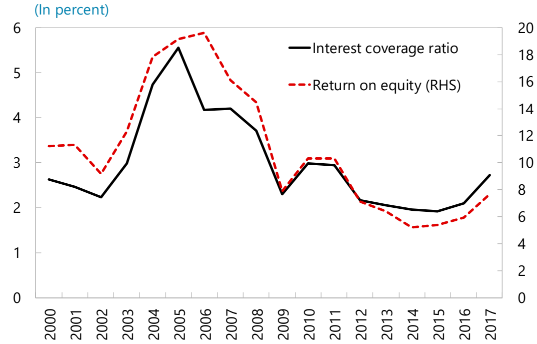
Outstanding Corporate Debt in India
(in trillions of Indian Rupees)



Sources: RBI; Dealogic; and IMF staff estimates.

Debt repayment capacity and profitability appear to have bottomed out.

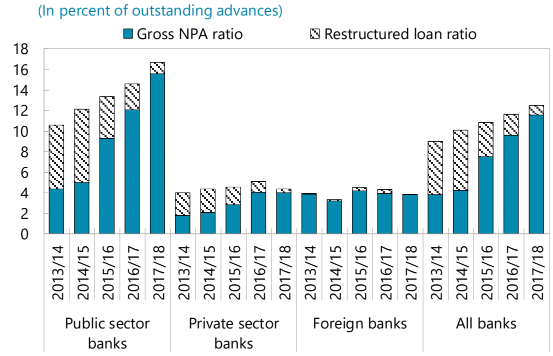
Corporate Debt Repayment Capacity and Profitability
(In percent)



Source: IMF, Corporate Vulnerability Utility.

Banks' asset quality deteriorated further, especially at PSBs, as more restructured loans are migrated to NPAs.

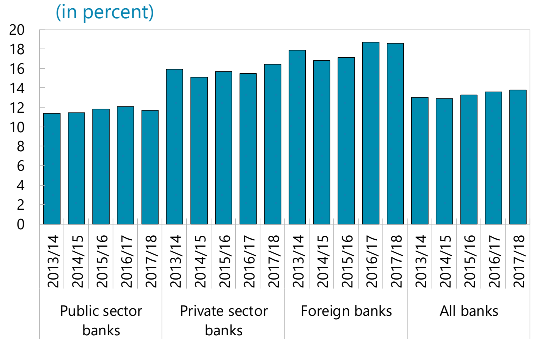
Banks' Nonperforming and Restructured Assets
(In percent of outstanding advances)



Sources: Reserve Bank of India; and IMF staff estimates

Sector-wide capital adequacy improved marginally and remains above the minimum requirement…

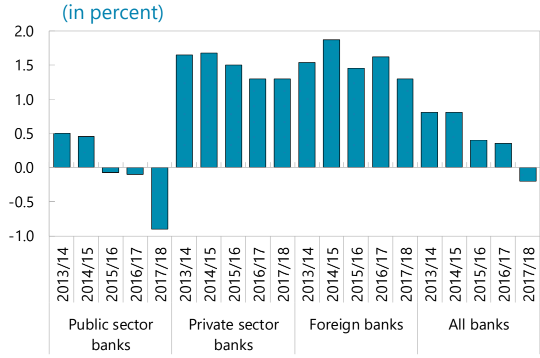
Capital Adequacy Ratio
(in percent)



Sources: The Reserve Bank of India

…despite pressures from low profitability at PSBs and increased provisioning needs

Return on Assets
(in percent)



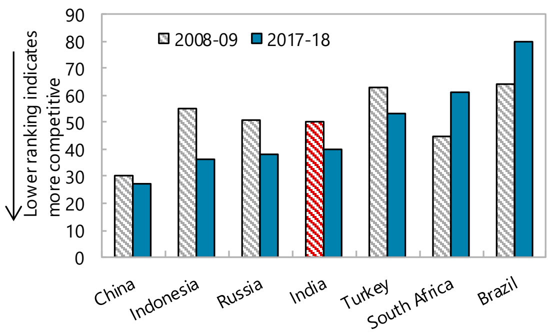
Sources: The Reserve Bank of India

Figure 8. India: Structural Reform Areas

Thanks to recent reform measures, India's competitiveness has improved, but more needs to be done.

Reform progress made in recent years contributed to improved competitiveness.

Global Competitiveness Ranking: BRICS

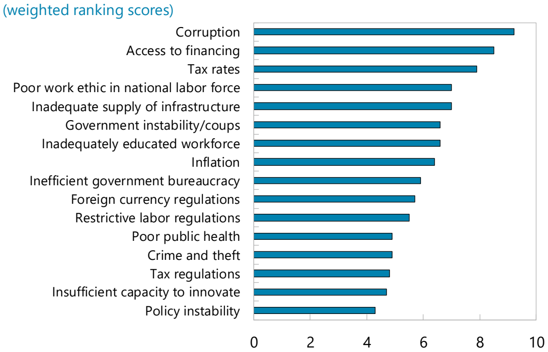


Source: Global Competitiveness Index, World Economic Forum

Nevertheless, doing business remains challenging. Tax, labor and product market regulations are burdensome

Most Problematic Factors for Doing Business

(weighted ranking scores)

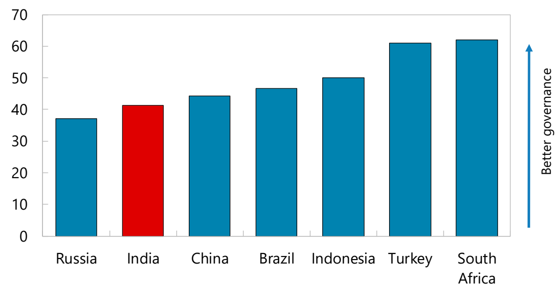


Source: World Economic Forum, Executive Opinion Survey 2017.

Regulatory quality could be further improved to support growth.

Regulatory Quality

(Percentile rank)



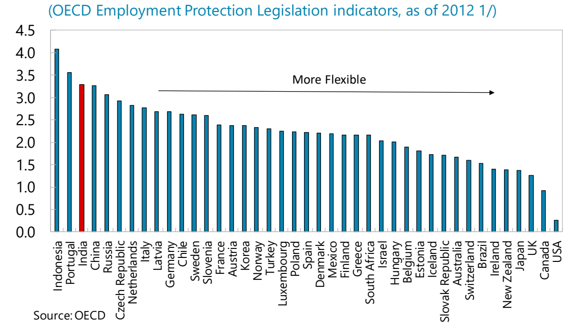
Source: Worldwide Governance Indicator (2016)

Note: Regulatory quality effects perceptions of the ability of the government to formulate and implement sound policies and regulations that permit and promote private sector.

Labor market regulations continue to be strict.

Strictness of Employment Protection

(OECD Employment Protection Legislation indicators, as of 2012 1/)



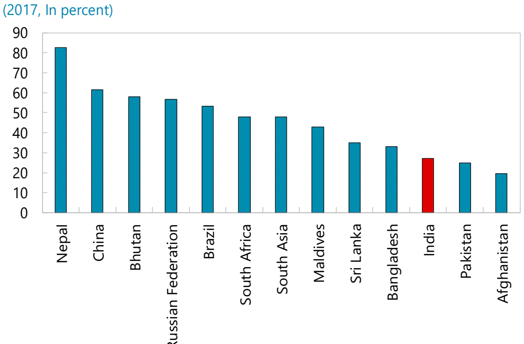
Source: OECD

1/ The OECD indicators of employment protection legislation measure the procedures and costs involved in dismissing individuals or groups of workers and the procedures involved in hiring workers on fixed-term or temporary work agency contracts.

India has fared poorly on gender-parity in labor force participation.

Female Labor Force Participation Rate

(2017, In percent)

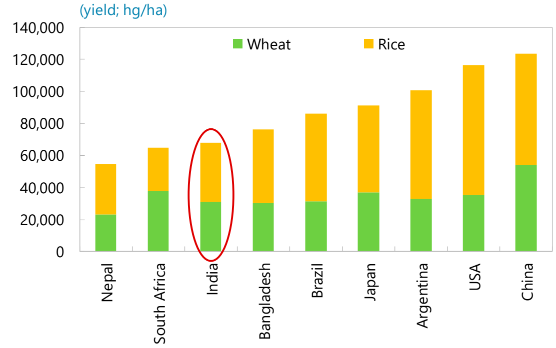


Sources: World Bank, World Development Indicators

Improving productivity and reducing distortions in the agricultural sector are increasingly pressing, given the importance of the sector to the Indian economy.

Agricultural Productivity

(yield; hg/ha)



Source: FAO Statistics, 2016.

Table 1. India: Selected Social and Economic Indicators, 2014/15–2019/20 1/

I. Social Indicators

GDP (2017/18)		**Poverty (percent of population)**	
Nominal GDP (in billions of U.S. dollars):	2,602	Headcount ratio at $1.90 a day (2011):	21.2
GDP per capita (U.S. dollars) (IMF staff est.):	1,942	Undernourished (2015):	14.5
Population characteristics (2016/17)		**Income distribution (2011, WDI)**	
Total (in billions):	1.32	Richest 10 percent of households:	29.8
Urban population (percent of total):	33.1	Poorest 20 percent of households:	8.3
Life expectancy at birth (years, 2015/16):	68.3	Gini index (2011):	35.2

II. Economic Indicators

	2014/15	2015/16	2016/17	2017/18	2018/19	2019/20
				Est.	Projections	
Growth (in percent)						
Real GDP (at market prices)	7.4	8.2	7.1	6.7	7.3	7.5
Industrial production	4.0	3.3	4.6	4.4	...	...
Prices (percent change, period average)						
Consumer prices - Combined	5.8	4.9	4.5	3.6	5.2	4.8
Saving and investment (percent of GDP)						
Gross saving 2/	33.0	30.7	29.7	28.8	29.6	30.0
Gross investment 2/	34.2	31.8	30.3	30.6	32.2	32.2
Fiscal position (percent of GDP) 3/						
Central government overall balance	-4.5	-4.1	-3.7	-4.0	-3.6	-3.5
General government overall balance	-7.2	-7.0	-6.7	-7.0	-6.6	-6.5
General government debt 4/	67.8	69.6	68.9	70.4	68.7	67.2
Cyclically adjusted balance (% of potential GDP)	-7.1	-7.1	-6.7	-6.9	-6.6	-6.5
Cyclically adjusted primary balance (% of potential GDP)	-2.4	-2.4	-1.8	-1.9	-1.6	-1.6
Money and credit (y/y percent change, end-period)						
Broad money	10.9	10.1	10.1	9.5	11.4	11.8
Bank credit to the private sector	9.3	10.6	8.0	9.8	13.6	13.3
Financial indicators (percent, end-period)						
91-day treasury bill yield (end-period)	8.3	7.3	5.8	6.1	...	...
10-year government bond yield (end-period)	7.8	7.5	6.7	7.4	...	...
Stock market (y/y percent change, end-period)	24.9	-9.4	16.9	11.3	...	...
External trade (on balance of payments basis)						
Merchandise exports (in billions of U.S. dollars)	316.5	266.4	280.1	309.0	349.7	385.0
(Annual percent change)	-0.6	-15.9	5.2	10.3	13.2	10.1
Merchandise imports (in billions of U.S. dollars)	461.5	396.4	392.6	469.0	546.6	592.2
(Annual percent change)	-1.0	-14.1	-1.0	19.5	16.5	8.3
Terms of trade (G&S, annual percent change)	3.0	6.0	1.4	-2.8	-2.9	1.8
Balance of payments (in billions of U.S. dollars)						
Current account balance	-26.8	-22.1	-15.2	-48.7	-70.6	-68.3
(In percent of GDP)	-1.3	-1.1	-0.7	-1.9	-2.6	-2.2
Foreign direct investment, net ("-" signifies inflow)	-31.3	-36.0	-35.6	-30.3	-38.7	-47.1
Portfolio investment, net (equity and debt, "-" = inflow)	-42.2	4.1	-7.6	-22.1	-0.9	-7.3
Overall balance ("-" signifies balance of payments surplus)	-61.4	-17.9	-21.6	-43.6	4.2	-14.4
External indicators						
Gross reserves (in billions of U.S. dollars, end-period)	341.6	360.2	370.0	424.5	420.4	434.7
(In months of next year's imports (goods and services))	8.5	8.9	7.6	7.5	6.8	6.5
External debt (in billions of U.S. dollars, end-period)	474.7	485.0	471.8	514.4	559.3	609.5
External debt (percent of GDP, end-period)	23.3	23.1	20.8	19.8	20.2	20.0
Of which: Short-term debt 5/	9.1	9.1	9.1	8.4	9.0	9.2
Ratio of gross reserves to short-term debt (end-period)	1.8	1.9	1.8	1.9	1.7	1.5
Debt service ratio 6/	7.6	8.8	7.8	7.9	8.3	8.5
Real effective exchange rate (annual avg. percent change)	7.0	5.8	1.6	3.1	...	...
Exchange rate (rupee/U.S. dollar, end-period)	62.6	68.3	64.8	65.0	...	...
Memorandum item (in percent of GDP)						
Fiscal balance under authorities' definition	-4.1	-3.9	-3.5	-3.5	-3.3	-3.2

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.
5/ Short-term debt on residual maturity basis, including estimated short-term NRI deposits on residual maturity basis.
6/ In percent of current account receipts, excluding grants.

Table 2. India: Balance of Payments, 2014/15–2019/20 1/
(In billions of U.S. dollars)

	2014/15	2015/16	2016/17	2017/18	2018/19	2019/20
				Est.	Projections	
Current account balance	-26.8	-22.1	-14.4	-48.7	-70.6	-68.3
Merchandise trade balance	-144.9	-130.1	-112.4	-160.0	-196.9	-207.2
Merchandise exports	316.5	266.4	280.1	309.0	349.7	385.0
Merchandise imports	461.5	396.4	392.6	469.0	546.6	592.2
Oil	138.3	82.9	87.0	108.7	…	…
Non-oil	323.2	313.5	305.6	360.3	…	…
Services balance	76.5	69.7	68.3	77.6	85.6	93.8
Credit	158.1	154.3	164.2	195.1	216.0	238.2
Of which : software services	73.1	74.2	73.7	77.3	…	…
Debit	81.6	84.6	95.9	117.5	130.4	144.5
Primary income balance, net	-24.1	-24.4	-26.3	-28.7	-26.8	-27.1
Secondary income balance, net	65.8	62.7	56.1	62.5	67.4	72.2
Capital and Financial account balance	-27.6	-23.1	-14.6	-47.8	-70.6	-68.1
Direct investment, net	-31.3	-36.0	-35.6	-30.3	-38.7	-47.1
Of which : Net incurrance of liabilties	35.3	44.9	42.2	39.4	49.8	60.8
Portfolio investment, net	-42.2	4.1	-7.6	-22.1	-0.9	-7.3
Financial derivatives, net	1.6	-0.6	-9.8	2.9	2.4	2.6
Other investment, net	-18.5	-8.9	16.8	-41.8	-29.3	-30.7
Reserve assets, net	61.4	17.9	21.6	43.6	-4.2	14.4
Errors and omissions	-1.1	-1.1	0.4	0.9	0.0	0.0
Increase in gross reserve stock						
(including valuation changes)	37.4	18.5	9.8	54.6	-4.2	14.4
of which: Valuation changes 2/	-24.0	0.6	-11.8	11.0	0.0	0.0
Memorandum items:						
Foreign exchange reserves	341.6	360.2	370.0	424.5	420.4	434.7
In months of next year's imports (goods and services)	8.5	8.8	7.6	7.5	6.8	6.5
Current account balance (percent of GDP)	-1.3	-1.1	-0.6	-1.9	-2.6	-2.2
Merchandise trade balance (percent of GDP)	-7.1	-6.2	-4.9	-6.1	-7.1	-6.8
Direct investment, net (percent of GDP)	-1.5	-1.7	-1.6	-1.2	-1.4	-1.6
Gold Imports (billions U.S. dollars)	34.4	31.8	27.5	33.7	…	…
GDP in USD	2,039.1	2,102.4	2,273.6	2,602.3	2,767.8	3,041.4

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/ Calculated as the difference between the stock of reserves and the flow changes to net reserve assets.

Table 3. India: Reserve Money and Monetary Survey, 2013/14–2018/19 1/

	2013/14	2014/15	2015/16	2016/17	2017/18	2018/19 May
Reserve money			(In billions of rupees, end-period)			
Reserve money	17,327	19,285	21,023	19,005	24,187	24,610
Net domestic assets of RBI	-698	-1,988	-2,812	-4,967	-3,421	-3,535
Claims on government (net)	6,987	3,645	4,250	6,208	4,760	6,234
Center	6,976	3,610	4,246	6,196	4,743	6,221
States	11	35	4	12	17	13
Claims on commercial sector	88	148	201	73	140	94
Claims on banks	486	1,877	2,845	-3,166	493	-132
Other items (net)	-8,259	-7,658	-10,107	-8,083	-8,814	-9,731
Net foreign assets of RBI	18,025	21,273	23,835	23,972	27,608	28,144
			(Contribution to twelve-month reserve money growth)			
Reserve money	14.4	11.3	9.0	-9.6	27.3	25.0
Net domestic assets of RBI	-1.8	-7.4	-4.3	-10.3	8.1	6.2
Claims on government (net)	7.1	-19.3	3.1	9.3	-7.6	-3.2
Net foreign assets of RBI	16.1	18.7	13.3	0.7	19.1	18.8
Monetary survey			(In billions of rupees, end-period)			
Broad money (M3)	95,174	105,502	116,176	127,919	140,114	140,284
Currency with public	12,458	13,862	15,973	12,641	17,593	18,534
Deposits	82,696	91,494	100,049	115,067	122,282	121,481
Non-bank deposits at RBI	20	146	154	211	239	269
Net domestic assets	75,934	82,995	90,839	102,337	111,168	110,801
Domestic credit	94,902	100,571	110,416	122,681	132,536	133,638
Net credit to government	30,449	30,074	32,385	38,566	40,147	42,127
Of which: RBI	6,987	3,645	4,250	6,208	4,760	6,234
Credit to commercial sector	64,453	70,497	78,031	84,115	92,389	91,511
Of which: Bank credit (excluding RBI)	64,365	70,349	77,830	84,042	92,249	91,416
Other items (net)	-18,967	-17,576	-19,577	-20,344	-21,368	-22,837
Net foreign assets	19,239	22,506	25,337	25,582	28,946	29,483
			(Twelve-month percent change)			
Broad money (M3)	13.4	10.9	10.1	10.1	9.5	10.7
Net domestic assets	12.4	9.3	9.5	12.7	8.6	10.1
Domestic credit	13.3	6.0	9.8	11.1	8.0	9.2
Net credit to government	12.4	-1.2	7.7	19.1	4.1	2.6
Credit to commercial sector	13.7	9.4	10.7	7.8	9.8	12.5
Of which: Bank credit (excluding RBI)	13.6	9.3	10.6	8.0	9.8	12.5
Net foreign assets	17.6	17.0	12.6	1.0	13.1	13.2

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, 2014/15–2019/20 1/

	2014/15	2015/16	2016/17	2017/18	2018/19	2019/20
				Est.	Projections	
	(In percent of GDP)					
Revenue	**9.1**	**9.0**	**9.3**	**8.8**	**9.4**	**9.4**
Taxes	7.3	6.9	7.3	7.4	7.9	7.9
Income tax	5.6	5.4	5.6	5.8	6.1	6.1
GST	...	...	...	2.6	4.0	4.0
Excise tax	1.5	2.1	2.5	1.5	1.4	1.4
Service tax	1.3	1.5	1.7	0.5	0.0	0.0
Customs duties	1.5	1.5	1.5	0.8	0.6	0.6
Other taxes	0.0	0.0	0.0	0.2	0.0	0.0
Less: States' share	2.7	3.7	4.0	4.0	4.2	4.2
Grants	0.0	0.0	0.0	0.0	0.0	0.0
Other revenue 2/	1.8	2.1	2.0	1.4	1.5	1.5
Property income	0.9	1.0	0.9	0.6	0.7	0.7
Sale of goods and services	0.3	0.2	0.2	0.3	0.2	0.2
Miscellaneous and unidentified revenue	0.7	0.8	0.9	0.5	0.6	0.6
Expenditure	**13.6**	**13.1**	**13.0**	**12.8**	**13.0**	**13.0**
Expense 3/	**12.0**	**11.2**	**11.1**	**11.2**	**11.4**	**11.4**
Compensation of employees 4/	1.1	0.8	1.2	1.1	1.1	1.1
Interest	3.2	3.2	3.2	3.2	3.1	3.1
Subsidies 5/	2.0	1.8	1.3	1.1	1.4	1.4
Food	0.9	1.0	0.7	0.6	0.9	0.9
Fertilizer	0.6	0.5	0.4	0.4	0.4	0.4
Petroleum	0.5	0.2	0.2	0.1	0.1	0.1
Grants and other expense 6/	5.7	5.4	5.5	5.8	5.8	5.8
Grants	2.7	2.3	2.4	2.6	2.5	2.5
Other expense 6/	3.0	3.1	3.1	3.3	3.4	3.4
Net acquisition of nonfinancial assets	**1.6**	**1.8**	**1.9**	**1.6**	**1.6**	**1.6**
Gross Operating Balance	-2.9	-2.2	-1.9	-2.4	-2.0	-2.0
Net lending / borrowing (overall balance)	**-4.5**	**-4.1**	**-3.7**	**-4.0**	**-3.6**	**-3.5**
Net financial transactions	-4.5	-4.1	-3.7	-4.0	-3.6	-3.5
Net acquisition of financial assets	-0.5	-0.7	-0.7	-1.0	-0.9	-0.5
Domestic	-0.5	-0.7	-0.7	-1.0	-0.9	-0.5
Currency and deposits	-0.4	-0.5	-0.6	-0.4	-0.5	0.0
Loans	0.1	0.0	0.1	0.0	0.1	-0.1
Share and other equity	-0.3	-0.3	-0.3	-0.7	-0.4	-0.4
Net incurrence of liabilities	4.0	3.3	3.0	3.0	2.8	3.0
Domestic	3.9	3.3	2.9	2.9	2.8	3.1
Debt securities 7/	3.6	3.0	2.2	2.5	2.3	3.1
Other accounts payable	0.3	0.2	0.6	0.4	0.5	0.0
Foreign	0.1	0.1	0.1	0.1	0.0	0.0
Loans	0.1	0.1	0.1	0.1	0.0	0.0
Memorandum items:						
Balance under authorities' definition	-4.1	-3.9	-3.5	-3.5	-3.3	-3.2
Primary balance	-1.3	-0.9	-0.6	-0.8	-0.5	-0.5
Central government debt 8/	51.4	51.6	50.0	50.1	47.5	45.4

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

1/ Data for April - March fiscal years

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

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

4/ Pensions are included under expense not otherwise classified.

5/ Includes subsidy-related bond issuance.

6/ Other expense includes purchases of goods and services.

7/ Debt securities include bonds and short-term bills, as well as loans.

8/ External debt measured at historical exchange rates.

Table 5. India: General Government Operations, 2014/15–2019/20 1/

	2014/15	2015/16	2016/17	2017/18	2018/19	2019/20
				Est.	Projections	
	(In percent of GDP)					
Revenue	**19.2**	**20.3**	**20.9**	**20.5**	**21.3**	**21.3**
Taxes	16.2	17.1	17.7	17.9	18.6	18.6
Grants	0.0	0.0	0.0	0.0	0.0	0.0
Other revenue	2.9	3.2	3.1	2.6	2.7	2.7
Expenditure	**26.3**	**27.3**	**27.5**	**27.5**	**27.9**	**27.8**
Expense	22.4	22.7	22.9	23.1	23.5	23.5
of which: interest	4.7	4.7	4.9	5.0	5.0	5.0
Net acquisition of nonfinancial assets	3.9	4.6	4.6	4.3	4.4	4.3
Gross Operating Balance	-3.2	-2.4	-2.0	-2.6	-2.3	-2.2
Net lending (+)/borrowing (–) (fiscal balance)	**-7.2**	**-7.0**	**-6.7**	**-7.0**	**-6.6**	**-6.5**
Net financial worth, transactions	-7.2	-7.0	-6.7	-7.0	-6.6	-6.5
Net acquisition of financial assets	-0.5	-0.8	-0.8	-1.1	-0.9	-0.5
Domestic	-0.5	-0.8	-0.8	-1.1	-0.9	-0.5
Currency and deposits	-0.3	-0.5	-0.6	-0.4	-0.5	0.0
Loans	0.1	0.0	0.1	0.0	0.1	-0.1
Equity and investment fund shares	-0.3	-0.3	-0.3	-0.7	-0.4	-0.4
Net incurrence of liabilities	6.7	6.2	5.9	5.9	5.8	6.1
Domestic	6.5	6.2	5.8	5.9	5.8	6.1
Debt securities	5.4	4.9	4.0	4.1	3.7	4.5
Other accounts payable	1.2	1.2	1.8	1.8	2.1	1.6
Foreign	0.1	0.1	0.1	0.1	0.0	0.0
Loans	0.1	0.1	0.1	0.1	0.0	0.0
Memorandum items:						
Primary balance	-2.5	-2.3	-1.8	-1.9	-1.7	-1.6
Nondefence capital expenditure	3.3	4.1	4.0	4.1	3.8	3.8
State and union territory governments' balance 2/	-2.7	-3.0	-3.0	-3.0	-3.0	-3.0
General government debt 3/	67.8	69.6	68.9	70.4	68.7	67.2

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. 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.

Table 6. India: Macroeconomic Framework, 2014/15–2023/24 1/

	2014/15	2015/16	2016/17	2017/18	2018/19	2019/20	2020/21	2021/22	2022/23	2023/24
				Est.			Projections			
Growth (percent change)										
Real GDP (at market prices)	7.4	8.2	7.1	6.7	7.3	7.5	7.7	7.7	7.7	7.7
Non-agricultural sector (at basic prices)	8.7	9.6	7.2	7.0	7.9	8.1	8.4	8.4	8.3	8.3
Prices (percent change, period average)										
Consumer prices	5.8	4.9	4.5	3.6	5.2	4.8	4.5	4.2	4.1	4.0
Saving and investment (percent of GDP)										
Gross saving 2/	33.0	30.7	29.7	28.8	29.6	30.0	30.3	30.6	30.6	30.8
Gross investment 3/	34.2	31.8	30.3	30.6	32.2	32.2	32.5	32.8	33.0	33.4
Money and credit (y/y percent change, end-period)										
Broad money	10.9	10.1	10.1	9.5	11.4	11.8	12.3	11.9	11.9	11.9
Bank credit to the private sector	9.3	10.6	8.0	9.8	13.6	13.3	13.4	13.7	13.2	13.3
Fiscal position (percent of GDP)										
Central government balance 4/	-4.5	-4.1	-3.7	-4.0	-3.6	-3.5	-3.3	-3.1	-3.0	-2.9
General government balance 4/	-7.2	-7.0	-6.7	-7.0	-6.6	-6.5	-6.4	-6.2	-6.0	-5.9
General government debt 5/	67.8	69.6	68.9	70.4	68.7	67.2	65.7	64.4	63.1	61.9
External trade (percent change, balance of payments basis)										
Merchandise exports (in U.S. dollars terms)	-0.6	-15.9	5.2	10.3	13.2	10.1	9.7	9.4	7.9	7.8
Merchandise imports (in U.S. dollars terms)	-1.0	-14.1	-1.0	19.5	16.5	8.3	9.0	9.4	9.4	9.5
Balance of payments (in billions of U.S. dollars, BMP6 (including sign conventions))										
Current account balance	-26.8	-22.1	-15.2	-48.7	-70.6	-68.3	-71.8	-81.0	-98.2	-115.4
(in percent of GDP)	-1.3	-1.1	-0.7	-1.9	-2.6	-2.2	-2.1	-2.2	-2.4	-2.6
Foreign direct investment, net ("-" sign is net FDI inflow)	-31.3	-36.0	-35.6	-30.3	-38.7	-47.1	-52.0	-59.1	-67.2	-76.2
Portfolio investment, net ("-" sign denotes capital inflow)	-40.9	4.5	-7.6	-22.1	-0.9	-7.3	-14.1	-17.4	-28.1	-30.9
Overall balance ("-" sign denotes surplus)	-61.4	-17.9	-21.6	-43.6	4.2	-14.4	-30.1	-40.9	-54.3	-64.0
External indicators										
Gross reserves (in billions of U.S. dollars, end-period)	341.6	360.2	370.0	424.5	420.4	434.7	464.9	505.7	560.1	624.1
(in months of imports) 6/	8.5	8.9	7.6	7.5	6.8	6.5	6.3	6.3	6.3	6.4
External debt (in billions of U.S. dollars, end-period)	474.7	485.0	471.8	514.4	559.3	609.5	666.4	730.4	812.4	903.3
External debt (percent of GDP, end-period)	23.3	23.1	20.8	19.8	20.2	20.0	19.9	19.8	20.0	20.1
Of which : short-term debt 7/	9.1	9.1	9.1	8.4	9.0	9.2	9.4	9.6	9.8	10.0
Ratio of gross reserves to short-term debt (end-period) 7/	1.8	1.9	1.8	1.9	1.7	1.5	1.5	1.4	1.4	1.4
GDP in billions of U.S. dollars	2,039.1	2,102.4	2,273.6	2,602.3	2,767.8	3,041.4	3,354.9	3,695.5	4,070.8	4,484.9

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/ Including short-term debt on contracted maturity basis, all NRI deposits, and medium and long-term debt on residual maturity basis, different from authorities' definition.

Table 7. India: Indicators of External Vulnerability, 2013/14–2017/18 1/

	2013/14	2014/15	2015/16	2016/17	2017/18
Financial indicators					
General government debt (percent of GDP)	68.5	67.8	69.6	68.9	70.4
Broad money (percent change, 12-month basis)	13.4	10.9	10.1	10.1	9.5
Private sector credit (percent change, 12-month basis)	13.7	9.3	10.6	8.0	9.8
91 day T-bill yield (percent; end-period)	8.9	8.3	7.3	5.8	6.1
91 day T-bill yield (real, percent; end-period) 2/	-0.7	2.4	2.3	2.6	2.5
External indicators					
Exports (percent change, 12-month basis in US$) 3/	3.9	-0.6	-15.9	5.2	10.3
Export volume (percent change, 12-month basis) 3/	5.0	3.5	-5.3	6.5	9.9
Imports (percent change, 12-month basis in US$) 3/	-7.2	-1.0	-14.1	-1.0	19.5
Import volume (percent change, 12-month basis) 3/	-3.6	5.3	0.4	4.0	12.8
Terms of trade (percent change, 12 month basis) 3/	2.1	3.0	6.0	1.4	-2.8
Current account balance (percent of GDP)	-1.7	-1.3	-1.1	-0.7	-1.9
Capital and financial account balance (percent of GDP, "-" sign for inflow)	-1.8	-1.4	-1.1	-0.7	-1.8
Of which: Net portfolio investment (debt and equity, "-" sign for inflow)	-0.3	-2.0	0.2	-0.3	-0.8
Other investment (loans, trade credits, etc., "-" sign for inflow	1.2	0.8	0.4	1.3	0.2
Net foreign direct investment ("-" sign denotes inflow)	-1.2	-1.5	-1.7	-1.6	-1.2
Foreign currency reserves (in billions of U.S. dollars)	304.2	341.6	360.2	370.0	424.5
Official reserves (in months of prospective imports of goods and services)	6.7	8.5	8.9	7.6	7.5
Ratio of foreign currency reserves to broad money (percent)	19.5	20.2	20.8	19.9	19.7
Total short-term external debt to reserves (percent) 4/	60.5	54.2	53.4	55.6	51.7
Total external debt (percent of GDP)	24.0	23.3	23.1	20.8	19.8
Of which: public sector debt	3.7	3.5	3.4	3.2	2.9
Total external debt to exports of goods and services (percent)	94.8	100.0	115.3	106.4	102.1
External interest payments to exports of goods and services (percent)	1.7	1.8	2.4	2.9	2.5
External amortization payments to exports of goods and services (percent)	19.2	20.6	25.7	26.8	23.0
Exchange rate (Indian rupees per U.S. dollar, annual average)	60.5	61.1	65.5	67.1	64.5
REER (percent change; based on annual average level)	-2.0	7.0	5.8	1.6	3.1
Financial market indicators					
Stock market index (end-period)	22,386	27,957	25,342	29,621	32,969
Foreign currency debt rating					
Moody's Investor Services	Baa3	Baa3	Baa3	Baa3	Baa2
Standard and Poor's	BBB-	BBB-	BBB-	BBB-	BBB-
Fitch Ratings	BBB-	BBB-	BBB-	BBB-	BBB-
Spread of benchmark bonds (basis points, end of period) 5/	608.5	581.4	569.6	429.3	466.0

Sources: Data provided by the Indian authorities; Bloomberg L.P.; CEIC Data Company Ltd.; IMF, *Information Notice System* and staff estimates and projections.

1/ Data for April-March fiscal years.

2/ Equals nominal yield minus actual CPI inflation.

3/ Terms of trade including goods and services. Goods volumes are derived from partner country trade price deflators, and services volumes are derived using U.S. CPI from the WEO database.

4/ Including short-term debt on contracted maturity basis, all NRI deposits, and medium and long-term debt on residual maturity basis, different from authorities' definition.

5/ 10-year sovereign bond spread over U.S. bond.

Table 8. India: Financial Soundness Indicators, 2013/14–2017/18

	2013/14	2014/15	2015/16	2016/17	2017/18
(In percent, unless indicated otherwise)					
Risk-weighted capital adequacy ratio (CAR)	**13.0**	**12.9**	**13.3**	**13.6**	**13.8**
Public sector banks	11.4	11.4	11.8	12.1	11.7
Private sector banks	15.9	15.1	15.7	15.5	16.4
Foreign banks	17.9	16.8	17.1	18.7	18.6
Number of institutions not meeting 9 percent CAR	**1**	**0**	**1**	**1**	...
Public sector banks	0	0	0	1	...
Private sector banks	1	0	1	0	...
Foreign banks	0	0	0	0	...
Net nonperforming assets (percent of outstanding net advances) 1/	**2.2**	**2.4**	**4.4**	**5.3**	**6.1**
Public sector banks	2.6	3.0	5.7	6.9	8.6
Private sector banks	0.6	0.8	1.4	2.2	2.0
Foreign banks	1.1	0.5	0.8	0.6	0.4
Gross nonperforming assets (percent of outstanding advances)	**3.8**	**4.3**	**7.5**	**9.6**	**11.6**
Public sector banks	4.4	5.0	9.3	12.5	15.6
Private sector banks	1.8	2.1	2.8	4.1	4.0
Foreign banks	3.9	3.2	4.2	4.0	3.8
Restructured loans (percent of outstanding loans)	**5.2**	**5.8**	**3.4**	**2.5**	**0.9**
Public sector banks	6.3	7.1	4.1	3.1	1.1
Private sector banks	2.3	2.4	1.8	1.1	0.4
Foreign banks	0.1	0.1	0.3	0.3	0.1
Return on assets 2/	**0.8**	**0.8**	**0.4**	**0.4**	**-0.2**
Public sector banks	0.5	0.5	-0.1	-0.1	-0.9
Private sector banks	1.7	1.7	1.5	1.3	1.3
Foreign banks	1.5	1.9	1.5	1.6	1.3
Balance sheet structure of all scheduled banks					
Loan/deposit ratio	77.8	76.6	77.7	72.9	...
Investment in government securities/deposit ratio	28.7	29.2	28.1	28.2	...

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.

Table 9. India: High Frequency Economic Activity Indicators

% y-o-y	2014		2015		2016				2017												2018				
	H1	H2	H1	H2	Q1	Q2	Q3	Q4	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec	Jan	Feb	Mar	Apr	May
Consumption																									
Domestic passenger vehicle sales	-2.9	4.9	5.0	10.4	2.5	6.7	17.8	1.8	14.4	9.1	10.0	14.7	8.7	-11.2	15.1	13.8	11.3	-0.3	14.3	5.2	7.6	7.8	6.4	7.5	19.7
Aviation: Passenger traffic	4.3	14.2	19.8	20.9	24.3	20.4	24.5	23.2	25.6	15.4	14.4	14.8	17.4	20.0	12.2	15.6	16.3	19.9	16.5	17.4	18.2	23.3	26.9	25.0	
Cellular subscribers	9.1	6.6	-2.3	1.5	10.3	8.2	7.6	7.1	19.0	19.7	18.1	21.2	22.2	22.7	22.6	21.4	20.9	22.2	22.4	22.2	9.1	10.3	13.9	11.9	
Consumer credit	14.1	14.6	16.4	17.6	18.9	19.1	18.9	15.2	12.9	12.0	16.4	14.4	13.7	14.1	15.0	15.7	16.8	16.0	17.3	18.9	20.0	20.4	17.8	19.1	
Rural wages (male)	25.4	15.3	7.0	6.1	5.9	6.3	5.6	5.9	6.2	6.2	5.8	6.1	5.7	5.4	6.2	5.9	6.1	5.7	5.3	5.1	4.8	5.1			
Domestic two-wheeler sales	13.1	9.6	0.2	1.5	8.6	14.3	20.6	-4.6	-7.4	0.0	0.3	7.3	11.9	4.0	13.7	14.7	9.1	-2.8	23.5	41.5	33.4	23.8	18.3	16.9	9.2
Investment																									
Railway traffic: Net tonne km	2.2	7.1	2.2	-4.9	-8.4	-8.6	-8.0	-4.7	-3.4	-0.7	3.4	3.1	4.5	2.5	4.0	6.1	4.9	6.8	6.6	12.3	8.7	5.9	7.5	11.8	7.5
Government Capex (YTD)	-20.2	-12.6	45.1	42.1	16.5	-16.4	23.5	-23.1	7.2	12.8	62.0	56.1	60.7	52.3	47.1	37.5	25.9	41.1	39.6	39.0	22.3	78.4	-74.3	-45.0	
External sector																									
Visitor arrivals	10.1	10.4	3.7	5.3	9.7	6.6	12.6	9.5	16.4	12.7	11.8	21.3	5.9	22.5	7.4	11.0	18.8	18.1	14.4	15.2	8.4	10.1	13.4	4.4	5.1
Exports value	3.8	1.1	-15.3	-18.6	-7.8	-1.6	-1.0	6.1	5.5	18.6	27.9	18.1	7.2	1.6	2.6	7.3	24.6	-2.2	30.0	15.0	11.6	4.5	-0.7	5.2	20.2
Export (ex-oil) value	3.4	3.1	-7.3	-10.9	-5.6	0.9	0.5	5.7	2.6	17.3	23.3	15.8	6.4	3.9	2.5	6.1	23.3	-3.8	27.5	13.2	7.0	1.5	1.0	6.5	9.1
Imports (ex-oil, gold) value	-3.8	12.3	3.9	-5.9	-3.8	-8.2	-4.4	7.2	5.5	8.7	20.9	41.9	20.8	16.9	13.6	23.4	21.2	6.3	24.4	12.9	24.0	7.3	12.2	-0.1	13.1
Industry																									
Industrial production	4.9	4.1	1.8	3.3	5.4	7.1	4.5	3.8	3.5	1.2	4.4	3.2	2.9	-0.3	1.0	4.8	4.1	1.8	8.5	7.3	7.5	7.0	4.6	4.9	
Manufacturing PMI*	51.7	53.6	52.1	50.2	51.9	51.1	52.3	51.7	49.8	50.7	54.0	52.5	51.9	50.3	46.8	52.3	51.6	50.5	53.1	54.5	50.0	52.0	51.6	52.2	51.7
Corporate (industry) credit	13.3	7.8	6.1	5.5	6.1	3.8	5.1	0.9	-0.4	-0.7	4.9	0.6	0.2	1.1	1.6	1.7	2.4	3.4	5.9	6.9	5.7	6.0	6.0	8.6	
Coal output	3.8	10.0	5.6	4.4	4.6	5.3	-4.2	2.8	3.5	6.6	10.6	-3.3	-3.2	-6.7	0.6	15.4	10.4	3.9	0.7	0.4	3.8	1.3	9.1	16.0	
Steel output	9.9	6.9	-1.9	-3.6	4.5	9.0	10.8	12.9	11.3	8.7	11.0	9.0	3.8	6.0	9.4	2.2	3.7	8.6	14.5	0.4	1.7	5.0	4.7	3.5	
Cement output	6.1	7.0	-0.2	3.2	11.8	5.8	3.4	-0.8	-13.3	-15.8	-6.8	-5.2	-1.4	-3.3	1.0	0.7	0.1	-1.3	16.9	17.7	19.6	23.0	13.0	16.6	
Electricity generation	12.5	16.4	5.7	5.5	9.2	10.0	3.1	6.1	5.2	1.2	6.2	5.3	8.2	2.2	6.6	8.3	3.4	3.2	3.9	4.4	7.7	4.6	6.0	2.2	
Services																									
Services PMI*	52.9	51.3	50.9	52.5	53.0	52.0	52.6	48.1	49.4	53.1	51.8	50.8	53.1	53.8	43.5	46.4	51.9	52.9	45.4	50.9	51.4	46.8	51.8	52.7	49.9
Light commercial vehicles	-22.9	-7.3	-3.1	1.3	13.9	12.6	8.1	-0.6	0.0	-0.6	3.6	-7.9	1.0	1.0	20.1	5.8	10.3	10.9	26.1	34.0	44.9	33.9	31.9	62.7	34.9
Medium & heavy commercial vehicles	-6.3	32.5	24.7	31.6	27.7	21.6	-16.7	4.3	-1.2	-9.9	1.7	-55.9	-58.0	-20.8	1.5	10.9	23.7	16.5	3.4	49.9	11.9	26.3	15.7	180.0	176.3
Railway traffic: passenger	3.1	-5.6	-6.6	1.9	2.0	0.0	0.6	1.5	1.4	-0.7	2.2	2.4	3.2	1.4	1.8	-2.5	-1.4	4.6	-4.6	1.4	1.0	1.0	2.1	1.2	-1.2
Airline: cargo traffic	10.2	12.5	7.8	4.8	10.2	7.0	8.4	11.1	13.7	9.4	18.3	17.4	17.2	13.9	10.9	16.3	18.6	5.2	19.6	13.8	9.7	9.6	3.9	6.1	
Deposits	14.4	12.0	11.1	10.5	9.1	9.2	10.1	13.6	12.8	12.0	15.4	10.9	10.3	12.7	9.5	8.9	8.2	8.7	2.9	3.6	4.5	5.4	6.6	8.1	8.5
Bank Credit	13.9	10.8	9.4	9.3	10.4	9.5	9.7	6.9	4.3	3.7	8.2	4.9	4.8	8.1	5.6	6.3	6.6	6.8	9.3	10.5	10.2	10.8	10.3	12.5	13.1
Other indicators																									
Gross tax (ex-service tax) (YTD)	7.6	8.6	15.8	21.3	6.9	30.9	7.1	19.8	11.2	15.4	17.9	19.7	20.0	16.6	17.8	21.5	23.0	24.9	24.6	25.6	47.5	33.6	19.3	26.3	
OECD Composite leading indicators*	99.2	99.8	100.0	100.0	99.9	99.8	99.5	99.2	99.2	99.2	99.2	99.2	99.3	99.4	99.5	99.6	99.8	99.9	100.1	100.3	100.5	100.7	100.9		

Sources: CEIC Data Company Ltd., Haver, OECD, and IMF staff estimates.

* Index values. Note: The cell is highlighted in dark green if the growth is above average. The cell is highlighted in dark red if the growth is below average. The average for each data series covers data points since 2012 H1 to latest month.

Appendix I. Key Policy Actions 2017–18[1]

Financial Sector	
May 4, 2017	**Banking Regulation (Amendment) Act, 2017**: The government amended the Act to provide special power to the RBI to issue directions to any banking company to initiate the insolvency resolution process in respect of a default, under the provisions of the Insolvency and Bankruptcy Code, 2016 (IBC). **RBI's First List of Defaulters** (June 14, 2017): Armed with special power, the RBI sent a list of 12 defaulting companies to commercial banks with specific direction to send these cases to the National Company Law Tribunal (NCLT) under the IBC. **RBI's Second List of Defaulters** (August 30, 2017): The RBI sent a second list of 26 defaulters to commercial banks with instructions that the accounts first be resolved through any of its schemes before December 13, 2017, failing which they should be referred to NCLT under the IBC before December 31, 2017.
June 7, 2017	**Rupee Denominated Bonds Overseas (Masala Bonds)**: The RBI excluded issuances of Masala Bonds from the limit for investments by foreign portfolio investors in corporate bonds, effective from October 3, 2017.
August 10, 2017	**Financial Resolution and Deposit Insurance Bill, 2017**: The government introduced the Bill in Parliament which has been referred to a Joint Committee for its consideration. The Bill seeks to create a framework for resolving bankruptcy in financial firms such as banks and insurance companies.
October 24, 2017	**Public Sector Bank (PSB) Recapitalization**: The government unveiled a INR 2.1 trillion PSB recapitalization plan. Of the total of INR 2.1 trillion to be funded over two years, the bulk of the recapitalization is to be financed through the issuance of recapitalization bonds (INR 1.35 trillion). While the budget would provide INR 181.39 billion, the government expects PSBs to raise an additional amount of INR 103 billion from the market.
January 24, 2018	**PSB Reforms**: Following its October 24, 2017 announcement, the government made public its capital infusion plan for 2017/18, which included INR 800 billion through recapitalization bonds and INR 81.39 billion as budgetary support. The government also unveiled a detailed roadmap across six themes that cover 30 action plans to improve the efficiency and better customer services in PSBs.
February 1, 2018	**Merger of Public Sector Insurance Companies**: The government has decided to merge three public sector general insurance companies: National Insurance Company, United India Assurance Company, and Oriental India Insurance Company into a single insurance entity and subsequently list it in the stock exchanges.
February 12, 2018	**Revised Framework on NPA Resolution**: The RBI withdrew all existing instructions on resolution of stressed assets such as: (i) Framework for Revitalizing Distressed Assets, (ii) Corporate Debt Restructuring Scheme, (iii) Flexible Structuring of Existing Long-Term Project Loans, (iv) Strategic Debt Restructuring Scheme, (v) Change in Ownership outside the Strategic Debt Restructuring Scheme, and (vi) Scheme for Sustainable Structuring of Stressed Assets and also discontinued the institution of Joint Lenders' Forum for resolution of such assets. According to the revised framework banks are directed resolve their stressed assets of INR 20 billion and above, with their own board approved strategies within a period of 180 days; failing which the banks will be mandated to approach the IBC process within a period of 15 days.
March 13, 2018	**Letters of Understanding/Letters of Comfort Discontinued**: Following an investigation of reports of fraudulent misuse of letters of undertaking and letters of comfort for trade credits for imports into India by banks, the RBI directed discontinuation of both these instruments.
April 2, 2018	**Regulatory Forbearance for Banks from Mark-to-Market losses**: The RBI allowed banks to spread over four quarters their bond-trading mark-to-market losses, incurred in the December 2017 and March 2018 quarters due to the sharp rise in government bond yields. The central bank also advised banks to create an Investment Fluctuation Reserve from the year 2018/19 that could be dipped into in case there was a need to provide for bond losses in the future.
April 6, 2018	**Virtual Currency**: The RBI prohibited entities regulated by it from dealing in virtual currencies, or facilitating any person from dealing in virtual currencies. Regulated entities which already provide such services have been directed to exit the relationship within three months.
April 27, 2018	**Foreign Portfolio Investment (FPI)**: The RBI permitted FPI investment in Government securities (G-secs) and State Development Loans (SDLs) in all maturities, subject to the condition that investment in residual maturity below one year shall not exceed 20 percent of the total investment in that category. Prior to this, investment by FPIs was restricted to maturities of three years and above. The RBI also allowed FPIs to invest in corporate bonds with minimum residual maturity of above one year.

[1] Starting April 2017.

	Concentration Limit: Investment by any FPI in each of the three categories of debt, G-secs, SDLs and corporate debt securities, shall be subject to the following concentration limits: (i) Long-term FPIs: 15% of the prevailing investment limit for that category; and (ii) Other FPIs: 10% of the prevailing investment limit for that category. **Single/Group Investor-wise Limit in Corporate Bonds**: FPI investment in corporate bonds shall be subject to the following requirements: (i) Investment by any FPI shall not exceed 50% of any issue of a corporate bond; and (ii) No FPI shall have an exposure of more than 20% of its corporate bond portfolio to a single corporate (including exposure to entities related to the corporate).
May 1, 2018	**FPI**: The RBI permitted FPI investment in corporate bonds with residual maturity below one year, subject to the condition that amounts will not exceed 20% of the total investment. FPIs also permitted to invest in treasury bills issued by the Central Government.
	Monetary Policy
April 6, 2017	**Narrowing of the Monetary Policy Rate Corridor**: The RBI narrowed the policy rate corridor around the policy repo rate to +/-25 basis points from +/- 50 basis points effective April 6, 2017 to ensure finer alignment of the operating target with the policy rate.
June 7, 2017	**Reduction of the Statutory Liquidity Ratio (SLR)**: The RBI notified a reduction in the SLR from 20.5 percent of net demand and time liabilities (NDTL) to 20.0 percent effective June 24, 2017. The SLR was further reduced to 19.5 percent effective October 14, 2017. This was aimed at providing greater flexibility to banks to comply with the 100 percent liquidity coverage ratio (LCR) requirement effective January 1, 2019 (October 4, 2017).
June 6, 2018	**Reversal in Policy Rate**: The Monetary Policy Committee raised the policy repo rate by 25 basis points to 6.25 percent. It had previously lowered the rate by 25 basis points on August 2, 2017. **Increase in the LCR Carve-out from the SLR**: The RBI permitted banks to include an additional 2 percent of their NDTL under Facility to Avail Liquidity for Liquidity Coverage Ratio within the mandatory SLR requirement, thus raising the total to 13 percent of their NDTL. Scheduled commercial banks are required to reach the minimum LCR of 100 percent by January 1, 2019.
	Fiscal Policy
July 1, 2017	**The Goods and Services Tax (GST)** rolled out across the country. **Relief for Small and Medium Enterprises**: • **Inter-state service providers** with annual turnover less than INR 2 million exempted from obtaining registration (GST Council 22nd meeting, October 6, 2017). • **Small and medium businesses** with annual turnover up to INR 15 million to file and pay taxes on a quarterly basis, starting from October-December 2017. The registered buyers from such small taxpayers to be eligible to avail input tax credit monthly (GST Council 22nd meeting, October 6, 2017). • The **reverse charge mechanism** under Central GST Act, 2017 and Integrated GST Act, 2017 to be suspended till March 2018 (GST Council 22nd meeting, October 6, 2017). **e-Way Bills**: • The e-way bill system to be introduced in a staggered manner with effect from January 1, 2018 and be rolled out nationwide with effect from April 1, 2018 (GST Council 22nd meeting, October 6, 2017). • Nation-wide **e-way bills** for ***inter-state movement*** of goods from April 1, 2018 (GST Council 24th meeting, December 16, 2017). States to choose their own timing for implementation of the e-way bill for ***intra-State movement***.
October 4, 2017	**Excise Duty on Petrol and Diesel Reduced**: The government reduced excise duty on petrol and diesel by INR 2 per liter to reduce the burden on the public following a sharp spike in international oil prices.
December 16, 2017	**Customs Duty on Electronics Goods Raised**: The government raised customs duty on electronics goods such as mobile phones, television sets, digital cameras, microwave ovens, and LED bulbs by 5-10 percent to give protection to domestic industry under its flagship "Make-in-India" program.
February 1, 2018	**Tax Policy Changes in Budget 2018/19**: (i) Reduced corporate tax rate to 25 percent for micro, small and medium enterprises which accounts for almost 99 percent of companies filing their tax returns. (ii) Replaced existing three percent education cess with a four per cent "Health and Education cess" on income and corporate tax. (iii) Imposed a fresh long-term capital gains tax at 10 percent on amounts exceeding INR 0.1 million. However, all gains up to January 31, 2018 are grandfathered.

	(iv) Raised customs duty on 46 line-items by 5-10 percent in sectors like food processing, electronics, auto components, footwear, and furniture to provide protection to domestic industry. (v) Abolished the education cess and secondary and higher education cess on imported goods, and in their place, imposed a social welfare surcharge of 10 percent on aggregate customs duties to provide for social welfare schemes.
February 1, 2018 **April 3, 2018**	**Government Accepts Recommendations of the FRBM Committee**: In the budget speech to Parliament, the finance minister indicated acceptance of two key recommendations of the FRBM Committee report, 2017. These are to: (i) set a medium-term target of debt-to-GDP ratio at 40 percent for the central government; and (ii) adopt the fiscal deficit as the key operational target consistent with achieving the targeted debt ceiling. **Amended the FRBM Act** to require the Central Government to achieve a 40 percent debt-to-GDP ratio by financial year 2024/25; and notified new rules that aim to reduce the fiscal deficit by 0.1 percent or more of GDP each financial year beginning 2018/19, and reach 3 percent of the GDP target by 2020/21.
March 26, 2018	**Government Guarantee for Indian Railway Finance Corporation bonds Approved**: The Ministry of Finance approved a government guarantee of INR 50 billion for Indian Railway Finance Corporation bonds to be subscribed by Life Insurance Corporation (LIC). The guarantee would allow LIC to subscribe to these bonds beyond the exposure limits set by the Insurance Regulatory and Development Authority (IRDA).
FDI Policy	
January 10 & 23, 2018	**Changes to FDI Policy**: 1. Allowed 100 percent FDI under the automatic route for Single Brand Retail Trading (the existing policy allowed 49 percent FDI under the automatic route, and FDI beyond 49 percent and up to 100 percent through the government approval route); 2. Foreign airlines allowed to invest up to 49 percent under the approval route in Air India, subject to conditions that (i) such investment shall not exceed 49 percent either directly or indirectly; and (ii) substantial ownership and effective control of Air India shall continue to be vested in Indian nationals. 3. Permitted 100 percent FDI under the automatic route into real-estate broking service. 4. Allowed 100 percent FDI into core investing companies through the automatic route if it is registered with the RBI and accordingly regulated. 5. Foreign Institutional Investment/FPI allowed in power exchanges through the primary market of up to the 49 percent permitted limit under the automatic route (the existing policy restricted these purchases to the secondary market only).
Agriculture Sector	
April 24, 2017	**Model Agricultural Produce and Livestock Marketing Act, 2017**: The Model Act provides for progressive agricultural marketing reforms, including setting up markets in the private sector, direct marketing, farmer-consumer markets, de-regulation of fruits and vegetables, e-trading, single point levy of market fee, issuance of an unified single trading license in the state, declaring warehouses/silos/cold storage as market sub-yards, and Market Yards of National Importance so that more markets are available for farmers to sell their produce for better prices. States and Union Territories are encouraged to adopt the Model Act to realize better potential from the sector.
November 22, 2017	**Pulses Exports**: The government removed all restrictions on exports of all varieties of pulses.
December 21, 2017	**Import Duty on Pulses**: To protect the interest of domestic farmers, the government imposed a 30 percent import duty on Chana (Chickpeas) and Masoor (Lentils).
February 1, 2018	**Minimum Support Prices (MSPs)**: The government proposed to set MSPs for all crops at one and half times of their production cost. The National Institution for Transforming India (NITI Aayog), in consultation with central and state governments, will put in place a mechanism for operationalizing the new scheme.
February 1, 2018	**Gramin Agricultural Markets (GrAMs)**: The government proposed to develop and upgrade existing 22,000 rural haats into Gramin Agricultural Markets (GrAMs) to provide farmers facility to make direct sale to consumers and bulk purchasers. These GrAMs will be electronically linked to e-NAM and exempted from regulations of Agricultural Produce Market Committees. **Agri-Market Infrastructure Fund**: The government will set up an Agri-Market Infrastructure Fund with a corpus of INR 20 billion for developing and upgrading agricultural marketing infrastructure in the 22,000 GrAMs and 585 Agricultural Produce Market Committees.
February 2, 2018	**Minimum Export Price for Onion**: The government permitted farmers to export onion without any minimum export price. Earlier government had imposed one of US$850 per ton effective November 23, 2017 and US$700 effective January 19, 2018.

February 6, 2018	**Import Duties Raised**: The government raised the import duty on raw and refined sugar to 100 percent. The government also raised the import duty on chick-peas to 40 percent from 30 percent.
	Trade Policy
October 18, 2017	**Restrictions on Gold Imports**: The government imposed fresh restrictions on four-star and five-star export houses with nominated agency certificates from importing gold only for export purposes and not for selling in the domestic market. The move was aimed at curbing duty free gold imports by these houses from countries such as South Korea with whom India has a free trade agreement.
December 5, 2017	**Mid-Term Review of Foreign Trade Policy 2015-2020**: **Exports Zero Rated**: On export of finished goods there is an option of either obtaining refund of the GST paid or getting exemption on submission of letter of undertaking/bond. **Issue of Working Capital Blockage**: Exporters have been extended the benefit of sourcing inputs/capital goods from abroad as well as domestic suppliers for exports without upfront payment of the GST. An 'E-wallet' scheme to be launched from April 1, 2018 to make these schemes operational. Merchant exporters allowed to pay nominal GST of 0.1 percent for procuring goods from domestic suppliers for export. **Duty Credit Scrips**: Validity period of Duty Credit Scrips has been increased from 18 to 24 months and GST rates on transfer/sale of scrips has been reduced to zero percent from 12 percent. **Specified Nominated Agency** permitted to import gold without payment of the Integrated GST. **Export Incentives**: Incentives under merchandise exports from India increased by 2 percent across the board for labor intensive MSME sectors. **Self-Assessment Based Duty-free Procurement of Inputs**: A new scheme of self-assessment based duty-free procurement of inputs required for exports has been introduced for authorized economic operators and will get expanded as more exporters join the authorized economic operator program.
	Factor Markets
December 15, 2017	**Special Package for Employment Generation in Leather and Footwear Sector,** totaling of INR 26 billion to be spent over the three financial years from 2017/18 to 2019/20. **Introduction of Fixed-term Employment** under Sub Section (1) of section 15 of Industrial Employment (Standing Order) Act, 1946 has been proposed. **Enhancing Scope of the Income Tax Act**: to allow a deduction of thirty percent of additional wages paid to new regular workmen in a factory for three years from profit & loss account with the provisions of a minimum 150 days of employment in a year, instead of 240 days. **Additional Employment Incentive**: The scheme would provide for employers' contribution of 3.67 percent to the employees' provident fund for all new employees in leather, footwear, and accessories sector, enrolling within the first 3 years of their employment.
February 1, 2018	**Labor Policy**: The government proposed to contribute 12 percent of wages of the new employees in the employees' provident fund for all the sectors for next three years.
March 16, 2018	**Fixed-term Employment**: The government extended fixed-term employment to all sectors. This flexibility was earlier applicable to the apparel manufacturing sector only.
	Other Policies
March 15, 2017	**National Health Policy, 2017**: The government approved the National Health Policy, 2017 that aims at achieving universal health coverage and delivering quality health care services to all at affordable cost. The policy proposes raising public health expenditure to 2.5 percent of GDP in a time bound manner.
May 17, 2017	**Maternity Benefit Program**: The government decided to extend the pilot Maternity Benefit Program, including INR 6,000 cash compensation for the wage loss of pregnant women and lactating mothers across all districts in the country.
September 21, 2017	**Affordable Housing**: The government proposed eight different models: two models for private investments in affordable housing on private lands and six models for private investments using government lands.
October 25, 2017	**Bharatmala Project**: The government announced the Bharatmala project to construct 83,677 km of roads involving capex of INR 6.92 trillion to be completed in 5 years by 2021-22.
February 1, 2018	**National Health Protection Scheme**: The government approved the launch of Ayushman Bharat-National Health Protection Mission that aims to provide a cover of INR 0.5 million per family per year to about 100 million families belonging to the poor and vulnerable population.

Appendix II. Risk Assessment Matrix

Nature/Source of Threat	Likelihood	Impact	Policies to Minimize Impact
		Domestic Risks	
Delays in addressing the twin balance sheet problems	***M***	***H*:** Delays or protracted processes in addressing promptly the bank capitalization needs of PSBs, dealing decisively with asset quality problems, and repairing corporate balance sheets may lead to further deterioration of the balance sheets of banks and corporates, thus undermining the capital position of PSBs and hindering banks' ability to lend to the economy.	The announced recapitalization for India's PSBs should proceed, as planned. The recapitalization plan should be part of a broader package of financial reforms to speed up the resolution of nonperforming assets, improve PSBs' governance, reduce the role of the public sector in the financial system, and enhance bank lending capacity and practices.
Fiscal revenue shortfalls related to the GST	***H***	***H*:** Protracted GST implementation issues, could cause the center's revenue expenditure to rise more than budgeted, adding risk to the FY2018/19 deficit target. Borrowing needs and financing costs may rise, putting upward pressure on market interest rates and crowding out private investment.	Ease GST compliance including through further simplification of the rate structure and streamlining filing and refund mechanisms, along with strengthening tax administration.
Setbacks in the structural reform process	***M***	***M*:** Difficulty in passing key bills (Labor Market and Land Acquisition) and slow progress on reforming factor and product markets, including agriculture, could weigh on investment and growth, add pressure on inflation, and wane investor sentiment.	Continue to facilitate state-led reform initiatives, address long-standing supply bottlenecks including through non-legislative measures, and strengthen the business climate.
		External Risks	
Tighter or more volatile global financial conditions	***H***	***M*:** Against the backdrop of recent large capital inflows into Indian equities and bonds, an abrupt change in global risk appetite including due to higher-than-expected inflation in the U.S. could lead to a sudden and sharp increase in interest rates, a tightening of global financial conditions, and corrections in market valuations.	Rupee flexibility and monetary policy tightening. Given adequate level of international reserves, provide foreign currency liquidity to prevent disorderly movements in the exchange rate. Continue to enhance the environment for attracting stable non-debt creating capital flows, particularly FDI.
Retreat from cross-border integration	***M***	***M*:** The United States may tighten imports from trading partners. As the United States is one of India's major trading partners, goods and services exports would be affected. At the same time, India's move to protectionism measures, including tariff hikes, could be broadly contractionary, reducing output, investment, and employment. It may also reduce incentives for businesses to compete and improve efficiency.	Facilitate trade liberalization, further reduce barriers to trade, and advance export sophistication and quality to better integrate into global value chains. Further supply-side reforms to improve the business climate and enhance the benefits from trade liberalization.
Structurally weak growth in key advanced economies	***H***	***M*:** Low productivity growth in advanced economies could undermine the medium-term outlook of India's major trading partners; therefore, it could cloud the sustainability of the recovery in India, and prospects for exports and investment.	Structural reform will help strengthen domestic sources of growth, support export competitiveness, and attract foreign investment flows.
Rising regional geopolitical tensions	***M***	***M*:** Cross-border tensions with China and Pakistan may damage confidence and further elevate economic and political pressures. If intensified, this may trigger financial market pressures, reduce capital inflows, and cause general tightening of financial conditions.	Exchange rate flexibility should continue to be the main shock absorber. Given adequate level of international reserves, provide foreign currency liquidity to prevent disorderly movements in the exchange rate.

"L"=Low; "M"=Medium; "H"=High.

The Risk Assessment Matrix (RAM) shows events that could materially alter the baseline path (the scenario most likely to materialize in the view of IMF staff). 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. "Short term (ST)" and "medium term (MT)" are meant to indicate that the risk could materialize within 1 year and 3 years, respectively.

Appendix III. Main Recommendations of the 2017 FSAP

Recommendations	Authority	Time frame
Policies to address vulnerabilities		
Improve the governance and financial operations of PSBs and develop a strategic plan for their consolidation, divestment, and privatization.	MoF	S
Conduct granular assessments of banks' capital needs and require additional provisions and swift recapitalization and restructuring.	RBI, MoF	S
Redesign the corporate debt restructuring mechanisms to make them more flexible.	RBI	S
Financial sector oversight framework		
System-wide oversight and macroprudential policies		
- Retain regulators' role in collecting firm-level data.	MoF	M
Banking supervision		
- Review loan classification and provisioning rules in the context of IFRS, and with respect to special loan categories.	RBI	S
- Amend the legal framework to provide the RBI with full supervisory powers over PSBs and clarify its legal independence.	Government	M
Insurance supervision		
- Introduce a risk-based solvency regime and risk-based supervision.	IRDAI	S
Securities regulation		
- Transfer legal authority over public-listed company reporting to SEBI and introduce a risk-based review of company disclosures.	Government, SEBI	M
- Adopt a strategy to unify regulation of commodities trading markets.		S
Financial markets infrastructure oversight		
- Improve stress testing scenarios and methodologies.	CCIL	S
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.	Government	S
- Improve the frameworks for emergency liquidity assistance, deposit insurance, and crisis preparedness.	RBI, Government	M
Market integrity		
- Subject domestic politically-exposed persons to adequate due diligence and qualify domestic tax evasion as predicate offense to money laundering.	MoF	S
Market development		
Progressively reduce the SLR to help deepen markets and encourage lending.	RBI	S
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
S = short term, M = medium term.		

Appendix IV. Public and External Debt Sustainability Analysis

India's debt is high, but favorable debt dynamics and financial repression make the debt path sustainable. Risks are further mitigated because public debt is denominated in domestic currency and predominantly held by residents. The statutory liquidity requirement creates a captive domestic market for debt which limits the interest cost of debt. Under the baseline, the public debt-to-GDP ratio would decline from 70 percent in 2017/18 to 63 percent of GDP by 2022/23, while gross financing needs would decline from about 12 percent to 9 percent of GDP. The primary risk to debt sustainability stems from shocks to real GDP growth and fiscal slippages. India's external debt at about 20 percent of GDP remains sustainable.

1. **India's debt-to-GDP ratio is high at around 70 percent of GDP**. Over the medium-term debt is projected to decline to around 63 percent of GDP driven by favorable debt dynamics. Nominal GDP growth is projected to increase from 10 percent to around 12 percent over the medium term and effective interest rates are projected to remain close to 8 percent. Inflation over the medium term is forecast to be stable around 4 percent. India's debt-stabilizing primary deficit is calculated at 2.5 percent of GDP, and the primary deficit in the baseline assumptions is nearly one percent of GDP lower than that over the medium term.

2. **India's public debt sustainability analysis is based on the following macroeconomic assumptions**:

- **Growth assumptions**. Real GDP growth is estimated to have bottomed out after the dual shocks of demonetization and disruptions from GST implementation. Growth was 6.7 percent in 2017/18 and is projected to increase to 7.3 percent in 2018/19 and gradually to 7¾ percent in the medium term. Robust growth will be driven by a moderate pickup in investment and increases in intra-Indian trade because of efficiency gains from the GST. The medium-term growth forecast has been revised downward compared to the last DSA because of a GST structure that was more complicated than anticipated and limited progress on land and labor reforms which are needed for a sustained rise in investment and a further acceleration in growth, along with a downward revision to historical growth.

- **Fiscal Assumptions**. The central government fiscal deficit deteriorated in 2017/18 relative to 2016/17 (IMF presentation), as non-tax revenue declined sharply, offset partly by a small increase in tax revenue and a reduction in expenditures, mainly lower capital spending. In the IMF's presentation the deterioration amounted to 0.3 percent of GDP. The government is set to resume consolidation with a planned reduction in the general government deficit by 0.4 percent of GDP (IMF presentation) in the 2018/19 budget. The consolidation is predicated on higher revenues due to base broadening effects and increased GST compliance.

3. **Fiscal Risks**.

- The center has committed to fill the gap potentially arising from GST-related revenue shortfalls in states. Specifically, the center has guaranteed states' annual revenue growth at 14 percent for a period of 5 years from the implementation of GST. Because of this, GST revenue slippages would affect the central government budget through higher transfers to the states.

- State fiscal deficits have broadly been within the 3 percent limit recommended by the 14th Finance Commission. However, risks remain and stem from announcements of farm loan waivers in several states, the implementation of the 17th Pay Commission (underway), and the taking on of losses from electricity generation corporations as stipulated in the UDAY scheme. Assessing these risks is complicated by the more-than-one-year lag in the availability of data on states' fiscal positions.
- The government recently announced a plan to recapitalize public sector banks over two years. The recapitalization will add at least 0.8 percent of GDP to the public debt. This is included in the baseline. The size of the recapitalization is in line with recommendations from the last FSSA. Further recapitalization needs are not anticipated, but the contingent liability shock is included to account for a financing need equivalent to 1 percent of GDP.

4. **India's debt profile is conducive to debt stability**. Nearly 95 percent of debt has a long and medium-term maturity, and debt is largely held by residents. Foreign currency-denominated debt is negligible. The composition of debt is set to remain the same over the projection period with the bulk of financing needs met by the issuance of medium and long-term debt denominated in domestic currency and held by residents. The interest bill is substantial with gross financing needs equivalent to nearly 12 percent of GDP. As fiscal consolidation resumes, these needs will decline by around 3 percent of GDP over the medium term. The statutory liquidity requirement creates a captive domestic market for debt which limits the interest cost of debt.

5. **Projections over the medium term are reasonable according to the assessment in the template**. Assumptions on fiscal consolidation are within the median for surveillance countries and are expected to be met. Past forecast errors in projecting real GDP growth and the primary balance are reasonable with a percentile rank around 50 percent for each. The team's forecast of inflation has been better than the median for other surveillance countries.

6. **The primary risk to India's debt sustainability is low growth, though the risks remain contained**. The stress test corresponding to a growth shock yields a deteriorating debt path with debt-to-GDP reaching a peak of 71 percent of GDP and gross financing needs reaching a peak of 12 percent of GDP. The combined macro-fiscal shock yields slightly worse outcomes though the debt path would return to a downward trajectory.

7. **Elevated vulnerabilities in the heat map stem from a high baseline debt-to-GDP ratio**. Since debt-to-GDP is slightly above 70 percent, the baseline threshold is breached and the heat map for the debt level is red. Gross financing needs are below the 15 percent of GDP threshold and do not deteriorate in shock scenarios. Risks stemming from market perception (measured by EMBI global spreads) and external financing requirements (defined as the current account balance and amortization of short term external debt) are limited.

Figure 1. India Public Debt Sustainability Analysis (DSA) – Baseline Scenario

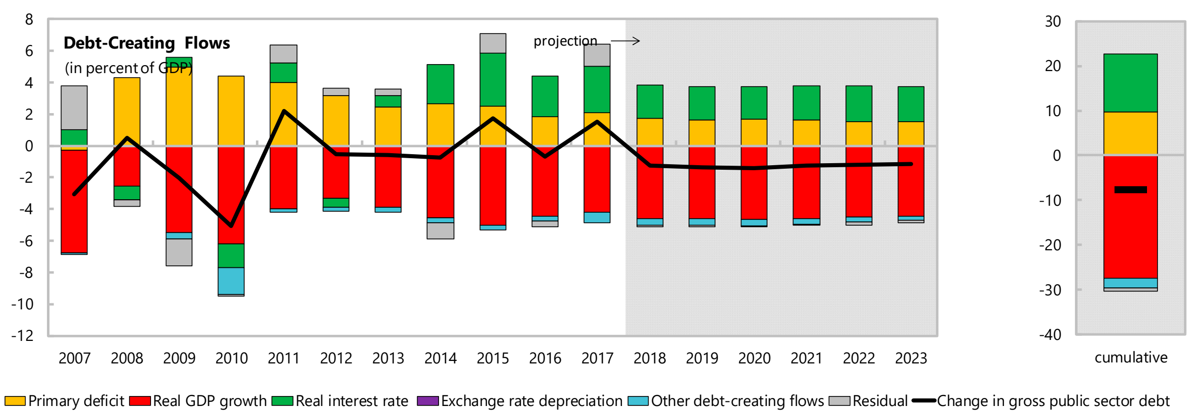
(In percent of GDP unless otherwise indicated)

Debt, Economic and Market Indicators [1/]

	Actual			Projections						As of March 13, 2018		
	2007-2015 [2/]	2016	2017	2018	2019	2020	2021	2022	2023	Sovereign Spreads		
Nominal gross public debt	70.4	68.9	70.4	69.2	67.8	66.4	65.1	63.9	62.8	EMBIG (bp) 3/		478
Public gross financing needs	12.4	11.1	11.7	11.1	10.8	10.4	10.2	10.0	8.7	5Y CDS (bp)		86
										Ratings	Foreign	Local
Real GDP growth (in percent)	7.4	7.1	6.7	7.3	7.5	7.7	7.7	7.7	7.7	Moody's	Baa2	Baa2
Inflation (GDP deflator, in percent)	6.0	3.5	3.1	4.2	4.3	4.2	3.8	3.7	3.7	S&Ps	BBB-	BBB-
Nominal GDP growth (in percent)	13.8	10.8	10.0	11.8	12.2	12.3	11.9	11.9	11.9	Fitch	BBB-	BBB-
Effective interest rate (in percent) [4/]	7.6	7.8	8.0	7.9	8.1	7.9	7.8	7.8	7.8			

Contribution to Changes in Public Debt

	Actual			Projections							
	2007-2015	2016	2017	2018	2019	2020	2021	2022	2023	cumulative	debt-stabilizing primary balance [9/]
Change in gross public sector debt	-0.8	-0.7	1.5	-1.2	-1.4	-1.4	-1.2	-1.2	-1.2	-7.6	
Identified debt-creating flows	-1.2	-0.3	0.1	-1.2	-1.3	-1.3	-1.2	-1.0	-1.0	-6.9	
Primary deficit	3.1	1.9	2.1	1.8	1.7	1.7	1.6	1.5	1.5	9.8	-2.5
Primary (noninterest) revenue and grants	19.4	20.8	20.8	21.2	21.2	21.2	21.3	21.3	21.3	127.5	
Primary (noninterest) expenditure	22.6	22.6	22.9	22.9	22.9	22.9	22.9	22.8	22.9	137.2	
Automatic debt dynamics [5/]	-3.9	-1.9	-1.2	-2.5	-2.5	-2.6	-2.4	-2.3	-2.2	-14.6	
Interest rate/growth differential [6/]	-3.9	-1.9	-1.2	-2.5	-2.5	-2.6	-2.4	-2.3	-2.2	-14.6	
Of which: real interest rate	0.7	2.6	2.9	2.1	2.1	2.1	2.2	2.2	2.2	12.9	
Of which: real GDP growth	-4.6	-4.5	-4.2	-4.6	-4.6	-4.7	-4.6	-4.5	-4.4	-27.4	
Exchange rate depreciation [7/]	0.0	0.0	0.0	…	…	…	…	…	…	…	
Other identified debt-creating flows	-0.4	-0.3	-0.7	-0.4	-0.4	-0.4	-0.3	-0.3	-0.3	-2.1	
Consolidated General Govt - Domestic Financ	-0.4	-0.3	-0.7	-0.4	-0.4	-0.4	-0.3	-0.3	-0.3	-2.1	
Contingent liabilities	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Please specify (2) (e.g., ESM and Euroarea loa	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Residual, including asset changes [8/]	0.3	-0.3	1.4	-0.1	-0.1	-0.1	-0.1	-0.2	-0.2	-0.8	



Source: IMF staff.

1/ Public sector is defined as general government.

2/ Based on available data.

3/ Long-term bond spread over U.S. bonds.

4/ Defined as interest payments divided by debt stock (excluding guarantees) at the end of previous year.

5/ Derived as [(r - π(1+g) - g + ae(1+r)]/(1+g+π+gπ)) times previous period debt ratio, with r = interest rate; π = growth rate of GDP deflator; g = real GDP growth rate; a = share of foreign-currency denominated debt; and e = nominal exchange rate depreciation (measured by increase in local currency value of U.S. dollar).

6/ The real interest rate contribution is derived from the numerator in footnote 5 as r - π (1+g) and the real growth contribution as -g.

7/ The exchange rate contribution is derived from the numerator in footnote 5 as ae(1+r).

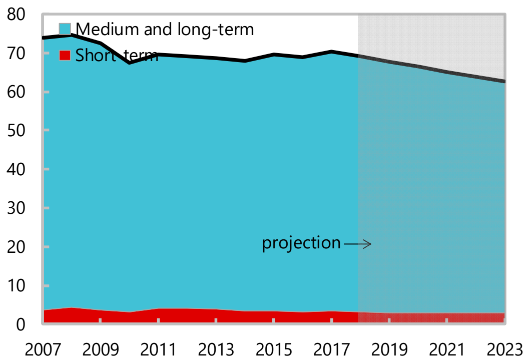
8/ Includes asset changes and interest revenues (if any). For projections, includes exchange rate changes during the projection period.

9/ Assumes that key variables (real GDP growth, real interest rate, and other identified debt-creating flows) remain at the level of the last projection year.

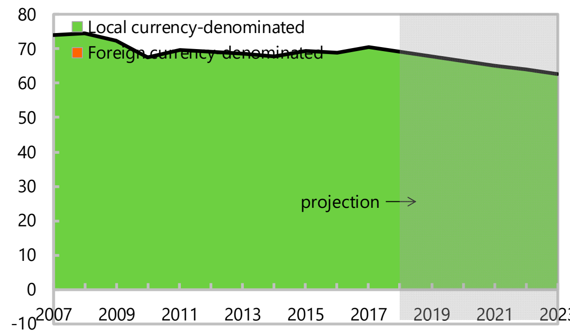
Figure 2. India Public Sector Debt Sustainability Analysis (DSA) – Baseline Scenario

Composition of Public Debt

By Maturity
(in percent of GDP)



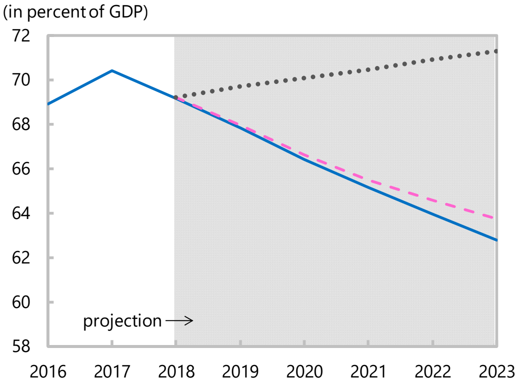
By Currency
(in percent of GDP)



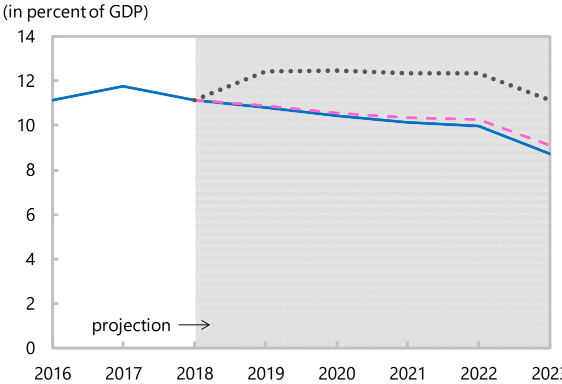
Alternative Scenarios

Baseline   Historical   Constant Primary Balance

Gross Nominal Public Debt
(in percent of GDP)



Public Gross Financing Needs
(in percent of GDP)



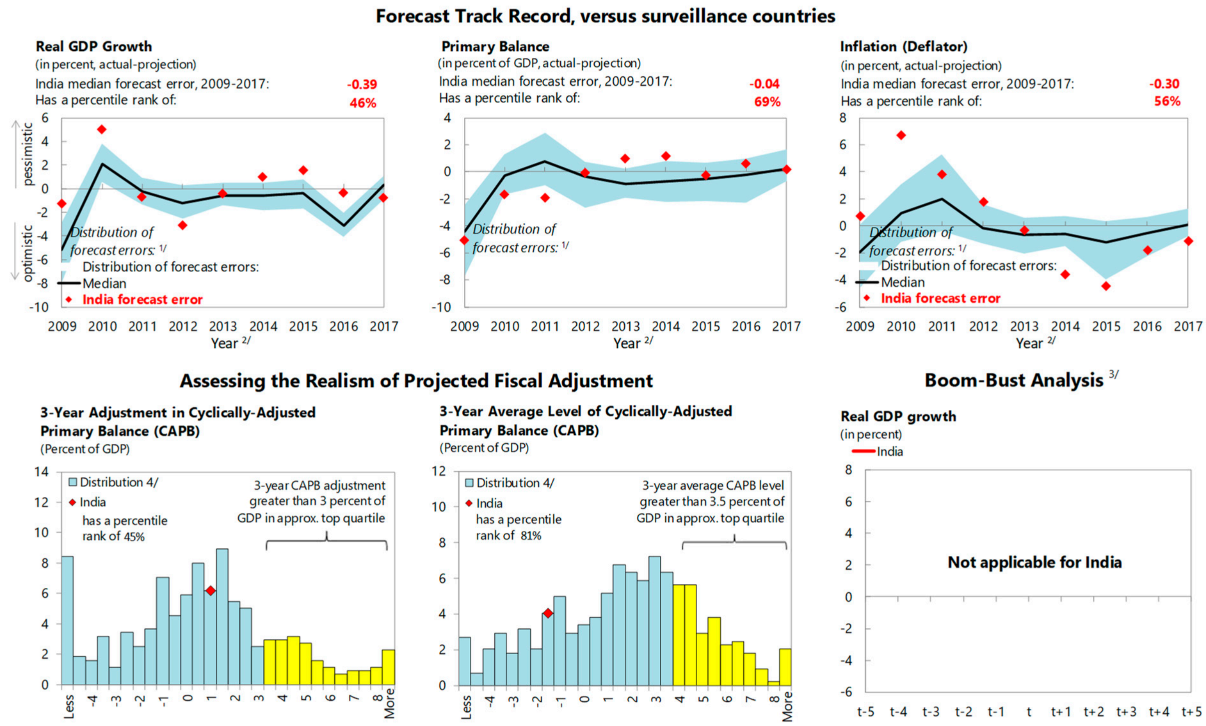
Underlying Assumptions
(in percent)

Baseline Scenario	2018	2019	2020	2021	2022	2023
Real GDP growth	7.3	7.5	7.7	7.7	7.7	7.7
Inflation	4.2	4.3	4.2	3.8	3.7	3.7
Primary Balance	-1.8	-1.7	-1.7	-1.6	-1.5	-1.5
Effective interest rate	7.9	8.1	7.9	7.8	7.8	7.8
Constant Primary Balance Scenario						
Real GDP growth	7.3	7.5	7.7	7.7	7.7	7.7
Inflation	4.2	4.3	4.2	3.8	3.7	3.7
Primary Balance	-1.8	-1.8	-1.8	-1.8	-1.8	-1.8
Effective interest rate	7.9	8.1	7.9	7.8	7.8	7.8

Historical Scenario	2018	2019	2020	2021	2022	2023
Real GDP growth	7.3	7.0	7.0	7.0	7.0	7.0
Inflation	4.2	4.3	4.2	3.8	3.7	3.7
Primary Balance	-1.8	-3.2	-3.2	-3.2	-3.2	-3.2
Effective interest rate	7.9	8.1	7.6	7.3	7.2	7.0

Source: IMF staff.

Figure 3. India Public DSA—Realism of Baseline Assumptions



Source : IMF Staff.

1/ Plotted distribution includes surveillance countries, percentile rank refers to all countries.

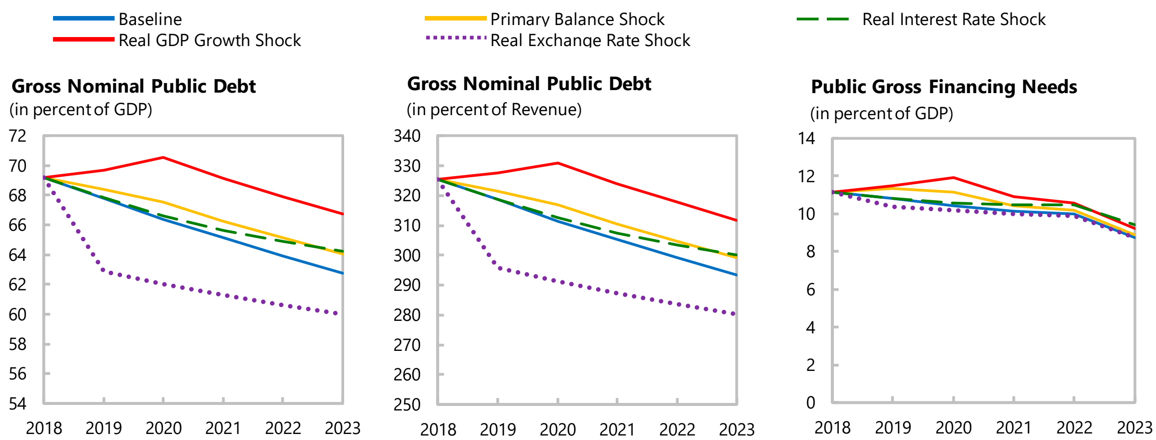
2/ Projections made in the spring WEO vintage of the preceding year.

3/ Not applicable for India, as it meets neither the positive output gap criterion nor the private credit growth criterion.

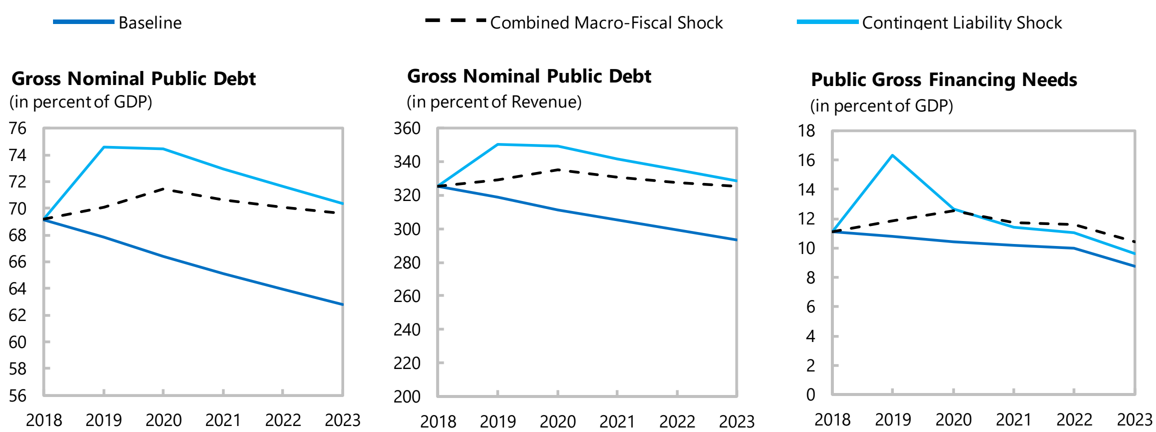
4/ Data cover annual obervations from 1990 to 2011 for advanced and emerging economies with debt greater than 60 percent of GDP. Percent of sample on vertical axis.

Figure 4. India Public DSA—Stress Tests

Macro-Fiscal Stress Tests



Additional Stress Tests



Underlying Assumptions

(in percent)

Primary Balance Shock	2018	2019	2020	2021	2022	2023
Real GDP growth	7.3	7.5	7.7	7.7	7.7	7.7
Inflation	4.2	4.3	4.2	3.8	3.7	3.7
Primary balance	-1.8	-2.2	-2.2	-1.6	-1.5	-1.5
Effective interest rate	7.9	8.1	7.9	7.8	7.8	7.8
Real Interest Rate Shock						
Real GDP growth	7.3	7.5	7.7	7.7	7.7	7.7
Inflation	4.2	4.3	4.2	3.8	3.7	3.7
Primary balance	-1.8	-1.7	-1.7	-1.6	-1.5	-1.5
Effective interest rate	7.9	8.1	8.2	8.3	8.4	8.6
Combined Shock						
Real GDP growth	7.3	5.8	6.0	7.7	7.7	7.7
Inflation	4.2	3.9	3.8	3.8	3.7	3.7
Primary balance	-1.8	-2.2	-2.6	-1.6	-1.5	-1.5
Effective interest rate	7.9	8.6	8.7	8.8	9.0	9.1

Real GDP Growth Shock	2018	2019	2020	2021	2022	2023
Real GDP growth	7.3	5.8	6.0	7.7	7.7	7.7
Inflation	4.2	3.9	3.8	3.8	3.7	3.7
Primary balance	-1.8	-2.1	-2.6	-1.6	-1.5	-1.5
Effective interest rate	7.9	8.1	7.9	7.8	7.8	7.8
Real Exchange Rate Shock						
Real GDP growth	7.3	7.5	7.7	7.7	7.7	7.7
Inflation	4.2	13.3	4.2	3.8	3.7	3.7
Primary balance	-1.8	-1.7	-1.7	-1.6	-1.5	-1.5
Effective interest rate	7.9	8.6	8.5	8.3	8.3	8.3
Contingent Liability Shock						
Real GDP growth	7.3	5.8	6.0	7.7	7.7	7.7
Inflation	4.2	3.9	3.8	3.8	3.7	3.7
Primary balance	-1.8	-6.6	-1.7	-1.6	-1.5	-1.5
Effective interest rate	7.9	8.7	8.0	7.9	7.9	7.9

Source: IMF staff.

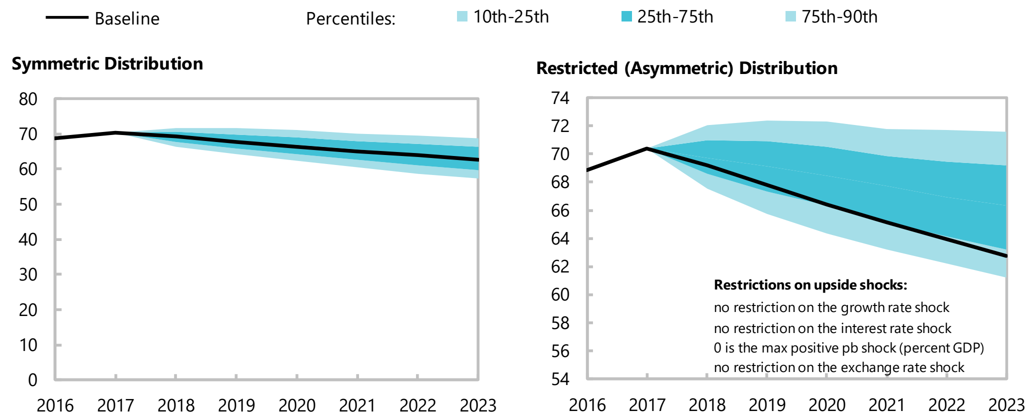
Figure 5. India Public Debt Sustainability Analysis (DSA)—Baseline Scenario

Heat Map

Debt level 1/	Real GDP Growth Shock	Primary Balance Shock	Real Interest Rate Shock	Exchange Rate Shock	Contingent Liability shock
Gross financing needs 2/	Real GDP Growth Shock	Primary Balance Shock	Real Interest Rate Shock	Exchange Rate Shock	Contingent Liability Shock
Debt profile 3/	Market Perception	External Financing Requirements	Change in the Share of Short-Term Debt	Public Debt Held by Non-Residents	Foreign Currency Debt

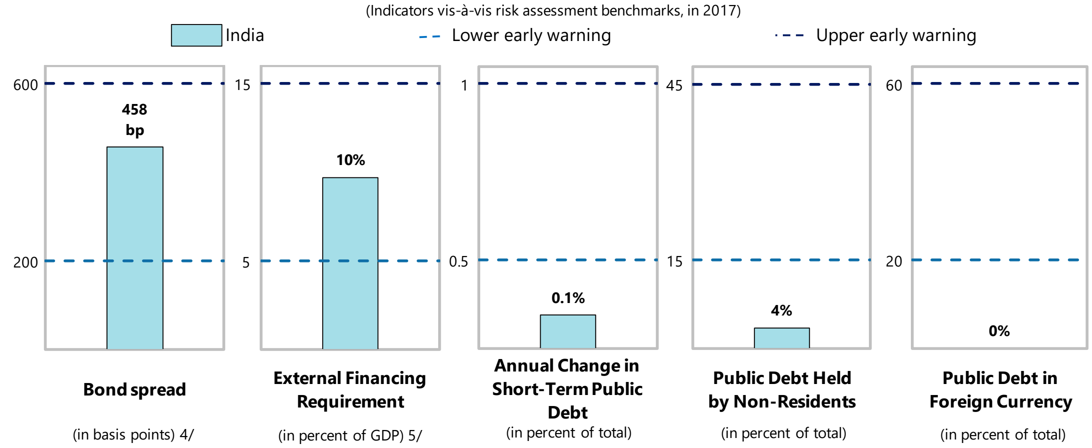
Evolution of Predictive Densities of Gross Nominal Public Debt

(in percent of GDP)



Debt Profile Vulnerabilities

(Indicators vis-à-vis risk assessment benchmarks, in 2017)



Source: IMF staff.

1/ The cell is highlighted in green if debt burden benchmark of 70% is not exceeded under the specific shock or baseline, yellow if exceeded under specific shock but not baseline, red if benchmark is exceeded under baseline, white if stress test is not relevant.

2/ The cell is highlighted in green if gross financing needs benchmark of 15% is not exceeded under the specific shock or baseline, yellow if exceeded under specific shock but not baseline, red if benchmark is exceeded under baseline, white if stress test is not relevant.

3/ The cell is highlighted in green if country value is less than the lower risk-assessment benchmark, red if country value exceeds the upper risk-assessment benchmark, yellow if country value is between the lower and upper risk-assessment benchmarks. If data are unavailable or indicator is not relevant, cell is white.
Lower and upper risk-assessment benchmarks are:

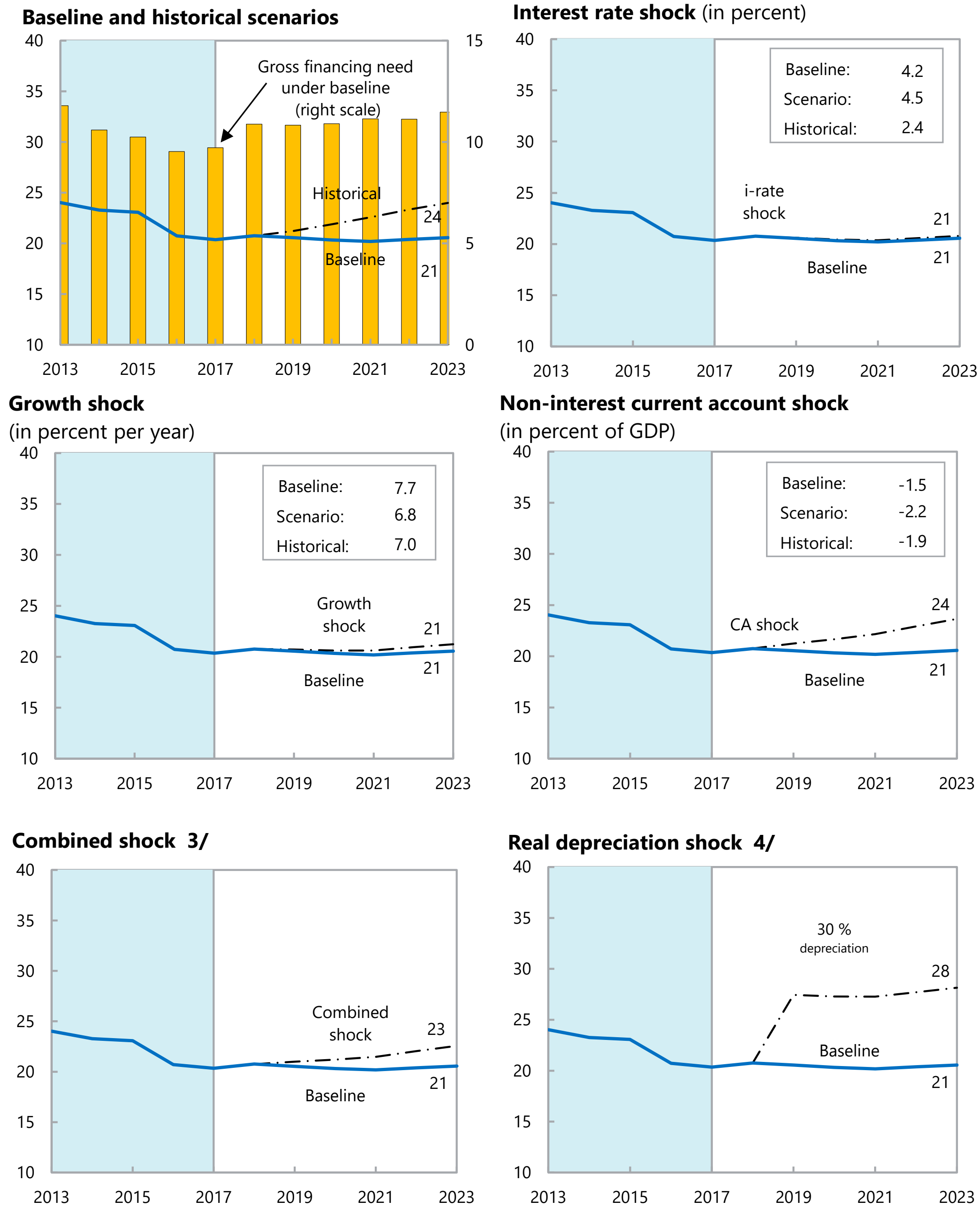
200 and 600 basis points for bond spreads; 5 and 15 percent of GDP for external financing requirement; 0.5 and 1 percent for change in the share of short-term debt; 15 and 45 percent for the public debt held by non-residents; and 20 and 60 percent for the share of foreign-currency denominated debt.

4/ Long-term bond spread over U.S. bonds, an average over the last 3 months, 13-Dec-17 through 13-Mar-18.

5/ External financing requirement is defined as the sum of current account deficit, amortization of medium and long-term total external debt, and short-term total external debt at the end of previous period.

Figure 6. India: External Debt Sustainability: Bound Tests 1/ 2/

(External debt in percent of GDP)



Sources: International Monetary Fund, Country desk data, and staff estimates.
1/ Shaded areas represent actual data. Individual shocks are permanent one-half standard deviation shocks. Figures in the boxes represent average projections for the respective variables in the baseline and scenario being presented. Ten-year historical average for the variable is also shown.
2/ For historical scenarios, the historical averages are calculated over the ten-year period, and the information is used to project debt dynamics five years ahead.
3/ Permanent 1/4 standard deviation shocks applied to real interest rate, growth rate, and current account balance.
4/ One-time real depreciation of 30 percent occurs in 2010.

Table 1. India: External Debt Sustainability Framework, 2013–2023

	Actual							Projections						
	2013	2014	2015	2016	2017	10-Year Historical Average	10-Year Standard Deviation	2018	2019	2020	2021	2022	2023	**Debt-stabilizing non-interest current account 6/**
Baseline: External debt	24.0	23.3	23.1	20.7	20.4			**20.8**	**20.6**	**20.3**	**20.2**	**20.4**	**20.6**	**-3.7**
Change in external debt	1.6	-0.8	-0.2	-2.3	-0.4			0.4	-0.2	-0.2	-0.1	0.2	0.2	
Identified external debt-creating flows (4+8+9)	-0.6	-4.4	-1.6	-3.2	-2.5			-1.0	-1.5	-1.7	-1.6	-1.4	-1.3	
Current account deficit, excluding interest payments	1.3	0.9	0.6	0.1	1.4			1.9	1.4	1.3	1.4	1.7	1.8	
Deficit in balance of goods and services	4.0	3.4	2.9	1.9	3.2			4.0	3.7	3.6	3.5	3.6	3.8	
Exports	25.3	23.3	20.0	19.5	19.4			20.4	20.5	20.4	20.4	20.2	20.0	
Imports	29.4	26.6	22.9	21.5	22.5			24.5	24.2	24.0	23.9	23.8	23.7	
Net non-debt creating capital inflows (negative)	-1.4	-3.5	-1.5	-1.9	-2.0			-2.2	-2.3	-2.4	-2.4	-2.4	-2.5	
Automatic debt dynamics 1/	-0.4	-1.8	-0.6	-1.3	-1.9			-0.7	-0.6	-0.6	-0.7	-0.7	-0.7	
Contribution from nominal interest rate	0.4	0.4	0.5	0.6	0.5			0.7	0.8	0.8	0.8	0.7	0.7	
Contribution from real GDP growth	-1.4	-1.6	-1.8	-1.5	-1.2			-1.4	-1.4	-1.4	-1.4	-1.4	-1.4	
Contribution from price and exchange rate changes 2/	0.5	-0.6	0.7	-0.4	-1.2			...	...	...	...	...	...	
Residual, incl. change in gross foreign assets (2-3) 3/	2.2	3.7	1.4	0.9	2.1			1.4	1.3	1.5	1.5	1.6	1.5	
External debt-to-exports ratio (in percent)	94.8	100.0	115.3	106.1	105.1			101.5	100.2	99.5	99.2	101.0	102.9	
Gross external financing need (in billions of US dollars) 4/	219.1	216.1	215.5	216.8	252.8			301.2	329.1	365.7	411.3	451.9	512.2	
in percent of GDP	11.8	10.6	10.3	9.5	9.7			10.9	10.8	10.9	11.1	11.1	11.5	
Scenario with key variables at their historical averages 5/								**20.8**	**21.2**	**21.9**	**22.6**	**23.3**	**24.0**	**-3.5**
Key Macroeconomic Assumptions Underlying Baseline														
Real GDP growth (in percent)	6.4	7.4	8.2	7.1	6.7	7.0	1.7	7.3	7.5	7.7	7.7	7.7	7.7	
GDP deflator in US dollars (change in percent)	-4.5	2.2	-4.7	1.0	7.3	0.8	6.1	-0.9	2.2	2.4	2.2	2.1	2.1	
Nominal external interest rate (in percent)	1.9	1.9	2.1	2.6	2.6	2.4	0.6	3.6	4.3	4.5	4.2	4.0	4.0	
Growth of exports (US dollar terms, in percent)	4.0	0.9	-11.4	5.6	13.4	7.8	13.9	12.2	10.2	9.9	9.8	9.0	8.9	
Growth of imports (US dollar terms, in percent)	-6.5	-0.3	-11.4	1.5	20.1	7.4	13.9	15.4	8.8	9.2	9.6	9.8	9.6	
Current account balance, excluding interest payments	-1.3	-0.9	-0.6	-0.1	-1.4	-1.9	1.4	-1.9	-1.4	-1.3	-1.4	-1.7	-1.8	
Net non-debt creating capital inflows	1.4	3.5	1.5	1.9	2.0	2.2	0.9	2.2	2.3	2.4	2.4	2.4	2.5	

1/ Derived as [r - g - r(1+g) + ea(1+r)]/(1+g+r+gr) times previous period debt stock, with r = nominal effective interest rate on external debt; r = change in domestic GDP deflator in US dollar terms, g = real GDP growth rate, e = nominal appreciation (increase in dollar value of domestic currency), and a = share of domestic-currency denominated debt in total external debt.

2/ The contribution from price and exchange rate changes is defined as [-r(1+g) + ea(1+r)]/(1+g+r+gr) times previous period debt stock. r increases with an appreciating domestic currency (e > 0) and rising inflation (based on GDP deflator).

3/ For projection, line includes the impact of price and exchange rate changes.

4/ Defined as current account deficit, plus amortization on medium- and long-term debt, plus short-term debt at end of previous period.

5/ The key variables include real GDP growth; nominal interest rate; dollar deflator growth; and both non-interest current account and non-debt inflows in percent of GDP.

6/ Long-run, constant balance that stabilizes the debt ratio assuming that key variables (real GDP growth, nominal interest rate, dollar deflator growth, and non-debt inflows in percent of GDP) remain at their levels of the last projection year.

Appendix V. Recent and Planned IMF Capacity Development

1. **The Fund's capacity development (CD) activities with India have been scaled up in recent years**. IMF technical assistance (TA) and training have supported the authorities' efforts to enhance the formulation and implementation of sound macroeconomic and financial policies as well as build institutions and capacity. Examples include the introduction of the inflation targeting framework, banking sector stress testing, the modernization of the insolvency regime, the design of the Goods and Services Tax (GST) and the fiscal responsibility framework, and the strengthening of macroeconomic statistics.

2. **Upon its inauguration in February 2017, the South Asia Regional Training and Technical Assistance Center (SARTTAC) has become the focal point for the delivery of IMF CD services to India and South Asian countries**. In FY2018, SARTTAC extensively provided training and TA in the Fund's core areas of expertise such as training on national accounts (June 2017, November 2017, and April 2018), BOP/IIP statistics (July 2017), strengthening budget institutions (September 2017), public financial management (June 2017), and a government finance statistics workshop (September 2017), as well as a course on managing capital flows (September 2017). To date, 235 Indian officials received training through SARTTAC.

3. **In line with the Fund's CD strategy**,

- **Recent activities and collaboration with Indian authorities has improved targeting to country needs**. At the request of the 15th Finance Commission, APD and FAD have planned a pipeline of TA missions to provide the Fund's analysis and assistance in developing approaches to handle issues on fiscal federalism. These issues include assisting on constraints on state budgets, achieving vertical fiscal balance, and incentivizing greater fiscal discipline among states, including through market discipline. In addition, an APD/SARTTAC monetary policy workshop is being planned to provide a forum for knowledge sharing on evolving monetary policy frameworks in India, Nepal, and Bhutan.

- **CD activities have been further integrated with surveillance and IMF policy advice**. Based on FSAP recommendations, LEG has conducted a workshop jointly with the Insolvency and Bankruptcy Board of India to discuss practical and operational challenges faced under the new Insolvency and Bankruptcy regime, including insolvency of enterprise groups and cross-border insolvency. SARTTAC has also started working bilaterally with the Reserve Bank of India (RBI), with possible workshops and TA on the accounting of NPLs under the IFRS and an early warning exercise. A customized training on External Sector Assessment was delivered for the RBI in October 2017. This will support IMF surveillance on exchange rate assessments. Statistics TA in various areas provided through both SARTTAC and IMF headquarters is benefiting surveillance and supports the authorities' CD needs.

Appendix VI. External Sector Assessment

	India	Overall Assessment
Foreign asset and liability position and trajectory	**Background**. India's net international investment position (NIIP) has improved slightly since 2014, going from -18.1 percent of GDP at end FY2014/15 to -17.3 percent of GDP as of end-2017. Gross foreign assets and liabilities were 24 and 42 percent of GDP, respectively, at end-2017. The modest level of foreign liabilities reflects India's gradual approach to capital account liberalization, which has focused mostly on FDI. The bulk of assets are in the form of official reserves and FDI, while liabilities include mostly FDI and portfolio equity. **Assessment**. With current account (CA) deficits of about 2½ percent of GDP projected for the medium term, the NIIP-to-GDP ratio is expected to slightly deteriorate. India's external debt, at about 20 percent of GDP, is moderate, compared to other emerging market economies. 48 percent of the external debt is denominated in U.S. dollars and another 37 percent is dominated in Indian rupees. The debt maturity profile is favorable, as long-term external debt accounts for about 81 percent of the total, and the ratio of short-term external debt to foreign exchange (FX) reserves is low.	**Overall Assessment**: *The external sector position in 2017/18 is broadly consistent with fundamentals and desirable policy settings*. India's low per capita income, favorable growth prospects, demographic trends, and development needs justify running CA deficits. External vulnerabilities remain, although they have been reduced since 2013. India's economic risks stem from more volatile global financial conditions, oil price volatility, and a retreat from cross-border integration. Progress has been made on FDI liberalization, while portfolio flows remain controlled. India's trade barriers remain significant. **Potential policy responses**: An increase in non-debt creating capital flows through FDI will help improve the CA financing mix and contain external vulnerabilities. Gradual liberalization of portfolio flows should be considered, while monitoring risks of portfolio flows' reversals. Exchange rate flexibility should remain the main shock absorber, with intervention limited to addressing disorderly market conditions. Continued vigilance is needed, given potential external shocks. Going forward, further structural reform efforts to revamp the business climate, ease domestic supply bottlenecks, and facilitate trade and investment liberalization are essential to improve competitiveness and investment prospects, attract FDI, and boost exports.
Current account	**Background**. The CA deficit is estimated to have increased to 1.9 percent of GDP in FY2017/18 from 0.7 percent of GDP in the previous year. Reflecting a recovery in commodity (especially oil) prices, imports surged by 19 percent in FY2017/18, following a slight decline in the previous year. Export growth also picked up to 10 percent in FY2017/18, from 5 percent in FY2016/17, in line with the global growth recovery. Over the medium term, the CA deficit is expected to increase to about 2½ percent of GDP, on the back of strengthening domestic demand. **Assessment**. The External Balance Assessment (EBA) cyclically-adjusted CA deficit stood at 2.3 percent of GDP in FY2017/18. The EBA CA regression estimates a norm of -3.2 percent of GDP for India in FY2017/18, with a standard deviation of 0.5 percent, thus implying an EBA gap of 0.9 percent. As discussed in previous External Sector Reports and Article IV Staff Reports, in Staff's judgment, a CA deficit of about 2.5 percent of GDP is a more appropriate norm and consistent with the External Sustainability (ES) approach. Based on India's historical cash flows and restrictions on capital inflows, global financial markets cannot be counted on to reliably finance a CA deficit above 3 percent of GDP. While FDI flows have increased in recent years, they are not sufficient to cover CA deficits for this and outer years. Portfolio flows are highly volatile and susceptible to changes in the global risk appetite as demonstrated in the Taper Tantrum episode. Thus, based on the staff-assessed CA norm, the CA gap is in the range of -0.8 to +1.2 percent of GDP. Positive policy contributions to the CA gap from a negative credit gap, larger-than-desirable intervention in the FX market, and a relatively closed capital account are offset by a negative unexplained residual, which likely captures underlying competitiveness problems.	
CA Assessment 2017	Actual CA: -1.9 · Cycl. Adj. CA: -2.3 · EBA CA Norm: -3.2 · EBA CA Gap: 0.9 · Staff Adj.: 0.7 · Staff CA Gap: 0.2	
Real exchange rate	**Background**. The average REER in 2017 appreciated by about 4.3 percent over its 2016 average. As of April 2018, the REER depreciated about 3 percent relative to its 2017 average. **Assessment**. The EBA Index REER and Level REER regression approaches estimate a gap of +10.2 and +8.5 percent for the 2017 average REER, respectively. However, these approaches have large estimation errors for India. Based on the CA gap, the REER is assessed to be in line with fundamentals with the range of -7 to +5 percent for FY2017/18.	
Capital and financial accounts: flows and policy measures	**Background**. The sum of FDI, portfolio, and financial derivatives flows on a net basis is estimated at 1.9 percent of GDP in FY2017/18, slowing from 2.3 percent in FY2016/17 despite larger portfolio inflows. Net FDI flows moderated to 1.2 percent of GDP in FY2017/18, from 1.6 percent in FY2016/17. Portfolio inflows into government and corporate securities were strong in 2017, almost fully exhausting the ceilings on non-resident investment. That said, in line with global trends, there were some portfolio outflows so far in 2018. **Assessment**. Given that portfolio debt flows have been volatile and the exchange rate has been sensitive to these flows and changes in global risk aversion, attracting more stable sources of financing is needed to reduce vulnerabilities. Implementation of structural reforms to improve business climate would help to attract FDI.	
FX intervention and reserves level	**Background**. The evolution of the rupee is generally consistent with a floating arrangement. Spot foreign exchange intervention was US$28 billion (1.1 percent of GDP) and net forwards increased by US$28.5 billion in 2017. International reserves reached $424.5 billion at end-March 2018, increasing by about $55 billion since March 2017. Reserves declined to about $412 billion as of end-May 2018. Reserve coverage currently is about 16.3 percent of GDP and about 7.5 months of prospective goods and services imports. **Assessment**. Reserve levels are adequate for precautionary purposes relative to various criteria. International reserves represent about 190 percent of short-term debt and more than 160 percent of the IMF's composite metric. 1/	
Technical Background Notes	1/ Reserves stand at about 210 percent of the metric adjusted for capital controls, the construction of which is explained in the IMF policy paper, *Assessing Reserve Adequacy—Specific Proposals*. While the adjusted reserve metric uses a composite index to measure capital account openness that is based on de jure capital control indices, staff analysis indicates that India's capital account is not as closed as suggested by traditional measures. See Annex IV in IMF (2016), *India: Staff Report for the 2016 Article IV Consultation*, IMF Country Report No. 16/75 and Chapter 5 in IMF (2016), *India: Selected Issues*, IMF Country Report No. 16/76.	

INTERNATIONAL MONETARY FUND

INDIA

STAFF REPORT FOR THE 2018 ARTICLE IV CONSULTATION—INFORMATIONAL ANNEX

July 2, 2018

Prepared By	Asia and Pacific Department

CONTENTS

FUND RELATIONS

(As of May 31, 2018)

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)	11,685.06	89.10
Reserve Tranche Position	1,429.72	10.90
Lending to the Fund		
New Arrangements to Borrow	470.61	

SDR Department:

	SDR Million	% Allocation
Net cumulative allocation	3,978.26	100.00
Holdings	1,056.66	26.56

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				
	2018	2019	2020	2021	2022
Principal	0.00	0.00	0.00	0.00	0.00
Charges/interest	13.77	27.53	27.54	27.52	27.53
Total	13.77	27.53	27.54	27.52	27.53

Exchange Rate Arrangement:

The exchange rate in India is classified as floating. The exchange rate of the rupee is determined in the interbank market, where the Reserve Bank of India (RBI) intervenes at times. The RBI's role is to modulate excessive volatility so as to maintain orderly conditions. 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 nontransferability 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 non-resident relatives. The Executive Board has not approved these restrictions.

Article IV Consultation:

The previous Article IV consultation discussions were held in November 2016. The Staff Report (IMF Country Report No. 17/54) and associated Selected Issues (IMF Country Report No. 17/55) were discussed by the Executive Board on January 25, 2017.

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.

Capacity Development (Technical Assistance and Training):

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

Resident Representative:

A resident representative's office was opened in November 1991. Mr. Andreas Bauer has been the Senior Resident Representative since August 2016.

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: https://www.adb.org/sites/default/files/publication/27768/ind-2017.pdf

STATISTICAL ISSUES

1. General: Data provision is broadly adequate for surveillance. However, weaknesses remain in the timeliness and coverage of certain statistical series. India has an intricate system for compiling economic and financial statistics and produces a vast quantity of data covering most sectors of the economy. India subscribed to the Special Data Dissemination Standards (SDDS) on December 27, 1996 and started posting its metadata on the Dissemination Standards Bulletin Board on October 30, 1997. It is currently in observance of the SDDS, although it uses flexibility options for timeliness of data on general government operations and on the periodicity and timeliness of labor market data. The data module of the Report on Observance of Standards and Codes (ROSC, IMF Country Report No. 04/96) was published in April 2004. It assesses India's data dissemination practices against the SDDS requirements and assesses the quality of six datasets based on the Data Quality Assessment Framework (DQAF) developed by the IMF's Statistics Department (STA).

2. 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. 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, a sales-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, and major discrepancies between GDP by activity and GDP by expenditure complicate analysis. There are long-standing deficiencies in employment data: they only cover the formal sector, which accounts for a small segment of the labor market, and are available only with a substantial lag.

3. Price statistics: A revised all-India Consumer Price Index (CPI) with new weights was released in early 2011, which covers combined rural and urban India, with 2009/10 as a base year. As well, separate corresponding urban and rural CPI series are published. The CPIs are published with a lag of about one month. In early 2015, the CPI weights were updated using 2011/12 expenditure data and the CPI series has been revised from January 2015. Since January 2006, the Labour Bureau has published a CPI for industrial workers with a 2001 base year. 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 WPI has been rebased to the 2011/12 base year. The authorities are in the process of developing a PPI to replace the WPI. A new RBI price series on residential property price indexes have helped surveillance in this area, though geographic coverage remains limited, and price data for commercial real estate are not available. The RBI has started producing a series covering rural wage data, which helps surveillance, but economy-wide wage data are scant.

4. Government finance statistics: The Ministry of Finance (MoF) is responsible for compiling and disseminating the Government Financial Statistics (GFS). India reports annual Budgetary Central Government data to STA. India disseminates the budgetary central government cash flow statement within one month after the reference month and stock of liabilities within one quarter after the reference quarter. Data on fiscal performance at the state level are available only at annual frequency and with a considerable lag. Data on the functional and economic classification of expenditures are available with considerable lag. There is also scope to improve the analytical usefulness of the presentation of the fiscal accounts. For example, classification of government expenditure between developmental/nondevelopmental and plan/nonplan obscures the economic nature and impact of fiscal actions. The MoF reports central government data (on a cash basis) for publication in the *Government Finance Statistics Yearbook*, the latest reported data corresponding to 2013. India reports GFS for Budgetary Central Government infrequently. The latest data reported to STA are for 2016, but due to the series' break these data are still not published. Data on the general government operations are not internationally comparable as they exclude data on the operations of the extra-budgetary funds, local governments, and social security funds. Under the SDDS, India disseminates annual general government data within 3 quarters after the reference year, using the timeliness flexibility option. India meets the SDDS specifications for central government debt and operations.

5. Monetary and financial statistics: The RBI web site 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, and results of government securities auctions. In 2011, the RBI started publishing a weighted-average lending interest rate and other lending rates at annual frequency. The frequency and quality of data dissemination have improved substantially in recent years.

6. The RBI reports monetary data to STA with substantial delays and 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 depository corporations only, and data on other financial corporations such as insurance corporations, pension funds, and investment funds are not covered.

7. Financial sector statistics: As for reporting of financial soundness indicators (FSIs), all 12 core and 11 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.

8. 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. 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. Data on trade in goods prices, volumes, and composition are not regularly available on a timely basis. External debt statistics are available on a quarterly basis with a one quarter lag. Estimates of short-term external debt are presented on an original maturity basis. The short-term maturity attribution on a residual maturity basis is only available annually (and excludes residual maturity of medium- and long-term nonresident Indian accounts). 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] Coverage of direct investment positions data is hampered by the absence of appropriate legal or institutional authority. 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, are available on a weekly basis and are disseminated as part of a weekly statistical supplement on the RBI web site.

[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 June 15, 2018)

	Date of latest observation	Date received	Frequency of Data 1/	Frequency of Reporting 1/	Frequency of Publication 1/
Exchange Rates	06/15/18	06/15/18	D	D	D
International reserve assets and reserve liabilities of the monetary authorities 2/	06/08/18	06/15/18	W	W	W
Reserve/base money	06/08/18	06/15/18	W	W	W
Broad money	05/25/18	06/08/18	BW	BW	BW
Central bank balance sheet	06/08/18	06/15/18	M	M	M
Consolidated balance sheet of the banking system	May 2018	06/14/18	M	M	M
Interest rates 3/	06/15/18	06/15/18	D	D	D
Consumer price index	May 2018	6/12/18	M	M	M
Revenue, expenditure, balance and composition of financing - General Government 4/ 5/	2016/17	05/31/17	A	A	A
Revenue, expenditure, balance and composition of financing - Central Government 4/ 5/	Apr. 2018	06/01/18	M	M	M
Stocks of central government and central government-guaranteed debt 6/	Dec. 2017	03/18/18	Q	Q	Q
External current account balance	Jan-Mar 2018	06/13/18	Q	Q	Q
Exports and imports of goods and services	May 2018	6/15/18	M	M	M
GDP/GNP	Jan-Mar 2018	5/31/18	Q	Q	Q
Gross external debt	Dec. 2017	03/28/18	Q	Q	Q
International Investment Position	Dec. 2017	03/28/18	Q	Q	Q

1/ Daily (D), Weekly (W), Biweekly (BW), Monthly (M), Quarterly (Q), Annually (A), Irregular (I); Not Available (NA)
2/ Any reserve assets that are pledged or 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.
3/ Both market-based and officially-determined, including discount rates, money market rates, rates on treasury bills, notes and bonds.
4/ Foreign, domestic bank, and domestic nonbank financing.
5/ The general government consists of the central government (budgetary funds, extra budgetary funds, and social security funds) and state governments.
6/ Including currency and maturity composition.

Statement by Subir Gokarn, Executive Director for India and Himanshu Joshi, Senior Advisor to Executive Director July 18, 2018

1. We thank the IMF India Mission team for their constructive engagement with our authorities during their visit to India and their excellent staff note and Selected Issues Papers. Our authorities broadly agree with the thrust of their analysis and recommendations. However, there are a few differences in views, which are pointed out in the relevant sections of this Buff statement.

Growth and Inflation

2. India is one of the fastest growing major economies in the world. GDP grew by 8.2 per cent in 2015-16 and 7.1 per cent in 2016-17. Growth in 2017-18 is estimated at 6.7 percent. The prolonged slowdown in global growth, subdued investments and stressed balance sheets of the banking and corporate sectors have impacted India's efforts to achieve its growth potential. Despite these challenges, growth has accelerated. The economy grew at 7.7 per cent in Q4 of 2017-18 – the fastest pace in the last seven quarters. Gross fixed capital formation (GFCF) growth has accelerated for three consecutive quarters up to Q4 of 2017-18 and capacity utilization by manufacturing firms increased significantly of late. Credit growth has been accelerating and has reached 12.8 per cent year-on-year as on June 22, 2018 as against 5.6 per cent a year ago. Total flow of resources, including those from non-bank sources, had increased to 27.4 per cent in 2017-18. Overall, despite higher oil prices, India's GDP growth outlook for 2018-19 remains positive and growth is expected to be broadly in line with the IMF staff projection of 7.3 per cent.

3. In view of the rising inflationary trend seen in recent months, the policy (repo) rate was increased to 6.25 per cent in June 2018 to preserve a neutral stance. For 2018-19 the Reserve Bank of India has projected CPI inflation at 4.8-4.9 per cent in H1 and 4.7 per cent in H2 with risks tilted to the upside. However, proactive food supply management by the Government and RBI's inflation targeting framework are well positioned to contain unwarranted building-up inflationary risks. Going forward, our authorities will continue to strengthen efforts to achieve the medium-term target of headline inflation of 4 percent on a durable basis.

The Fiscal Situation

4. The government is committed to fiscal prudence. The central government finances have achieved substantial consolidation since 2013-14, helped by buoyancy in tax revenues and rationalization of subsidies. The gross fiscal deficit (GFD) was brought down to 3.5 per cent in 2016-17 without sacrificing public investment needs and social sector spending. Though 3.2 percent GFD was budgeted for FY 2017-18, this has been revised upwards to 3.5 percent. The government has budgeted a lower order of GFD of 3.3 percent for FY 2018-19. Further, the government has resolved to achieve a target of 3 percent GFD by 2020-21.

5. The Goods and Services Tax (GST) system introduced with effect from July 01, 2017 has reformed the system of indirect taxes of goods and services in one stroke. By subsuming a plethora of central and state level indirect taxes, the GST has simplified and streamlined payments and credits and enhanced the efficiency of inter-state movement of goods. Needless to mention, the implementation of a far-reaching reform like the GST has been complex and painstaking process

in a large country like India. As the tax collection goes up, the capacity to rationalize the slabs and the rates, also will certainly increase. Therefore, these capacities will increase once the total volume of tax collected significantly increases. Also, this tax system will ensure that evasion doesn't take place. Our authorities believe that with the robust implied buoyancy of GST of 1.2, the tax proceeds could be expected to add up to ½ percent of GDP in revenues in each of the next two years. The positive spinoffs from the GST system have enabled bringing a large part of the unorganized sector within the fold of indirect tax system. Our authorities strongly object to the report's reference to domestic risks pertaining to tax revenue shortfalls related to continued GST implementation issues. We would like to emphasize that the disappearance of the initial policy inertia over time will ensure that the future revenue stream from GST is more regular and predictable and not subject to these risks.

6. On the expenditure front, the implementation of public financial management system has strengthened expenditure management, with granular reporting of expenditures. Funds leave the consolidated account only when matched to needs. While the linkage of AADHAR unique identity numbers to Direct Benefit Transfer (DBT) have reduced leakages substantially, the government is incentivizing states for their effort to reduce the outgo on subsidies. Reduction in project cost overruns have further helped to tighten expenditure controls. We differ with staff's views on overshooting of central government's budget deficit owing to transfers to states on account of GST. We reiterate that such transfers are essentially fiscally neutral.

The External Sector

7. In recent years, India's external sector has benefited from lower current account deficit (CAD), robust foreign direct investments (FDI) inflows, build-up of reserves and improvement in other vulnerability indicators. India's foreign exchange reserves stood at US$ 405.8 billion as of July 6, 2018. The CAD to GDP ratio was 0.7 per cent in 2016-17. The CAD ratio increased to 1.9 percent for FY 2017-18.

8. India's exchange rate interventions are meant to prevent disorderly market conditions. Under normal market circumstances, the exchange rate can move flexibly in line with evolving market developments.

9. On the trade front, India is committed to a free and fair international trade system. Although India recently crossed the income threshold for prohibition of subsidies, the Government is of the view that an 8-year transition period should be applicable for unwinding subsidy schemes as was earlier permitted to countries that crossed the said income threshold in 1994 when the WTO's Subsidies and Countervailing Measures Agreement was implemented. Our authorities are deeply concerned about a possible reversal of global trade integration. Following the announcement of the imposition of large steel and aluminum tariffs by the United States, the Indian authorities sought consultations on their consistency with the WTO norms. India is concerned about the compounded effect of actions that may be triggered by these tariffs e.g. safeguard actions initiated by the EU on domestic industry and its possible adverse impact on the global trade system. Moreover, selective exemptions potentially undermine the MFN/ non-discrimination principle. The average MFN applied rate for India for all commodities was 13.1 per cent in 2016. However, for non-agricultural commodities, the applied MFN rate was lower at 9.8 per cent in 2016. By these yardsticks, India's

tariffs are not substantially higher than those of its peer countries, given that it is still at a relatively lower level of economic development. The bound rates have been negotiated based on the level of economic development of the country and the tariffs are well within these bound rates. Besides tariff changes are infrequent and certain changes within the bound rates should not be construed as 'frequent' modifications in tariffs, as has been mentioned in staff report.

10. India has taken several reforms to liberalize services trade. Thus, the assessment of restrictiveness based on the figures using OECD Services Trade Restrictiveness Index (STRI) and the World Bank (WB) STRI may not be appropriate given India's serious objections to the methodology and construction of the STRI, which portrays India as being excessively restrictive despite several reforms. It may also be underscored that while the STRI does not consider several reforms undertaken by India to liberalize services trade, the areas in which the developed countries' regime is most restrictive, *e.g.*, Mode 4, are not reckoned in the calculus of the STRI. Finally, India's FDI regime, which includes investment in services, has been significantly liberalized, with 100 percent FDI being allowed under the automatic route in several sectors. The staff report's reference to statement about restrictions on foreign entry, barriers to competition and lack of regulatory transparency as the main obstacles are unsubstantiated by facts and we object to this characterization of the trade regime in India.

11. Most sectors have been brought under automatic approvals route for foreign investments and caps in different sectors have also been largely relaxed. With the successful implementation of e-filing and online processing of FDI applications, the approval system based on a single window system for FDI has been put in place. The system of inter-ministerial joint quarterly reviews of FDI proposals enable quick processing of foreign investments request. The continuing thrust on liberalization in recent years has given India the unique status of the most open economy in the world for FDI. The UNCTAD's survey of multinational enterprises ranked India as the third most favorite host country for FDI for 2017-19 after the US and China. Gross FDI inflows during FY 2017-18 stood at US$ 60.97 billion compared with US$ 60.22 billion in the previous year, US$ 55.56 billion in 2015-16 and US $ 45.15 billion in 2014-15.

12. The initiatives taken towards ease of doing business have started to bear fruit as can be seen from the World Bank Doing Business (DB) Report, 2018 (released in October 2017), which ranked India 100 among 190 countries, registering a leap of 30 ranks over its previous rank of 130 in the Doing Business Report 2017. A single window portal has been established for receiving FDI applications that require Government approval. The applicants can file online applications on this portal, which are then electronically transferred to the concerned Administrative Ministry/Department. The present system has been functioning smoothly since its inception and average time taken to process the FDI applications has reduced significantly.

The Financial Sector

13. The financial sector is undergoing transformation with a focus on resolution of stressed assets in the banking system, the legal framework for insolvency resolution has been reinforced with the enactment of Insolvency and Bankruptcy Code (IBC), 2016 and amendments made to the Securitization and Reconstruction of Financial Assets and Enforcement of Security Interest (SARFAESI) and Debt Recovery Tribunal Acts. The IBC 2016 provides for a market-determined,

time-bound process for orderly resolution of insolvency, and ease of exit, wherever required. Rules governing voluntary corporate liquidation have since been established by the Insolvency and Bankruptcy Board of India (IBBI) responsible for implementation of IBC 2016. The National Company Law Tribunal (NCLT) and National Company Law Appellate Tribunal (NCLAT) - the arbitration and appellate frameworks - are already functional and have established operational processes for complete resolution of cases brought before them. The implementation of the IBC will contribute to the speeding up of the NPA resolution.

14. Banks' provisioning is improving, and early indications from some of the large cases subject to the IBC process suggest that the provisioning requirements may be sufficient. To mitigate further build-up of balance sheets risks, smaller public sector banks (PSBs) have been advised to reduce their corporate loan exposures by a minimum of 15 per cent by March 2019 and put in place board-approved policies to ensure appropriate loan exposure mix. Meanwhile the Financial Resolution and Deposit Insurance Bill 2017 (FRDI Bill), has been introduced in the Indian Parliament. The Bill envisages constitution of Resolution Corporation to protect consumers of financial service providers from financial distress. The FRDI Bill will complement the IBC, and together, they will provide a comprehensive resolution framework for the entire economy. Our authorities are committed to governance reforms in PSBs and are monitoring the progress through a reporting framework. In fact, governance reforms and action plans to enhance operational efficiency and customer services are integral to the recapitalization package provided to the PSBs.

Agriculture and the Rural Economy

15. Emphasis on the implementation of rural roads program, rural electrification and affordable housing projects have added depth to growth and employment. Continuing the thrust on agriculture and rural sector, the central budget 2018-19 increased allocation for creation of livelihoods and rural infrastructure with an objective to provide maximum opportunities in the rural areas by substantially ramping up spending on agriculture and allied activities and construction of irrigation and other rural infrastructure. In the absence of fair marketing infrastructure, the Minimum Support Price (MSP) system has played an important role in supporting the farmer incomes through fair realization of their produce. The government has initiated measures to double farmers' incomes by 2022 through price support measures, better marketing infrastructure, thrust on exports and enhanced private investments. An Agri-Market Infrastructure Fund is proposed to be set up to develop and upgrade agricultural marketing infrastructure in rural agricultural markets. However, given the wide disparity in nutritional status among the people, the state's role in procurement and distribution of foodgrains to identified beneficiaries will remain significant for supply management and inflation control.

Infrastructure

16. To facilitate international as well as domestic funding in infrastructure, the National Infrastructure and Investment Fund (NIIF) was formed. The objective of NIIF is to attract equity capital from both international and domestic sources for infrastructure investments in commercially viable projects, both greenfield and brownfield, and stalled projects. It will operate with the highest standards of governance, and keep in mind the need to balance transparency and confidentiality among stakeholders and partners. The NIIF Ltd. plans to partner with leading

infrastructure operators, who bring well-rounded industry knowledge from India and around the world to build world class companies in infrastructure and related sectors in India.

17. Budget Announcements 2018-19 emphasised on using innovative monetizing structures like Toll-Operate-Transfer (TOT) and Infrastructure Investment Trusts (InvITs) to monetize select Central Public Sector Enterprises (CPSEs) assets. To improve user services, augment infrastructure investment and create opportunities for the private sector, an asset recycling strategy for mature operational assets is proposed to be introduced across infrastructure sectors covering highways, railways, petroleum, telecommunications etc. through Public Sector Asset Monetization (PSAM). PSAM involves transferring existing public-sector infrastructure assets to institutional investors and private operators to unlock efficiencies and reinvest proceeds in new infrastructure projects. Asset recycling is common in several countries including Australia, US and UK. In recent years, India has begun recycling of infrastructure assets, through models such as Toll-Operate-Transfer (TOT) and Infrastructure Investment Trusts (InvITs) which hold immense potential. The Asset Recycling Model and 100 percent FDI in construction will attract foreign investment in the infrastructure sector as well as help tackle the problem of stressed assets in the banking sector.

Labor Market Reforms

18. Our authorities are addressing labor market rigidities. Four Labor Codes on Wages, Industrial Relations, Social Security and Welfare and Occupation safety, Health and Working Conditions, respectively have been drafted by simplifying, amalgamating and rationalizing the relevant provisions of the existing central Labor Laws. In a key development, the Government amended the prevailing legislation to allow 'fixed term employment' for all sectors. This and other meaures will be instrumental in removing structural rigidities in the labour market, reduce informality and encourage firms to expand and benefit from economies of scale and contribute to productivity gains and higher long-term growth. Labor market rigidities may also partly be responsible for lower female labor force participation. However, lower female labor force participation could also mean higher engagement of females in learning and education. Recent plans to increase the coverage of healthcare and new welfare provisions which cover the informal sector and enhanced paid maternity leave of 26 weeks under the Maternity Benefit (Amendment) Act 2017 should improve female participation in labor force.

Social Protection

19. Social safety nets for the common people have been strengthened with the introduction of affordable insurance and pension schemes. As part of efforts to improve food distribution system, the Government is taking steps to (a) modernize the PDS; (b) introduce best practices; (c) improve the efficiency; (d) bring in transparency in the PDS operations; and (e) enable rightful targeting of food subsidies. The Department of Food & Public Distribution in collaboration with States is implementing a scheme on 'End-to-End Computerization of PDS Operations'. Activities under the scheme include digitization of ration cards/beneficiaries, online allocation of foodgrains, computerization of supply chain management, setting up transparency portals and online grievance redressal mechanisms. Seeding of AADHAR numbers with digitized ration cards/beneficiary database is also being done.

20. The central budget for FY 2018-19 has introduced the flagship 'National Health Protection Scheme' which will cover 100 million poor and vulnerable families in the country, or about 500 million beneficiaries, with a defined benefit cover of Rs. 0.5 million per family per year for secondary and tertiary care hospitalization. To step up investments in research and related infrastructure in premier educational institutions, including health institutions, a major initiative named 'Revitalizing Infrastructure and Systems in Education (RISE) by 2022' with a total investment of Rs.1000 billion in next four years is envisaged.

Conclusion

21. Our authorities are pursuing a balanced policy agenda, which combines macroeconomic stability, fiscal prudence, financial robustness and a sustainable external sector with long-term objectives of building infrastructure, rural development and a dynamic labor market, which promotes job growth with gender equity. Integral to this strategy are welfare and social protection priorities, which are being addressed with a mix of instruments including, significantly, an ambitious and far-reaching digitization initiative. They are confident that this agenda will facilitate rapid, stable, sustainable and equitable growth over the long term.