



Economic Outlook for India and Nepal in Global Context

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Global Setting

- Gradual upturn in growth outlook as tail risks recedes

Asia Outlook

- Resilience and growth pick-up as capital inflow returns
- Risks and policy challenges

India & Nepal Outlook

- Growth to recover but only moderately. Domestic reforms are the key concerns

Global Setting

Main Messages

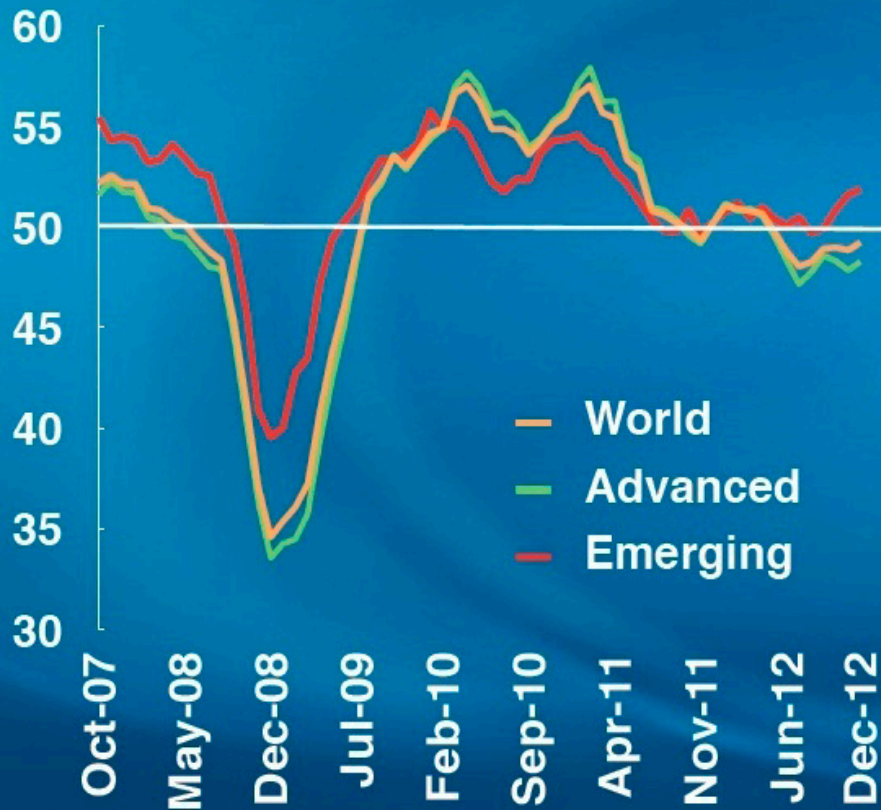
- Global recovery expected later this year—acute risks diminished
- Yet downside risks remain significant
- So policy action needed to secure recovery

World Economy: Tail risks receding...

Global

Global Manufacturing PMI

(Index; >50 = expansion; SA)



Selected Europe: Sovereign CDS Spreads

(In basis points; 5-year senior debt)



Source: IMF, Global Data Source.

Sources: Thomson Reuters Datastream; and Haver Analytics.

Global outlook remains subdued

Global

Growth Projections (Year-on-year percent change)



Real GDP Growth (Year-on-year percent change)

	2012	2013
World	3.2	3.5
Advanced economies	1.3	1.4
Emerging economies	5.1	5.5



Source: IMF, World Economic Outlook.

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IMF global GDP forecasts recently marked down

WEO Real GDP Growth Projections

(percent change from a year earlier)



	World	U.S.	Euro Area	Japan	Brazil	Russia	India	China
2012								
(Jan 2013)	3.2	2.3	-0.4	2.0	1.0	3.6	4.5	7.8
(Oct 2012)	3.3	2.2	-0.4	2.2	1.5	3.7	4.9	7.8
(Jul 2012)	3.5	2.0	-0.3	2.4	2.5	4.0	6.1	8.0
2013								
(Jan 2013)	3.5	2.0	-0.2	1.2	3.5	3.7	5.9	8.2
(Oct 2012)	3.6	2.1	0.2	1.2	4.0	3.8	6.0	8.2
(Jul 2012)	3.9	2.3	0.7	1.5	4.6	3.9	6.5	8.5

Asia Outlook

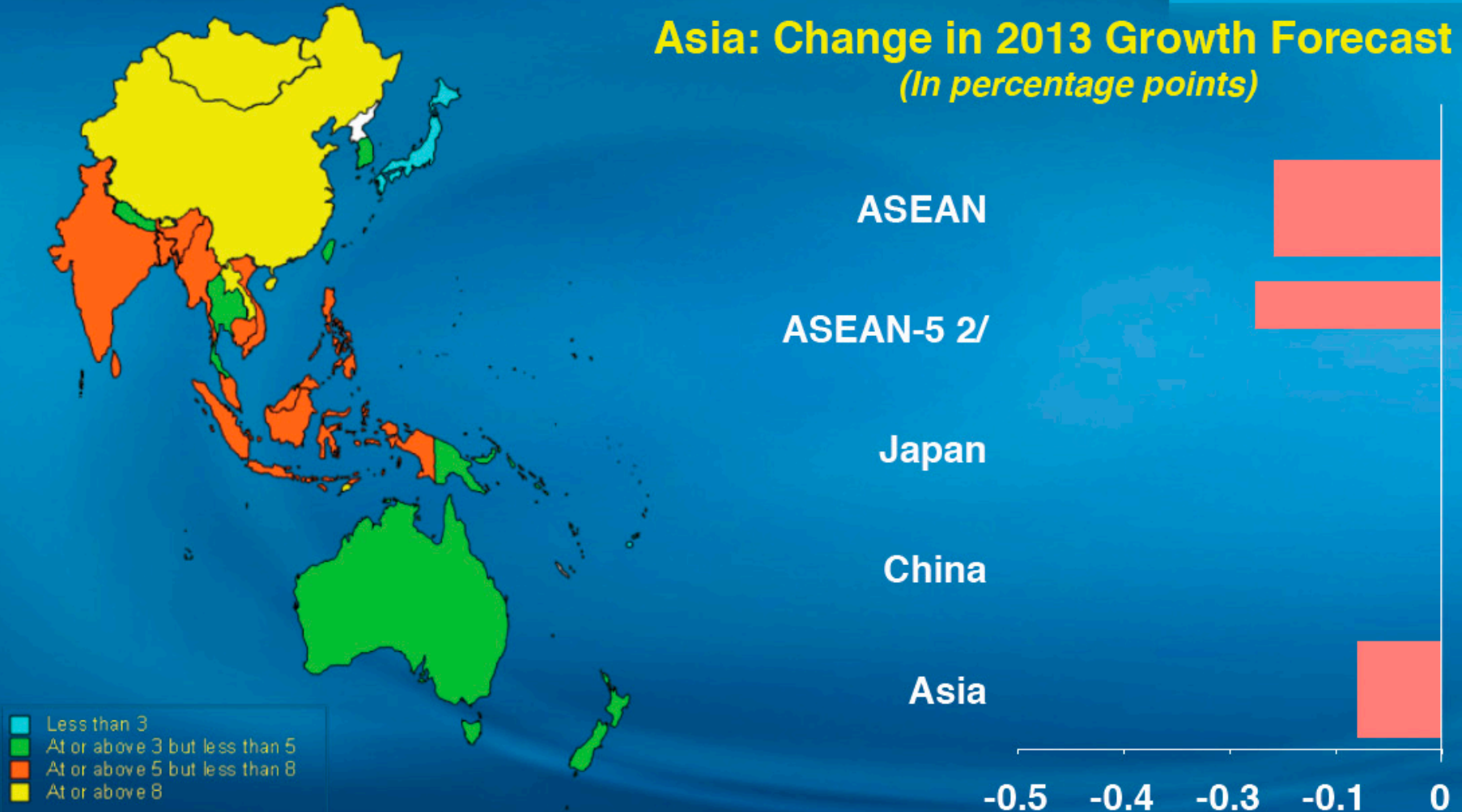
Main Messages

- Asia is still global growth leader
- Recovery of demand for most countries, leading to capital inflows
- Most countries have some fiscal space, but not India or Japan
- Try to avoid “middle income trap”

Asia remains global growth leader, but some downward revisions to forecasts.

Outlook and Risks

Asia: Change in 2013 Growth Forecast 1/ (In percentage points)



Source: IMF, World Economic Outlook.

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1/ Compared with October 2012 WEO projections.

2/ ASEAN-5 includes Indonesia, Malaysia, the Philippines, Singapore, and Thailand.

Growth has stabilized across the region... Except in Japan

Asia: Changes in Real GDP at Market Prices (In percent)

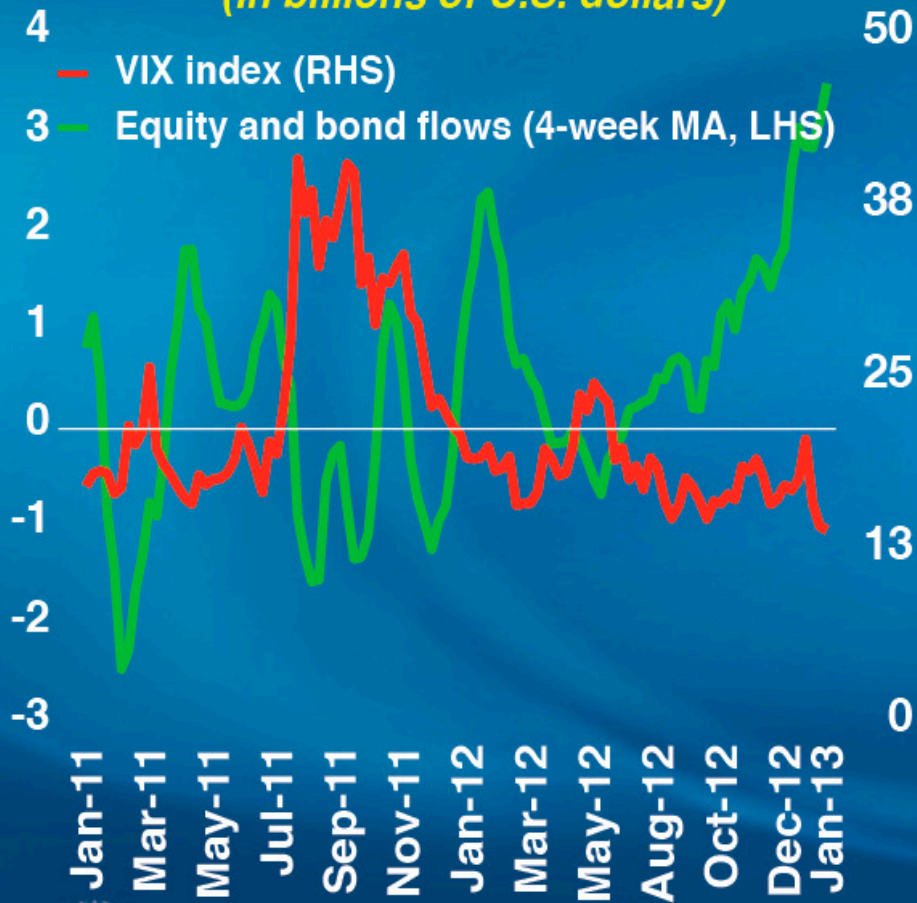
Asia



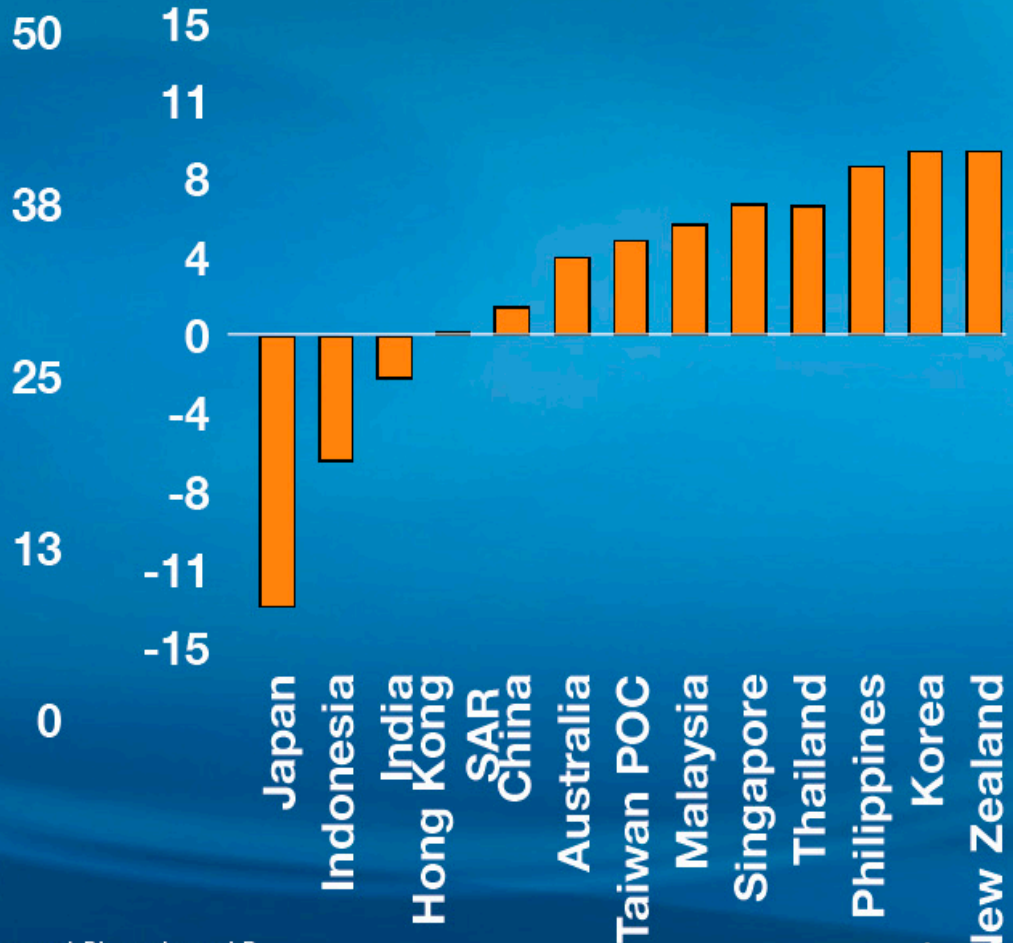
Sources: CEIC Data Co.Ltd; Haver Analytics; and IMF staff calculations.
1/ Includes Indonesia, Malaysia, the Philippines, Singapore, and Thailand.

Portfolio inflows have clearly picked up, resulting in currency appreciation in many EMs.

Emerging Asia: Equity and Bond Funds Net Flows
(In billions of U.S. dollars)



Changes in Bilateral Exchange Rates
(Percentage change in US\$ to national currency)

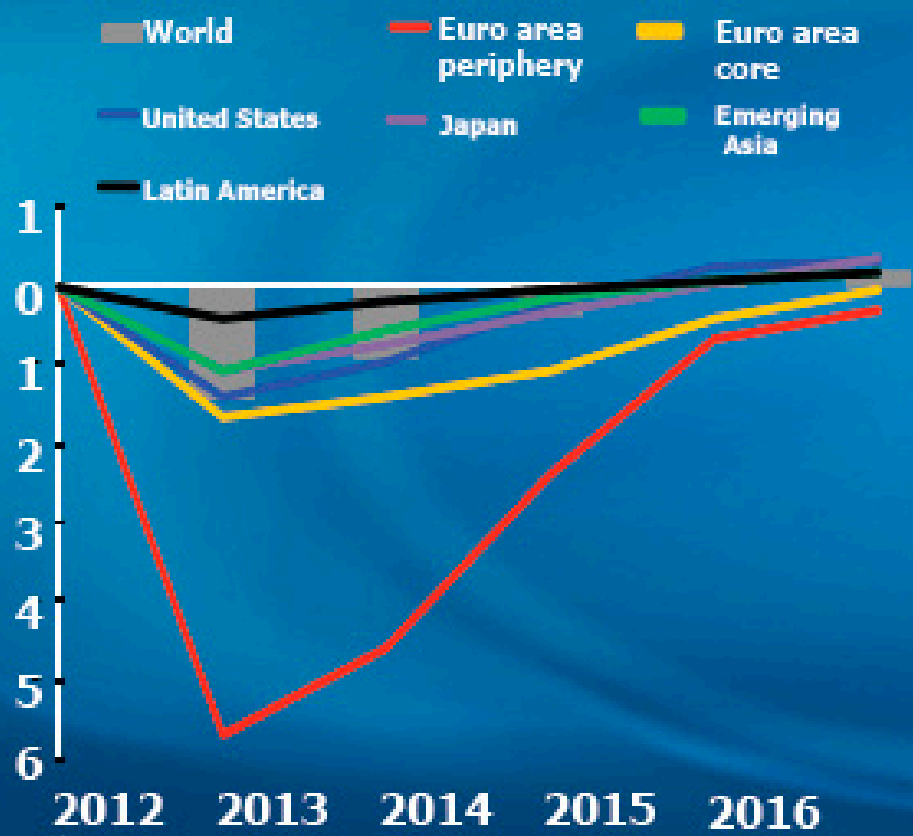


Sources: EPFR Global accessed through Haver Analytics; and Bloomberg LP.

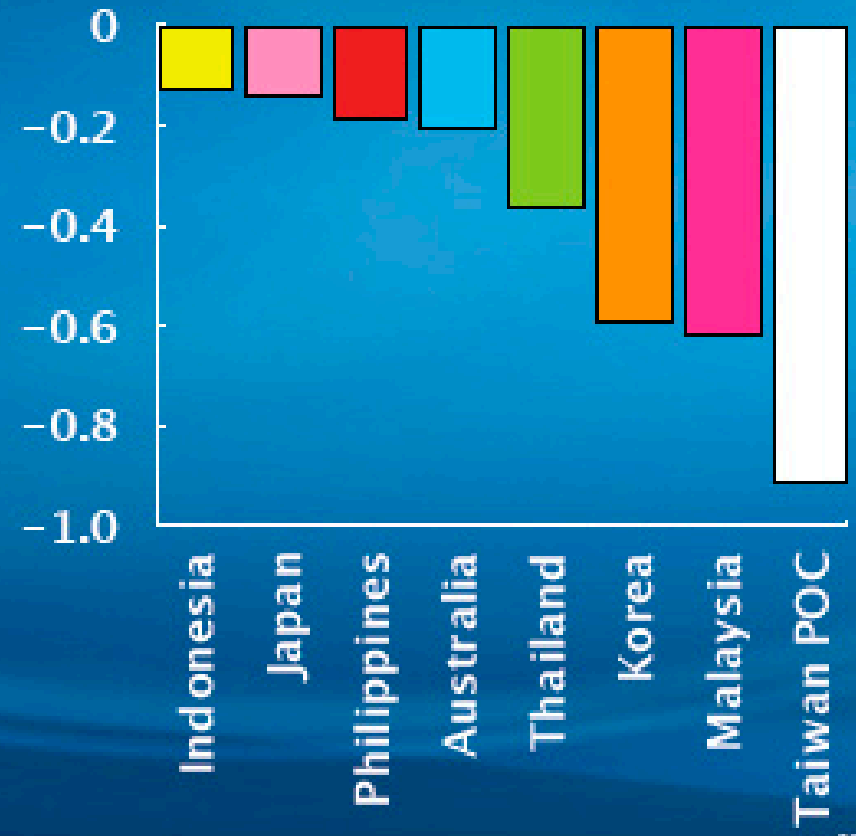
Major downside risks: Escalation of the Euro area crisis and renewed China slowdown...

Near-term Challenges

Euro Area Downside Scenario (GDP growth; percentage deviation from baseline)



China Investment Slowdown (1 pct point): Impact on Growth (in percentage points)

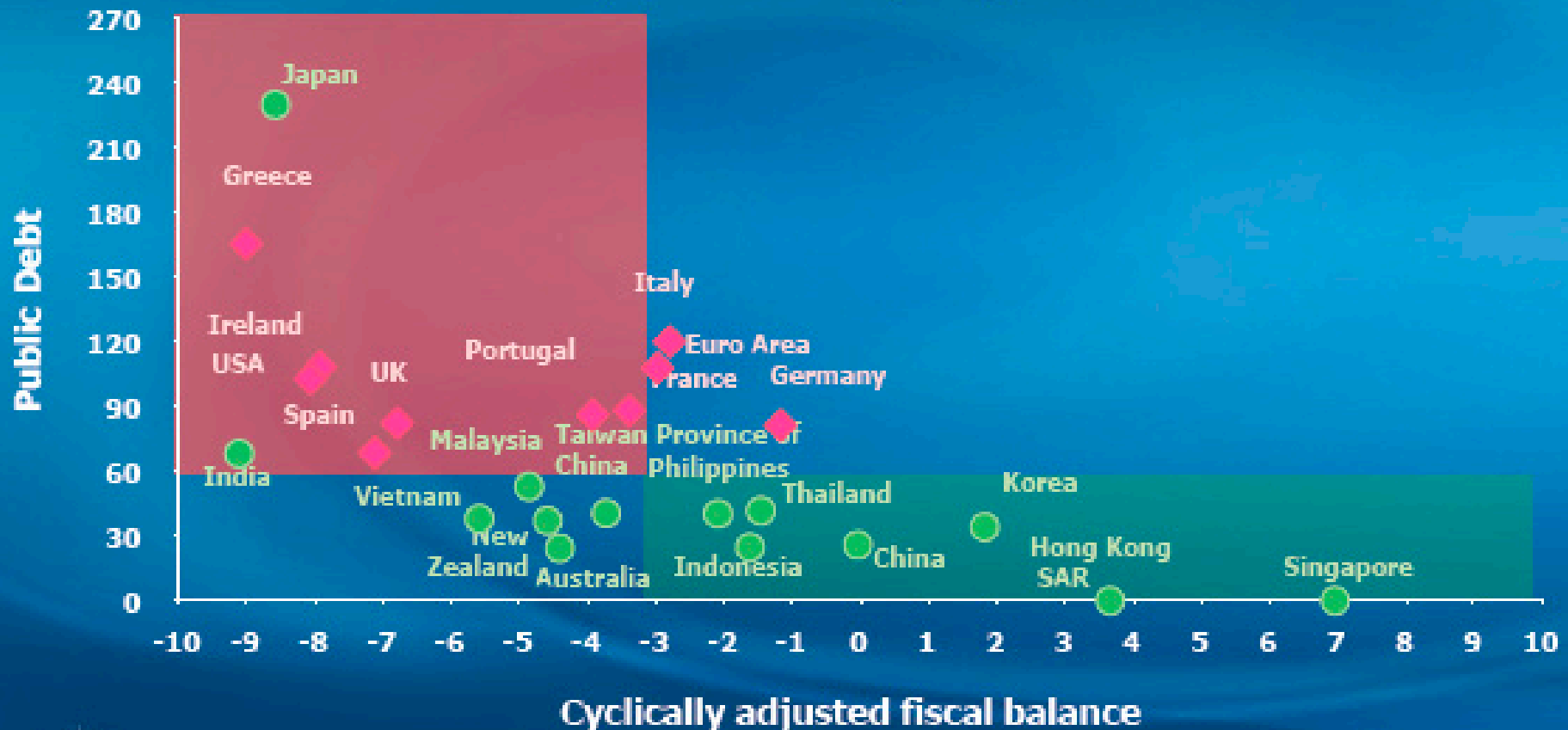


Source: IMF staff estimates.

Fiscal Policy: Need to maintain fiscal space, but room to cushion new external shocks

Near-term Challenges

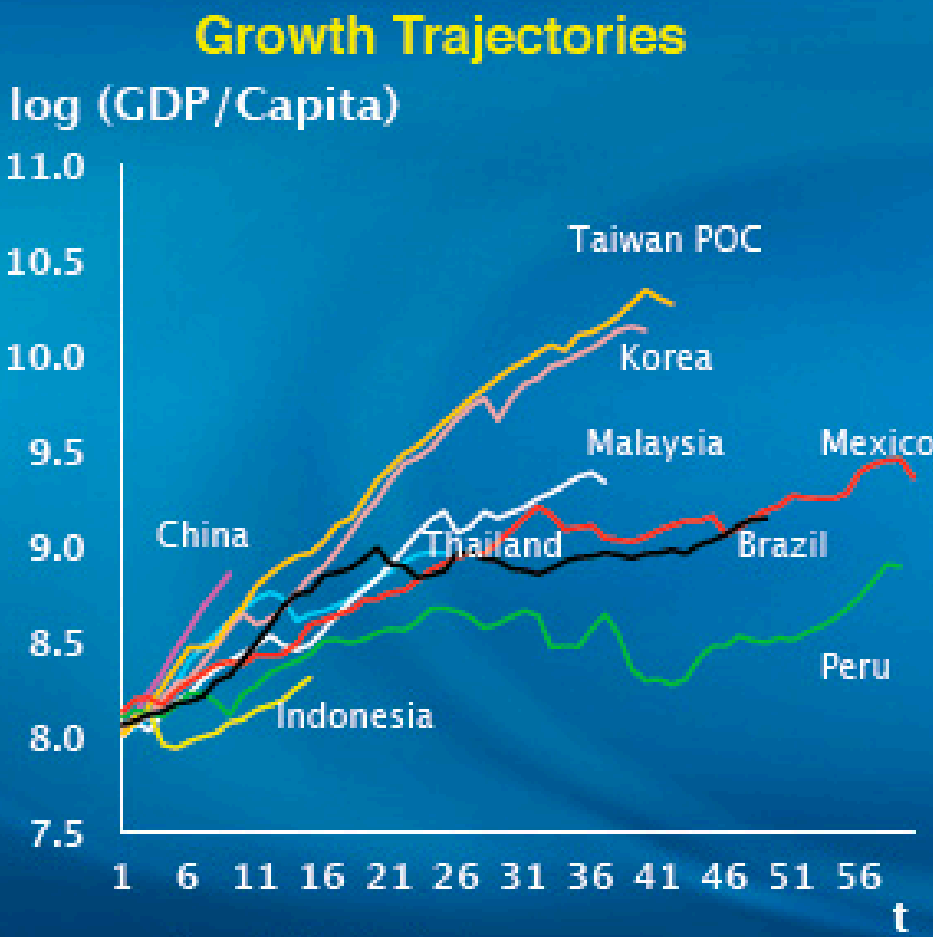
Cyclically Adjusted Fiscal Balance versus Public Debt (In percent of GDP, 2011)



Source: IMF, World Economic Outlook.

Broader challenges: Avoiding middle-income trap, and achieving inclusive growth.

Medium Term Challenges



Source: IMF staff estimates.
 Note: t=0 is defined as the year when the GDP/capita for a particular country reached US\$ 3000 in PPP terms.



Sources: World Bank, World Development Indicators, PovCal database; OECD; IMF staff calculations.



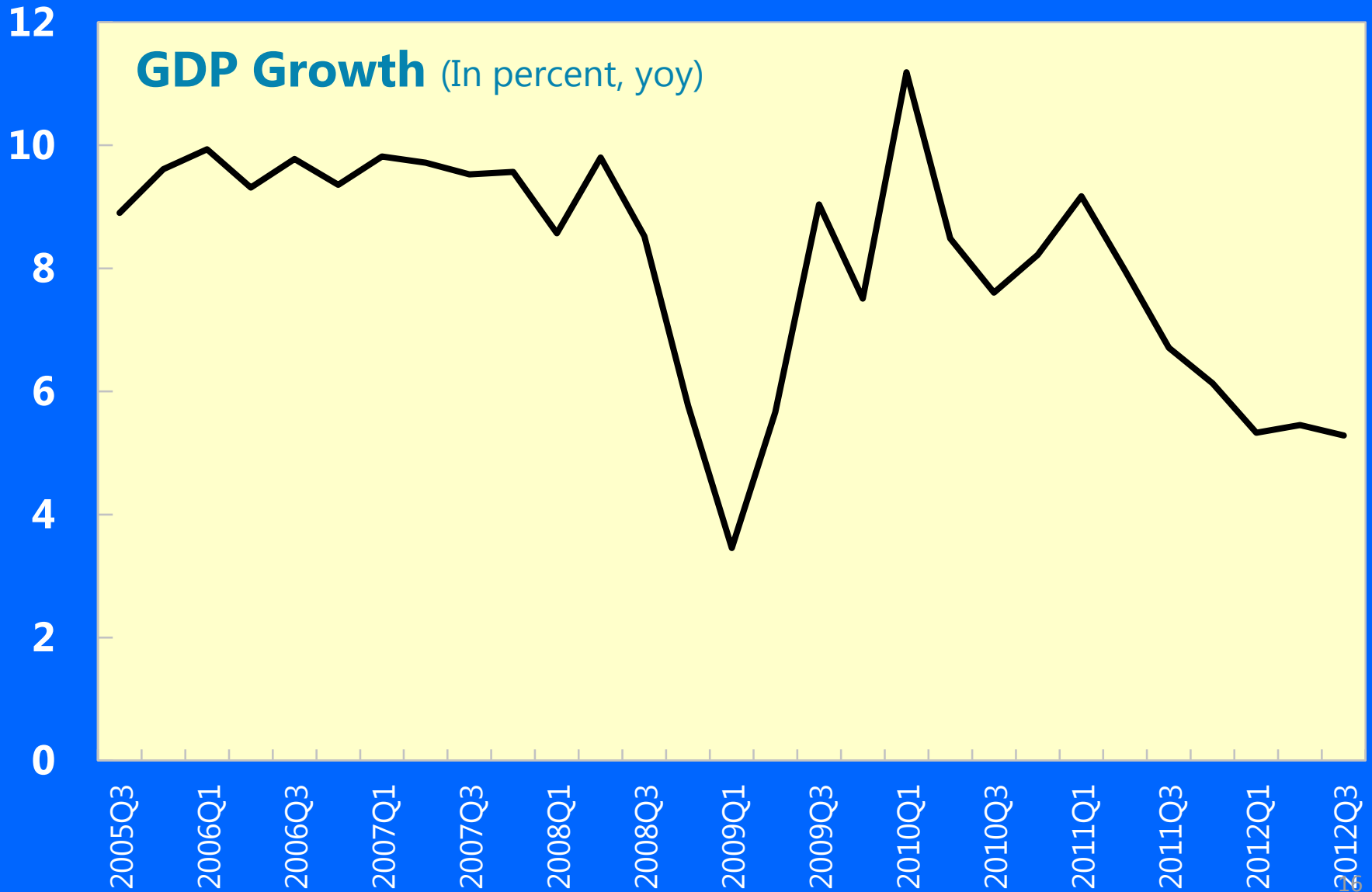
India Outlook

India's economy to witness subdued growth in 2013...

Growth Outlook

- **The growth slowdown has become generalized and has led to large downward revisions in projections.**

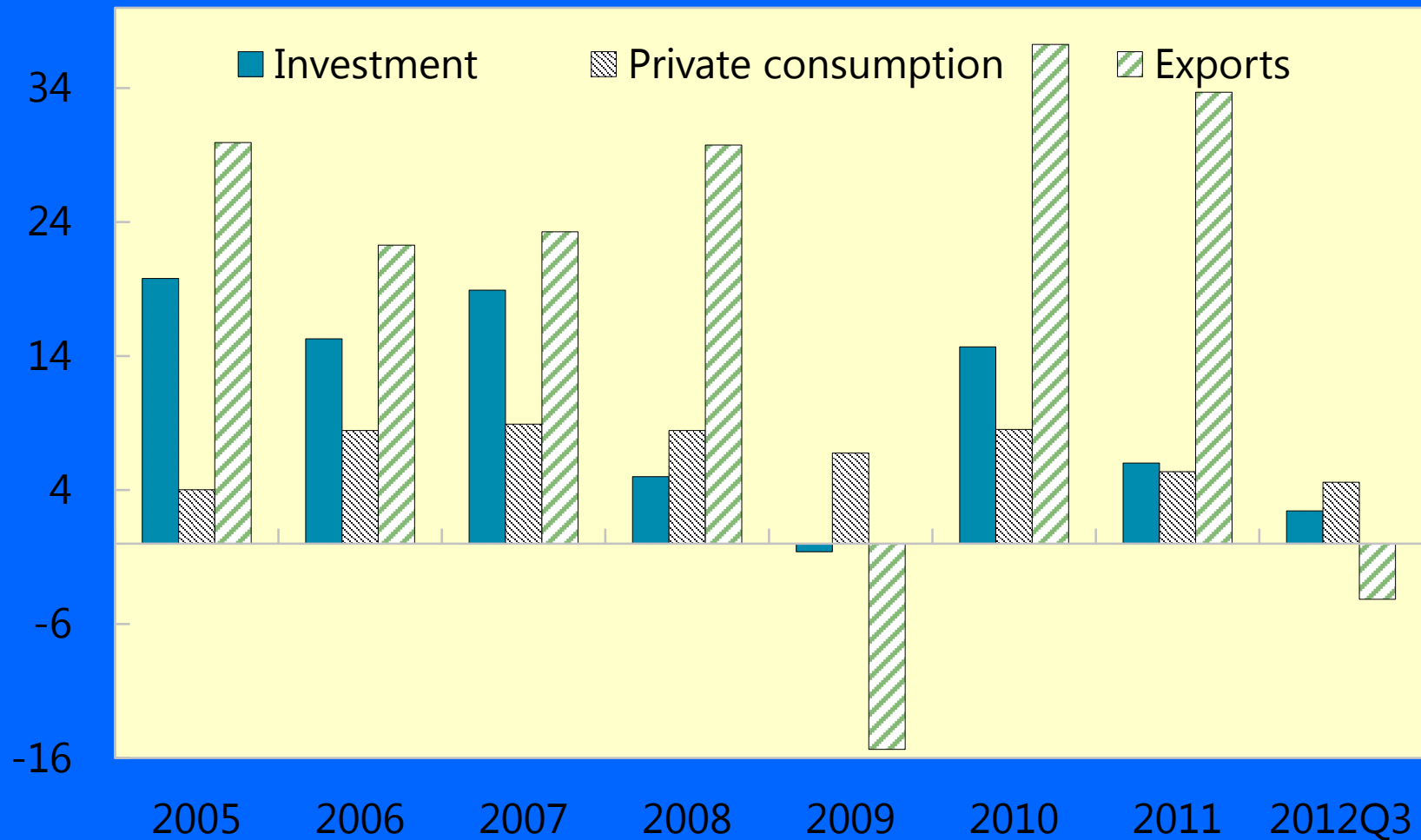
India's growth has decelerated sharply over the past year and half



What started as an investment slump has become a generalized slowdown.

Demand Components of GDP

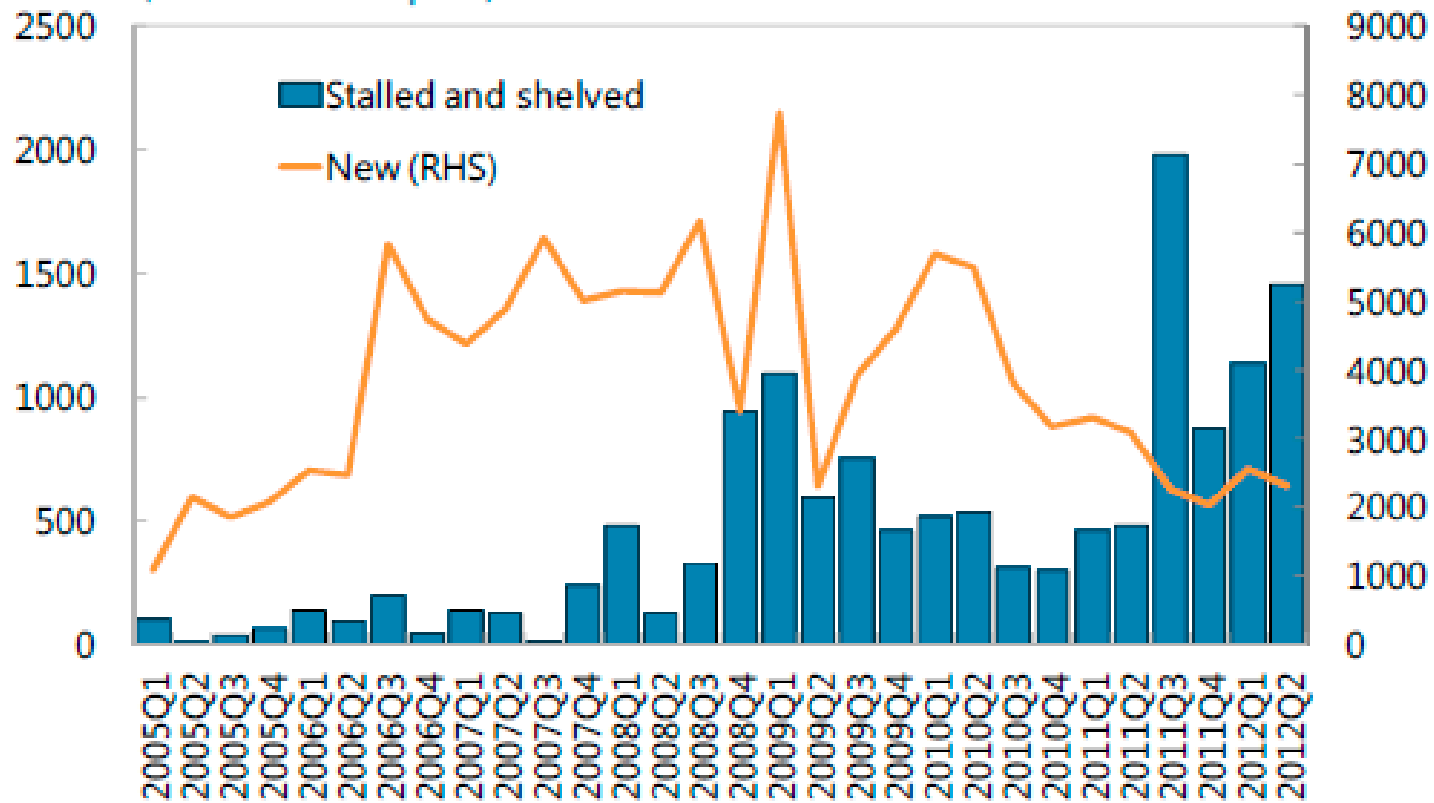
(In percent, yoy)



New investment project are sharply down and many projects are stalled or being shelved

Investment

(In billions of Rupees)

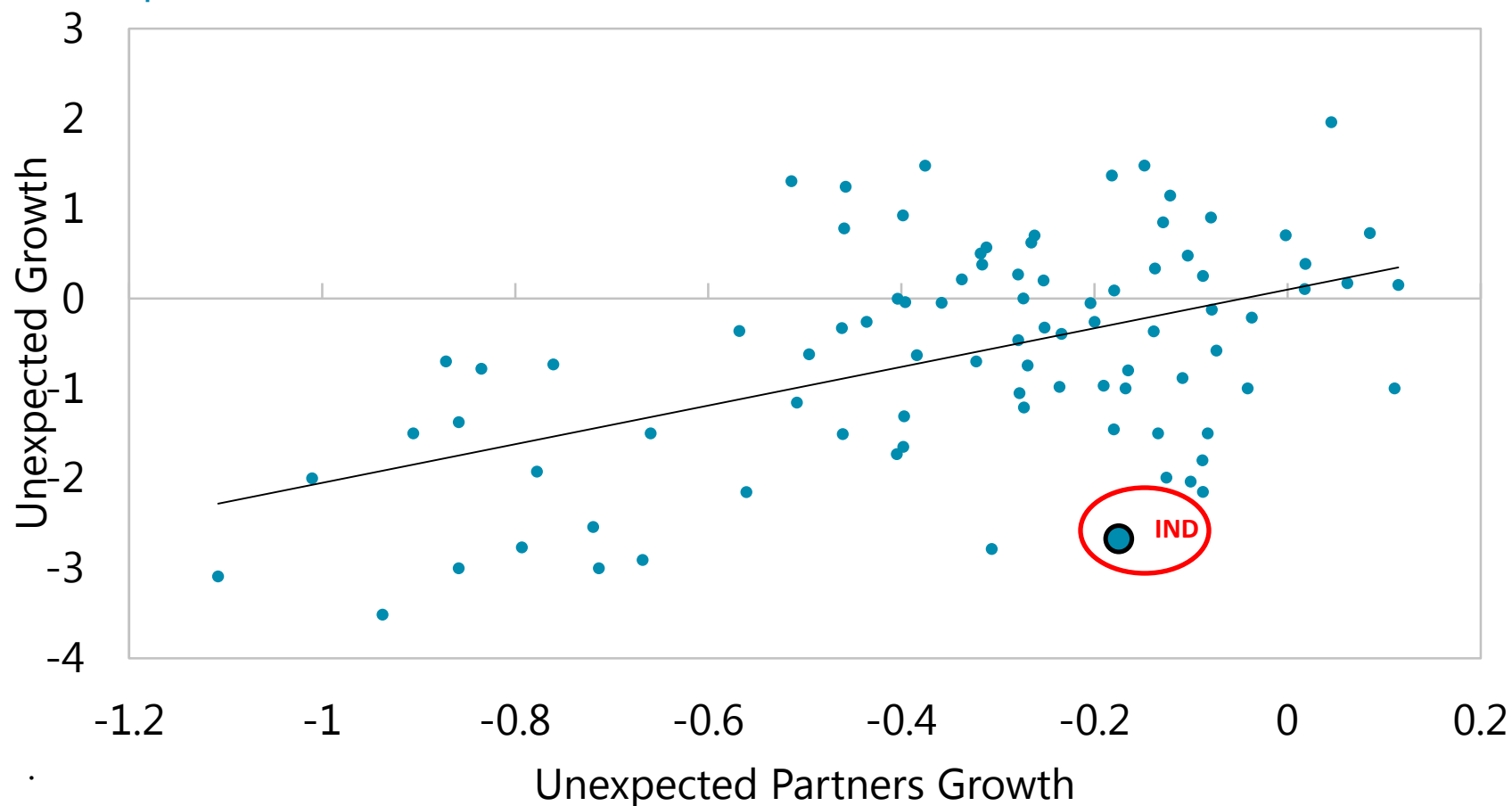


Source: CMIE.

GDP growth has slowed more than external factors can explain.

The 2012 Slowdown: More than External Spillover

(In percent)



Inflation to remain elevated ...

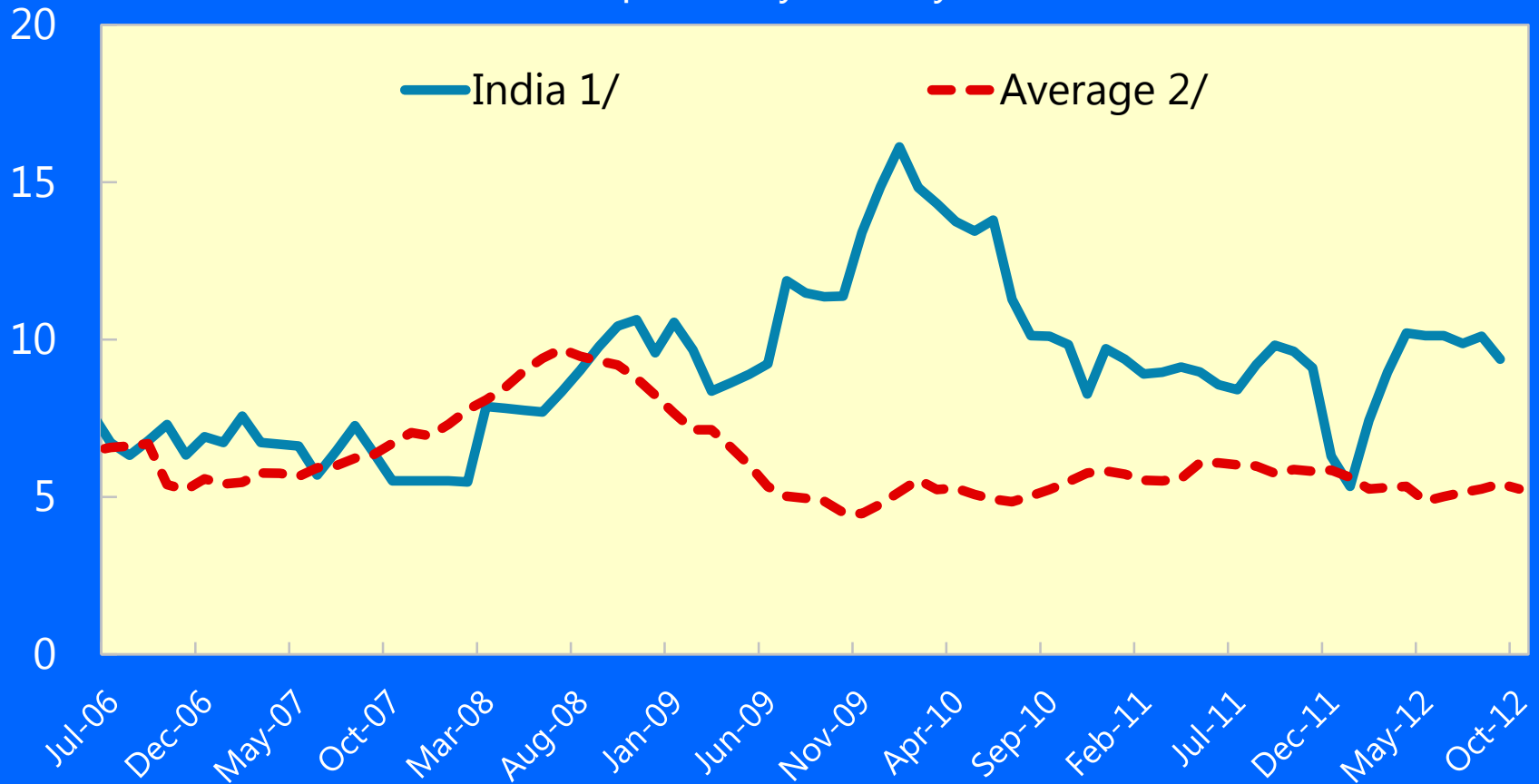
Inflation Outlook

- **Inflation pressures have moderated, but remain substantial**

Inflation remains well above the average of other emerging market economies

Inflation

(In percent year on year)



Sources: Haver Analytics and staff calculations

1/CPI Industrial Workers

2/ Brazil, Russia, China, South Africa, Indonesia, Turkey, Mexico

Banking sector is under some stress...

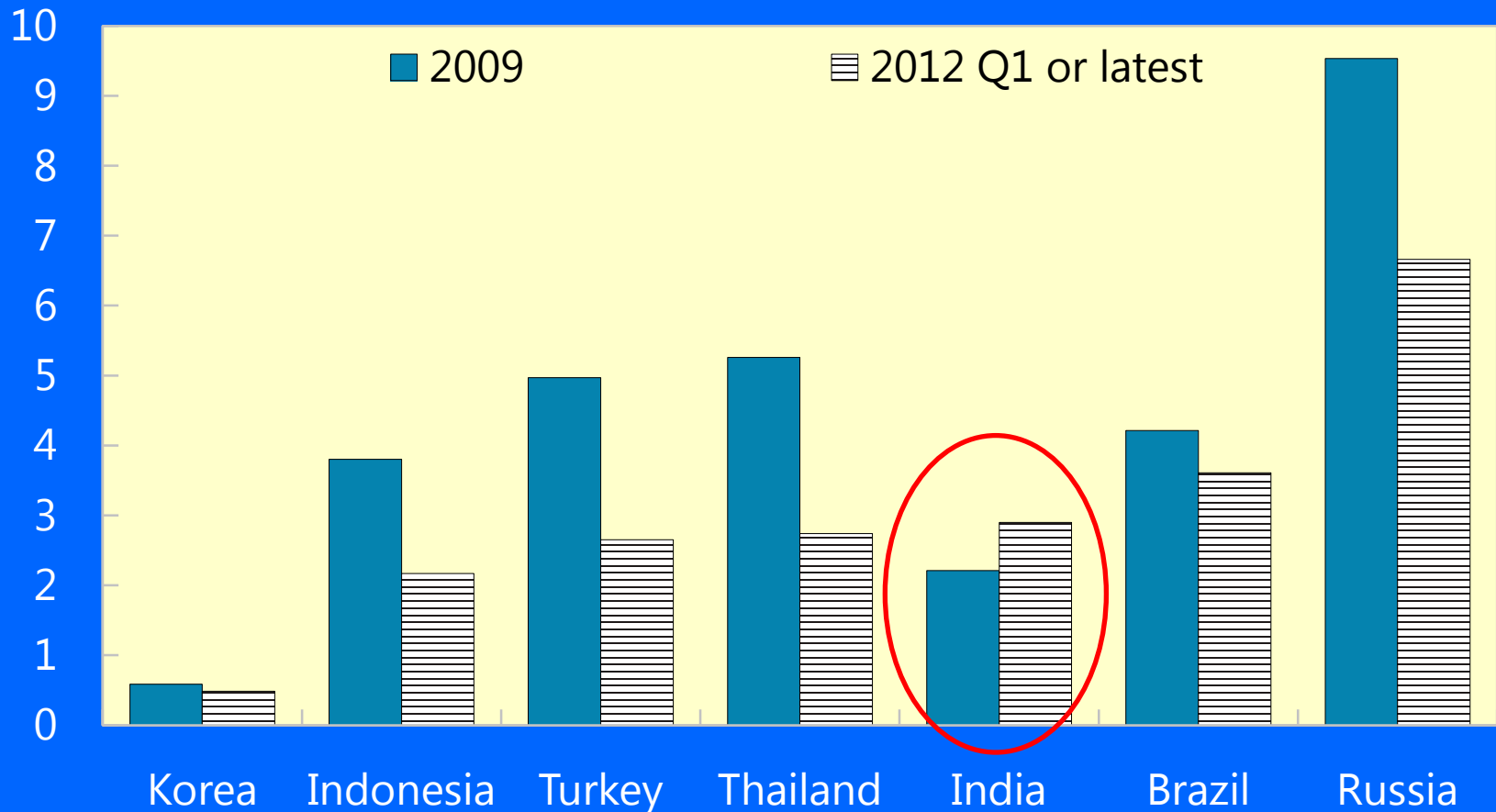
Banking Sector Outlook

- **The banking system has seen a significant deterioration in asset quality, with public banks underperforming private banks.**

... resulting in a deterioration of asset quality

Non Performing Loans

(In percent to total gross loans)

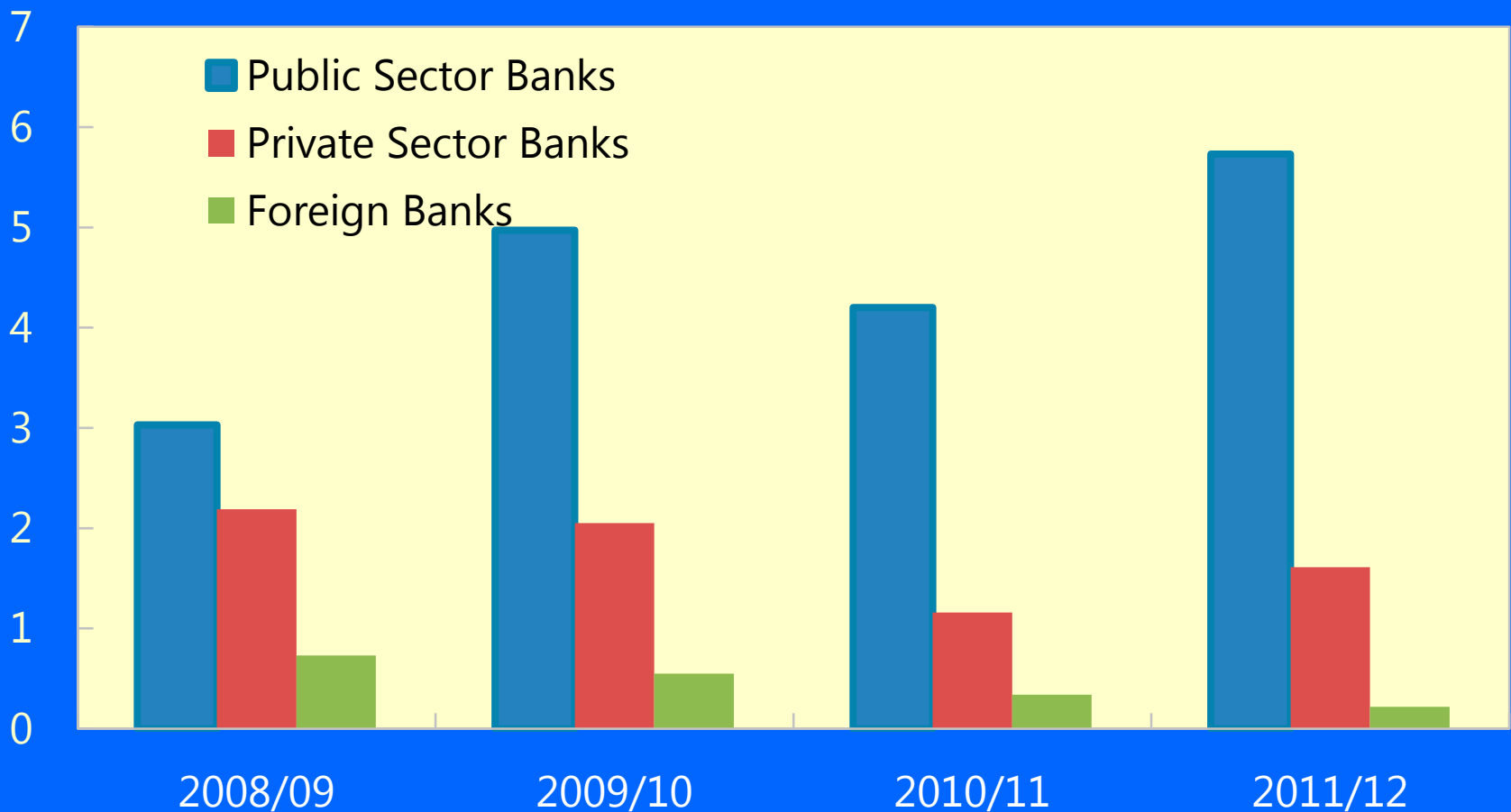


Sources: IMF, Financial Soundness Indicators; Country authorities; and CEIC Data Company.

Restructured loans have risen sharply, especially in PSU banks

Outstanding Restructured Advances

(In percent of gross advances)



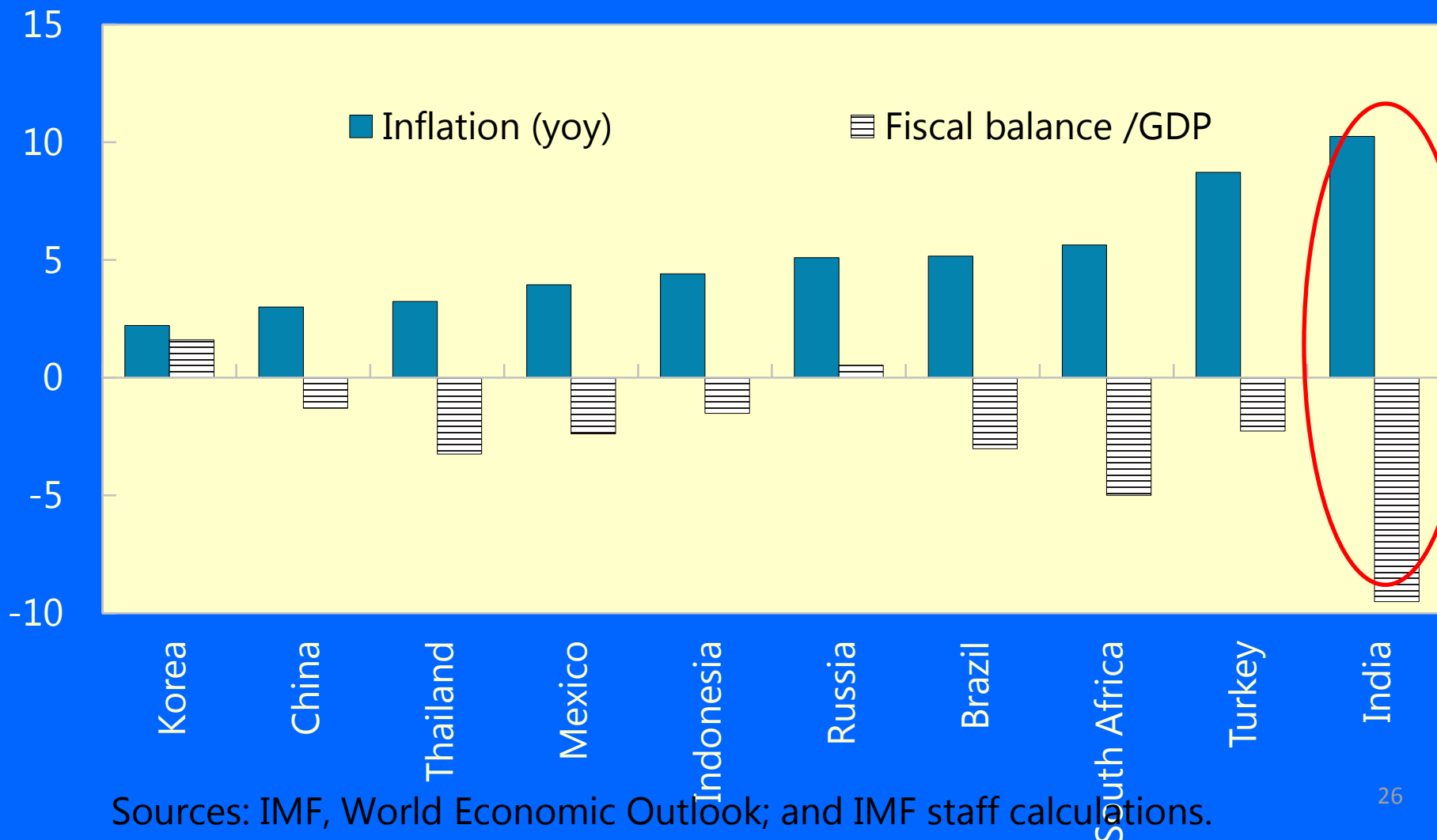
Fiscal space to remain limited over near term...

Fiscal
Sector
Outlook

- **The post-crisis fiscal consolidation came to a halt, but may now be picking up**

India's fiscal deficits are large compared to other EMs

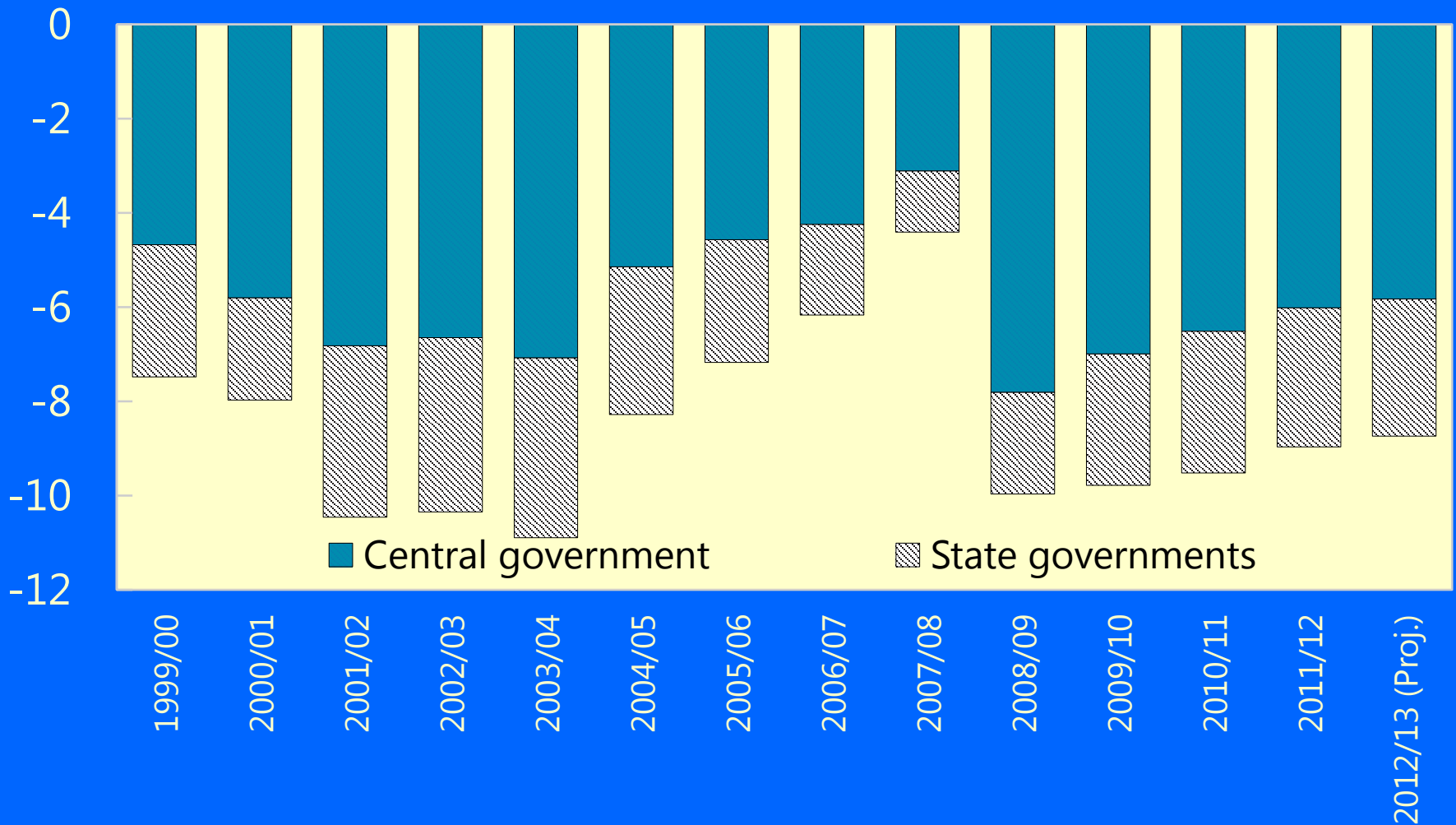
Inflation and Fiscal Balance, 2012 (In percent)



Sources: IMF, World Economic Outlook; and IMF staff calculations.

The budget deficit has been falling only slowly since the global financial crisis.

Government Balance (In percent of GDP) 1/

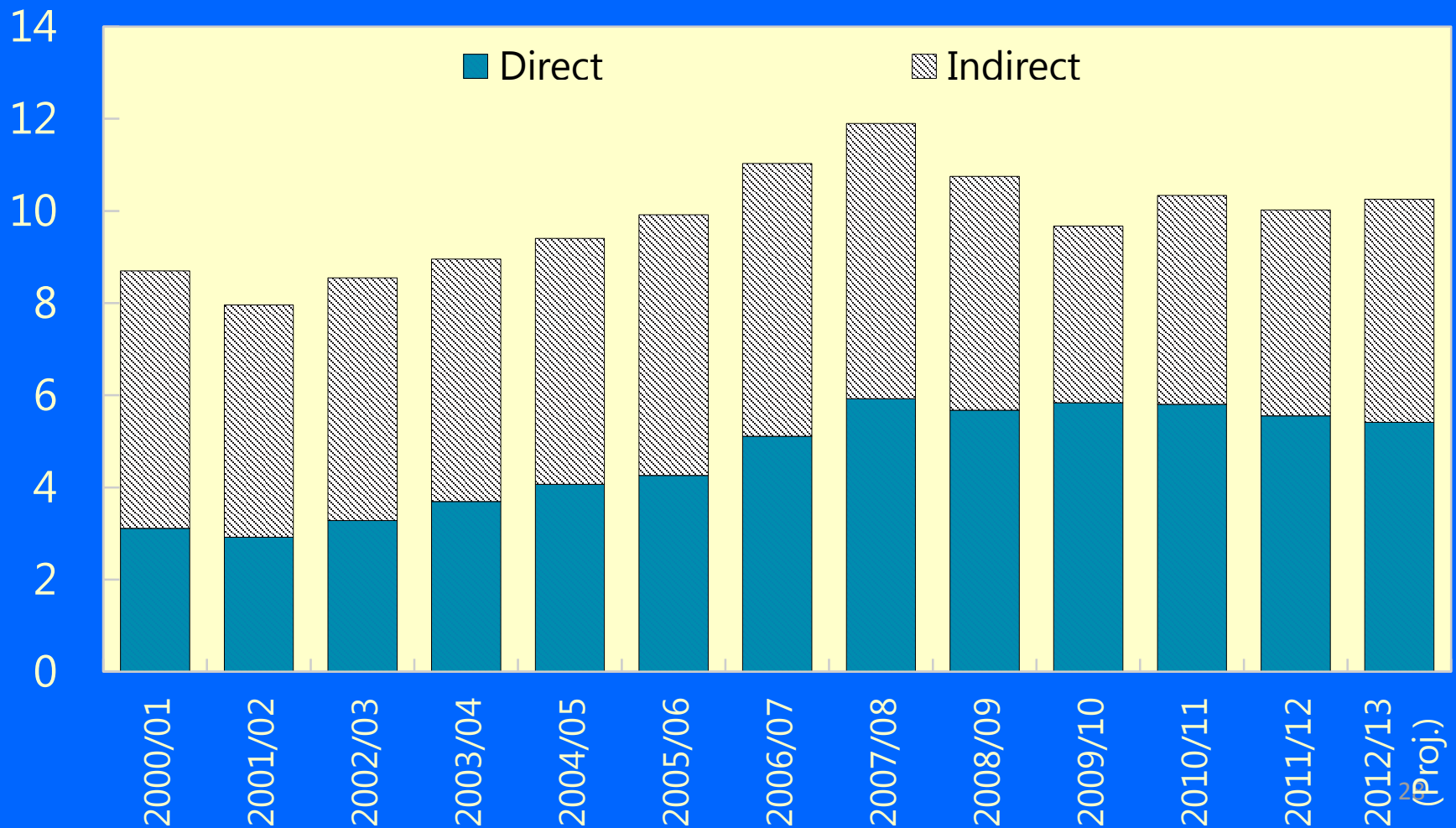


1/ Includes subsidy-related bond issuance.

Tax revenue remains below levels reached before the global financial crisis.

Central Government Revenue

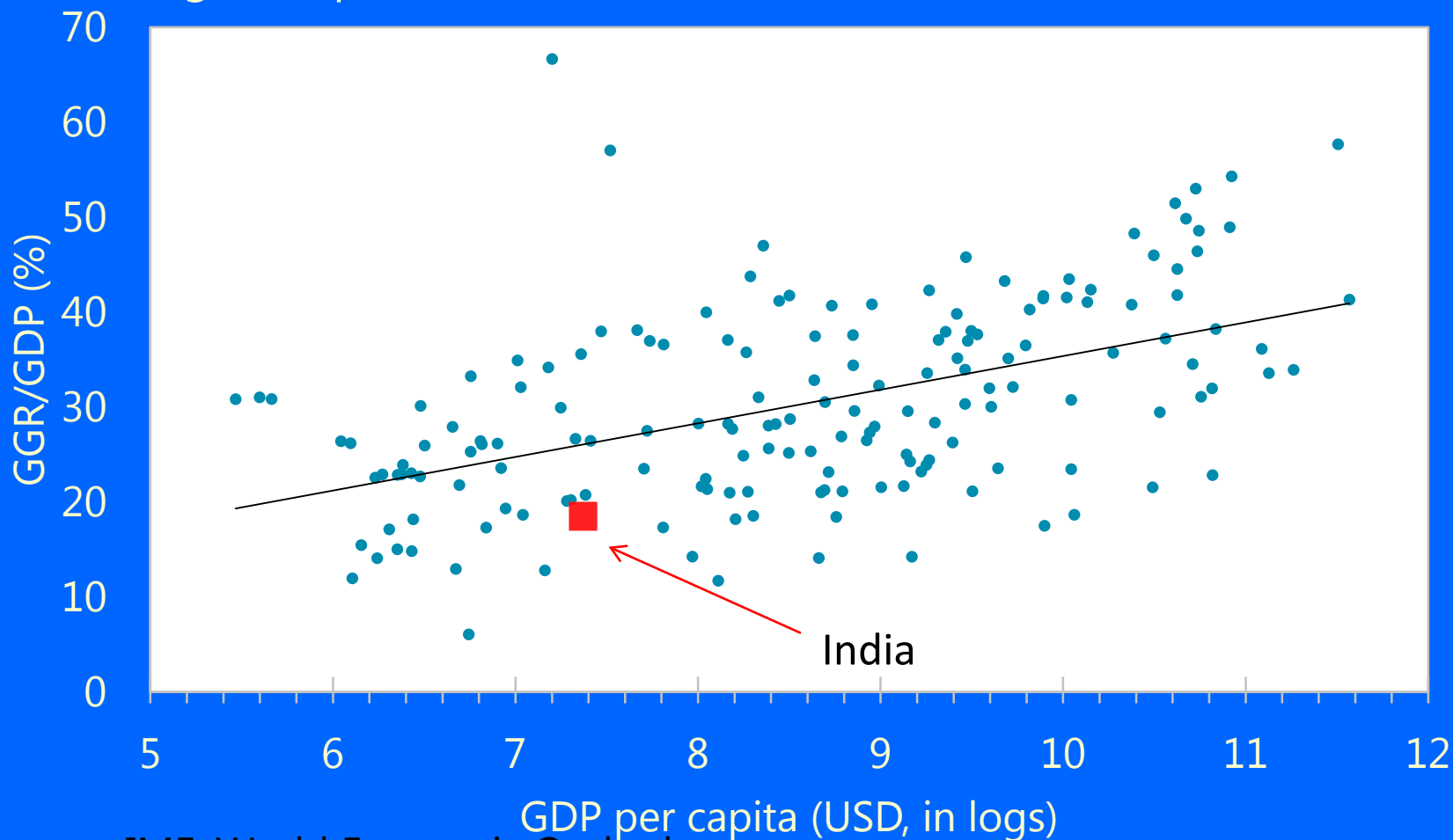
(In percent of GDP)



Cross-country comparison: India's fiscal revenue is on the low side

General Government Revenue and GDP per capita, 2012

(excluding oil exporters and microstates)



External vulnerability has increased...

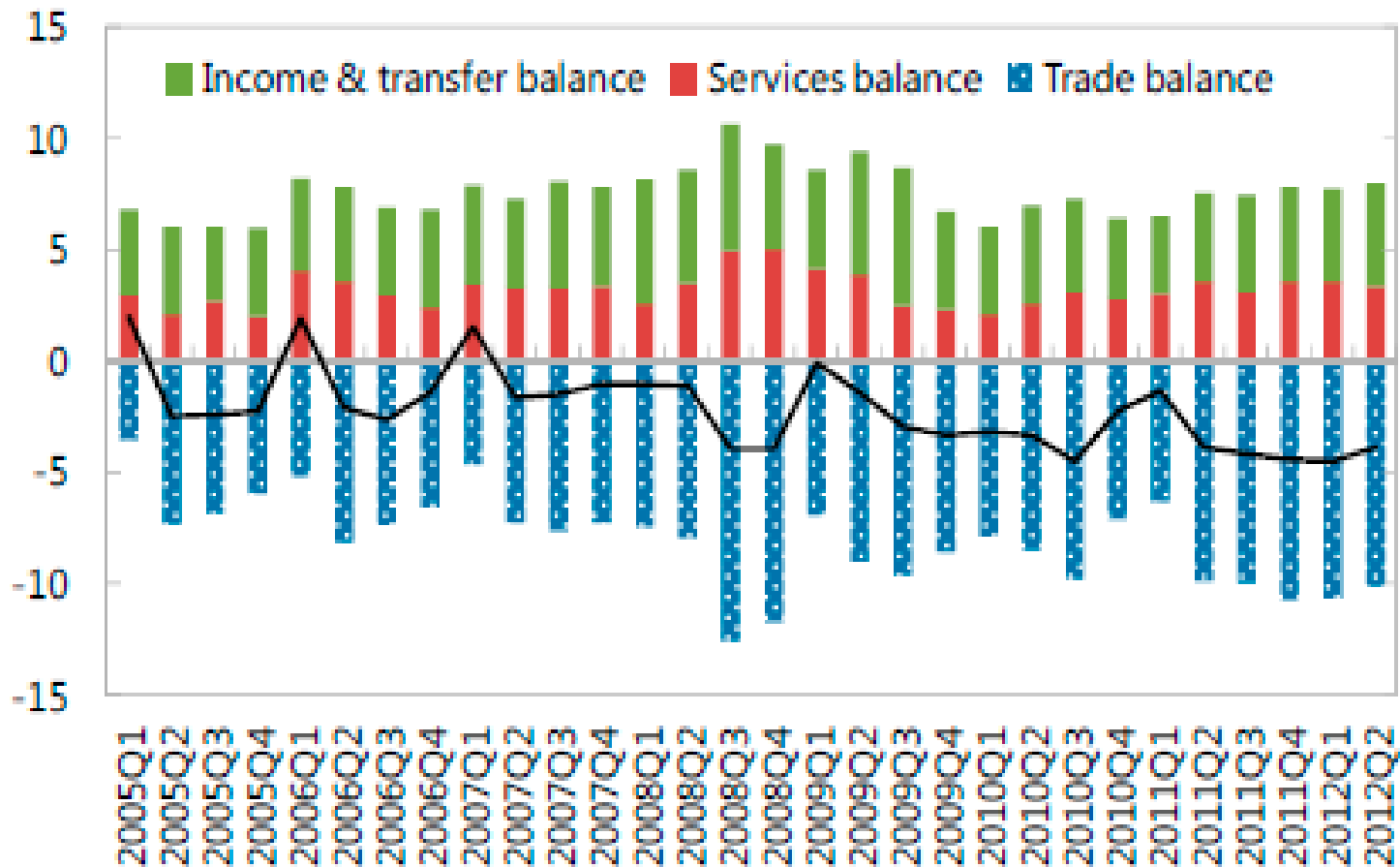
External Sector Outlook

- **The current account deficit widened on the back of a rising trade deficit**

The current account deficit has widened, but remains manageable

Current Account Balance

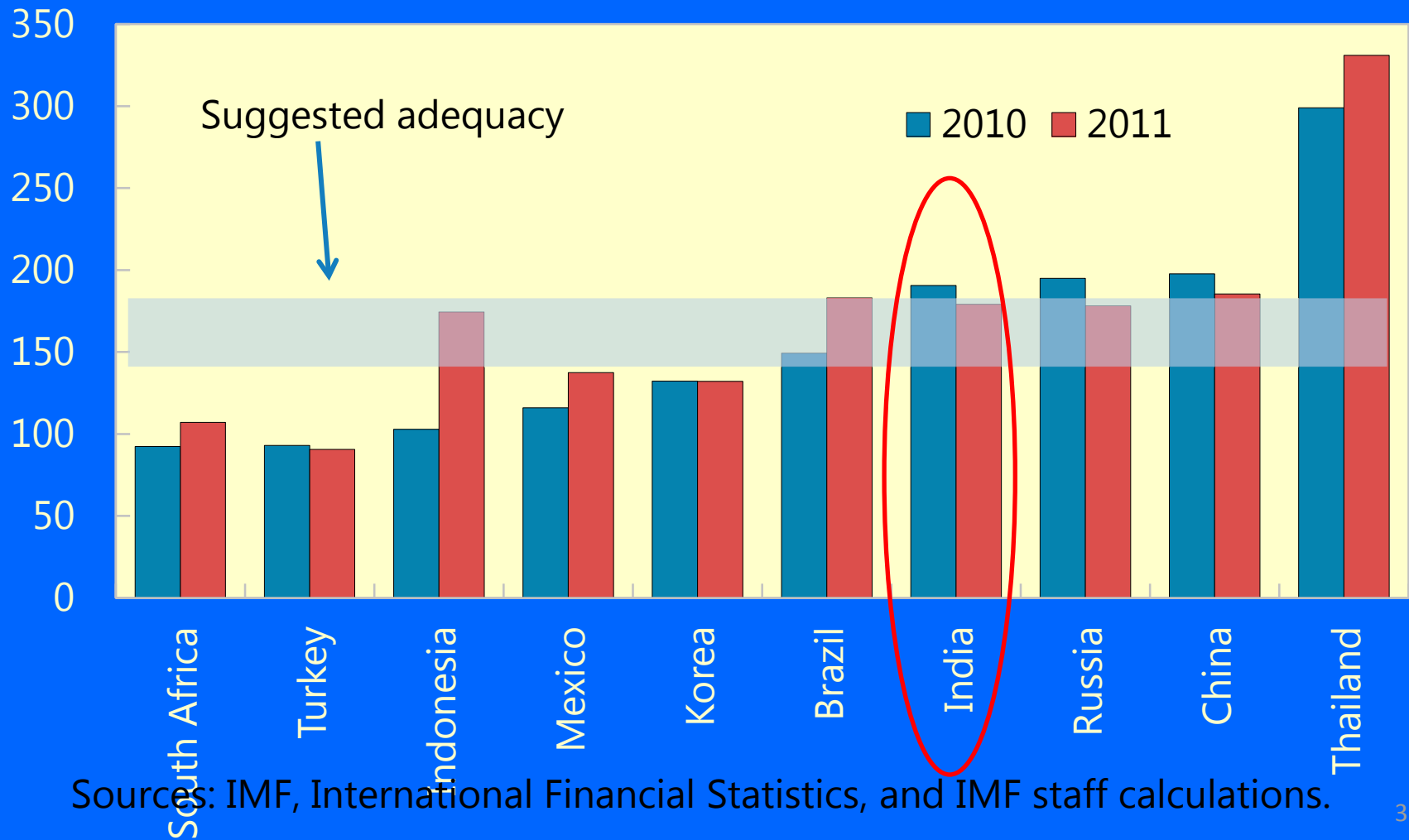
(In percent of GDP)



Although RBI's reserve coverage is adequate...

Estimated Reserve Adequacy

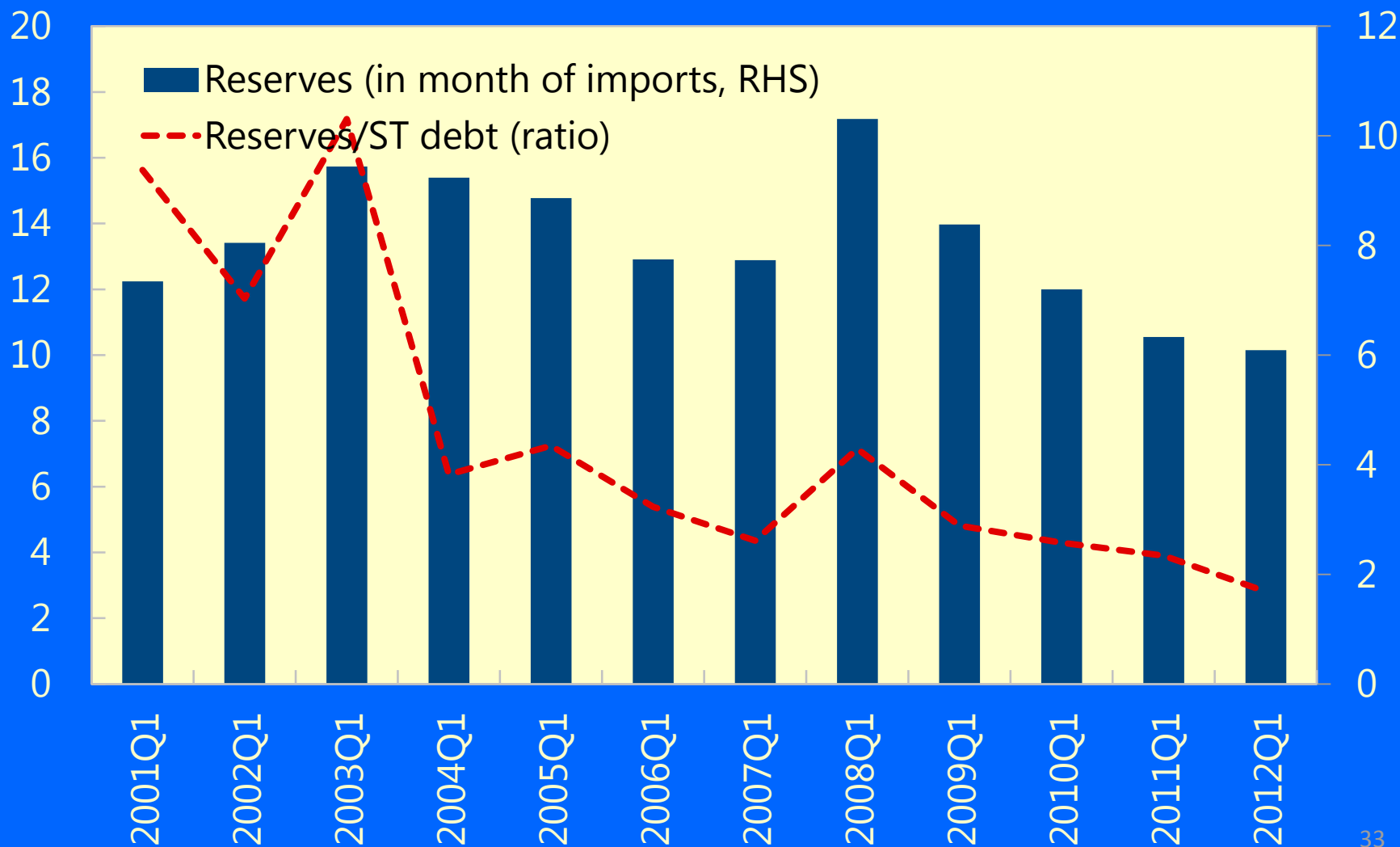
(Official reserves as a percent of IMF country-specific metric)



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

...it has deteriorated somewhat in recent years

India: Reserve Coverage

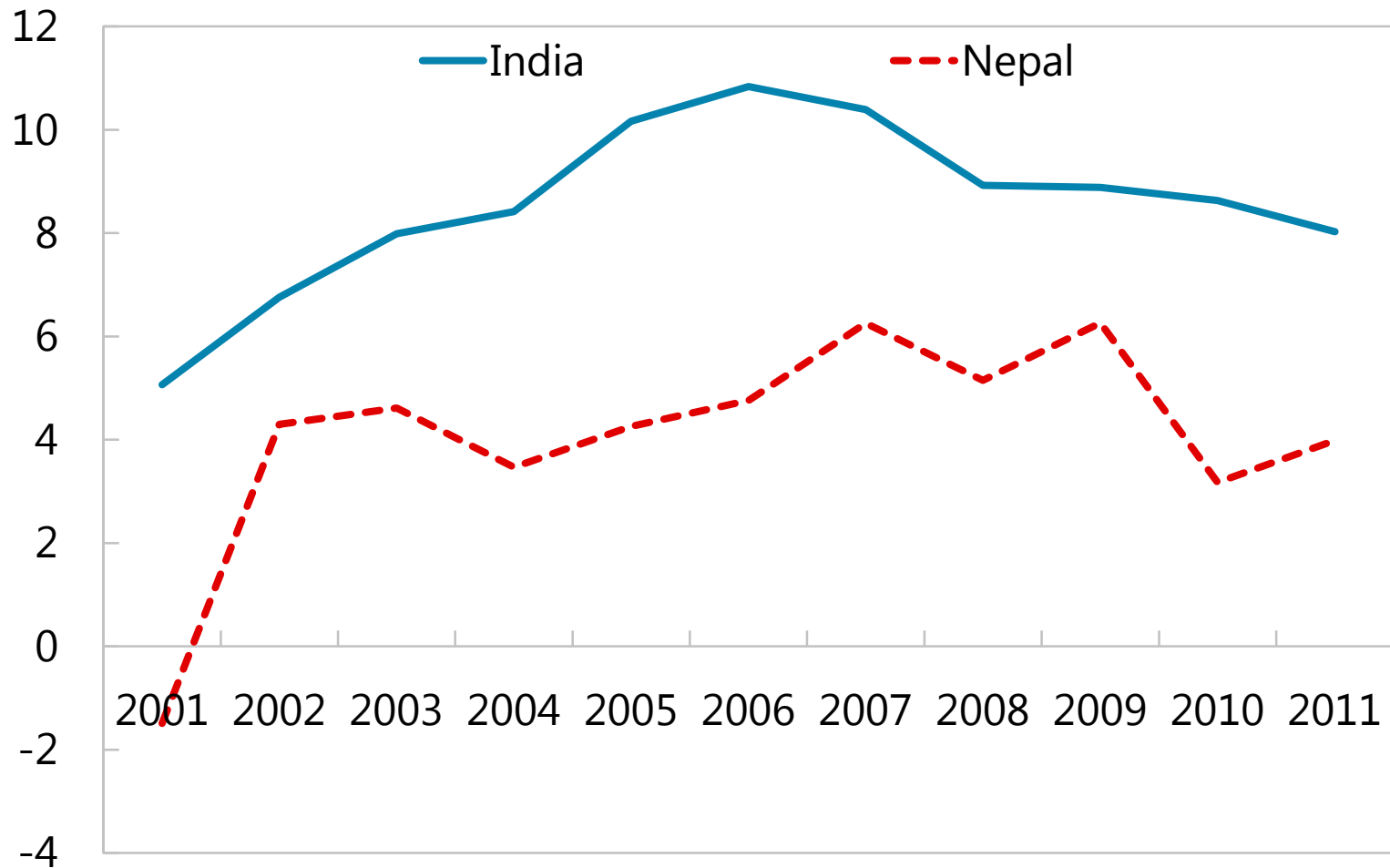


Nepal Outlook

Growth is linked to (but below) that in India

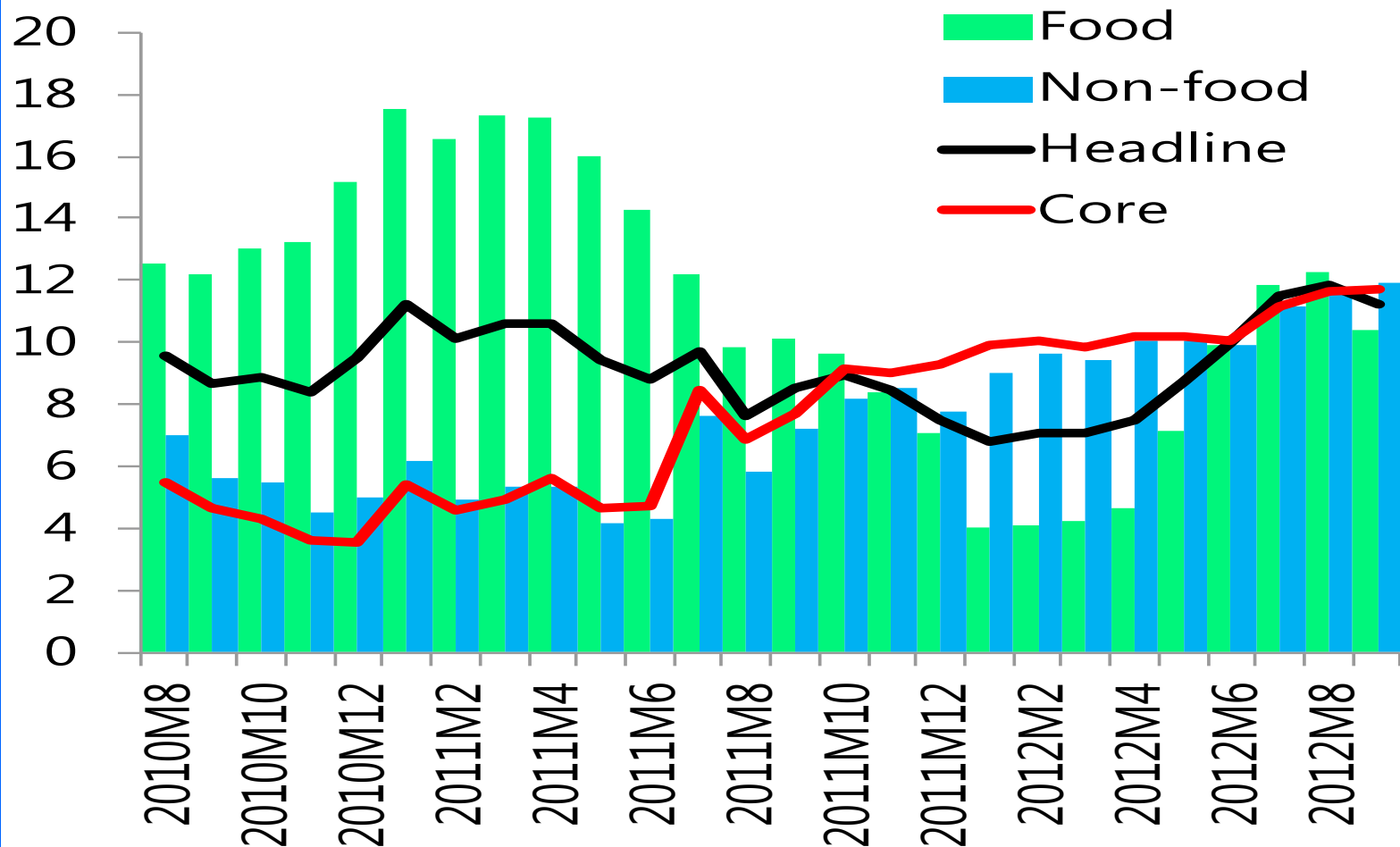
India and Nepal: Nonagricultural GDP Growth

(in percent)



But inflation remains a concern

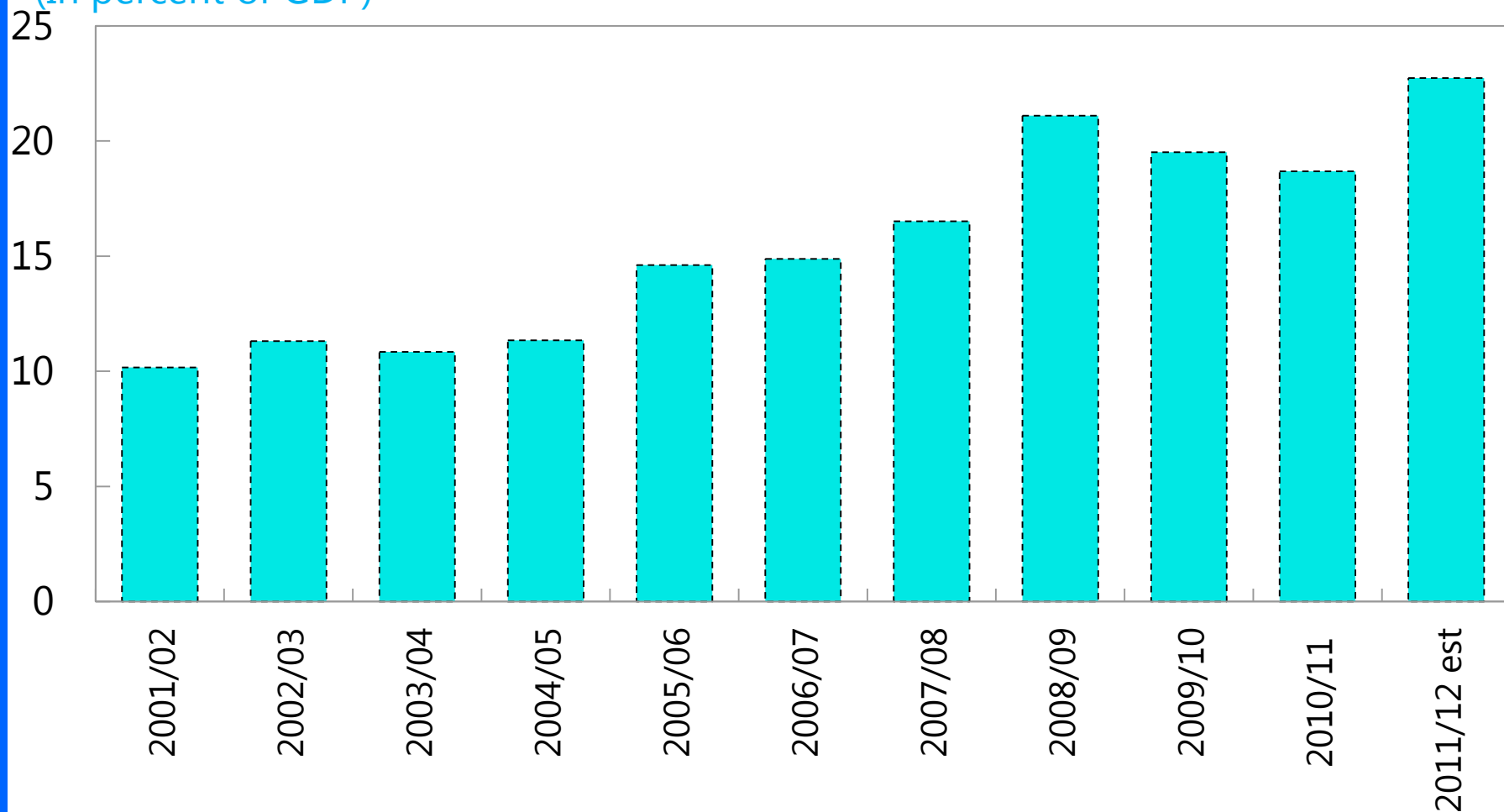
Inflation (Year-on-year percent change)



Remittances—export of labor—bolster the BoP

Remittances

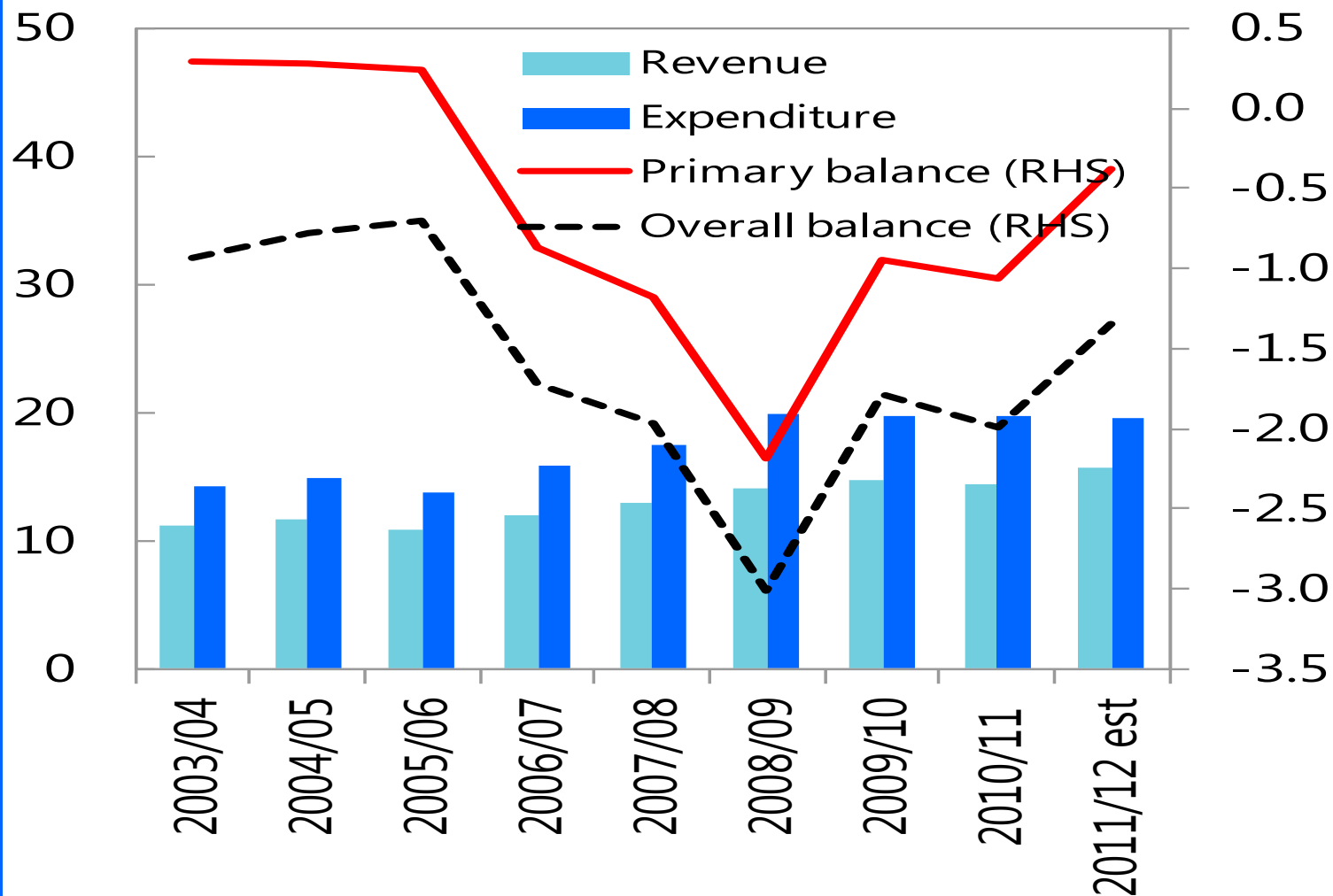
(In percent of GDP)



Fiscal deficit “over-performance” is a problem

Revenue and Expenditure

(In percent of GDP)



Outlook for Nepal

- **GDP growth is likely to decline further**
 - Agriculture (poor monsoon)
 - Global economic uncertainty
 - Fiscal “cliff” is a drag on growth
- **Inflation to remain elevated**
 - Spillover from India
- **Current account to weaken**
 - Outflow of workers is slowing, so remittances could fall
 - Imports seem to be recovering

Policy Messages for Nepal

- Need proper full-year budget (avoid “fiscal cliff”)
- Structural reforms needed:
 - Mounting quasi-fiscal liabilities (NOC)
 - Weak capital spending (will need to catch up)
 - Interest rate differential with India and rising inflation limit monetary policy
 - Strengthen business climate to promote investment
- Addressing financial sector vulnerability is key
 - Strengthen Anti-Money Laundering (AML) regime

Thank you



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