



INDIA

2015 ARTICLE IV CONSULTATION—STAFF REPORT; PRESS RELEASE; AND STATEMENT BY THE EXECUTIVE DIRECTOR FOR INDIA

March 2015

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 2015 Article IV consultation with India, the following documents have been released and are included in this package:

- The **Staff Report** prepared by a staff team of the IMF for the Executive Board's consideration on February 13, 2015, following discussions that ended on December 12, 2014, 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 January 26, 2015.
- An **Informational Annex** prepared by the IMF.
- A **Staff Statement** of February 13, 2015 updating information on recent developments.
- A **Press Release** summarizing the views of the Executive Board as expressed during its February 13, 2015 consideration of the staff report that concluded the Article IV consultation with India.
- A **Statement by the Executive Director** for India.

The following documents have been or will be separately released.

Selected Issues Paper

The policy of publication of staff reports and other documents allows for the deletion of market-sensitive information.

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INDIA

STAFF REPORT FOR THE 2015 ARTICLE IV CONSULTATION

January 26, 2015

KEY ISSUES

Outlook and Risks: India's near-term growth outlook has improved and the balance of risks is now more favorable, helped by increased political certainty, several policy actions, improved business confidence, lower commodity import prices, and reduced external vulnerabilities. Nonetheless, high inflation expectations and wide fiscal deficits remain key macroeconomic challenges, resulting in limited policy space to adopt countercyclical policies. Supply-side bottlenecks and structural challenges—particularly in the agriculture, mining and power sectors—constrain medium-term growth and hinder job creation. Risks are still tilted to the downside, with the main external risk stemming from surges in global financial market volatility. On the domestic side, a further weakening of bank and corporate balance sheets could pose risks to economic recovery and weigh on financial soundness. Sustained low global energy prices constitutes an upside risk to growth and downside risk to inflation, and would help contain both external and fiscal imbalances.

Key Policy Recommendations:

- Despite recent moderation in headline inflation, underlying inflationary pressures and upside risks remain. Monetary policy should remain tight to reduce inflation and inflation expectations durably.
- Fiscal consolidation should continue. The quality of the consolidation should be improved, underpinned by comprehensive tax reform (such as introducing the goods and services tax and improving tax administration) and measures to further reduce subsidies.
- To safeguard financial stability in the presence of rising corporate and banking sector strains, regulation should be further enhanced, provisioning increased, monitoring of corporate vulnerabilities strengthened (especially in light of large unhedged FX exposures), and debt recovery by banks further encouraged.
- Should external pressures from global financial market volatility resurface, rupee flexibility is an important shock absorber, complemented by tightening of the monetary stance, with foreign exchange intervention limited to preventing excessive volatility.
- While several policy actions have been taken recently, further steps in relaxing long-standing supply bottlenecks, especially in energy, mining and power sectors, as well as labor market reforms, are crucial to achieving faster and more inclusive growth.

Approved By
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(APD) and Seán Nolan
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Discussions took place in New Delhi and Mumbai during November 26–December 12, 2014. The team comprised Mr. Cashin (head), Ms. Jain-Chandra, Mr. Tulin, Mr. Raissi, Ms. Das (all APD), Mr. Lindner (MCM), Mr. Richardson (Senior Resident Representative), and Mr. Mohapatra (Resident Representative Office). Messrs. Mohan and Raj (OED) also participated in the discussions. The mission met with Finance Secretary Mehrishi, Chief Economic Advisor Subramanian, Reserve Bank of India (RBI) Deputy Governor Patel, Securities and Exchange Board of India (SEBI) Chairman Sinha, other senior officials and representatives of the business community. May Inoue, Michael Dalesio and Shari Boyce assisted in the preparation of this report.

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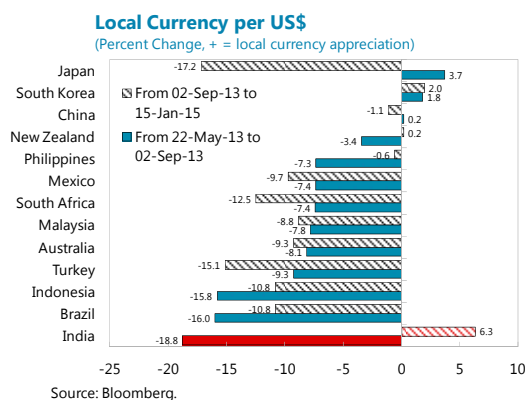
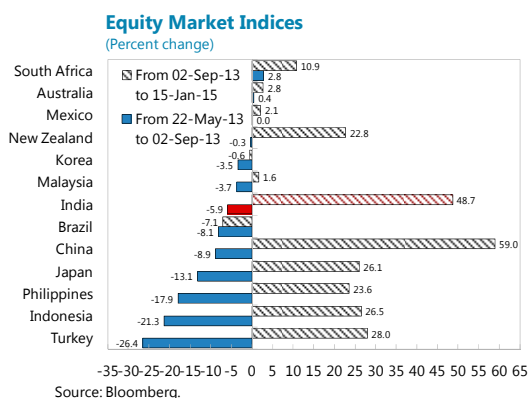
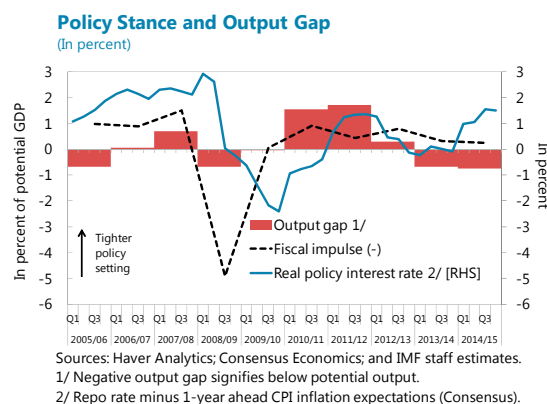
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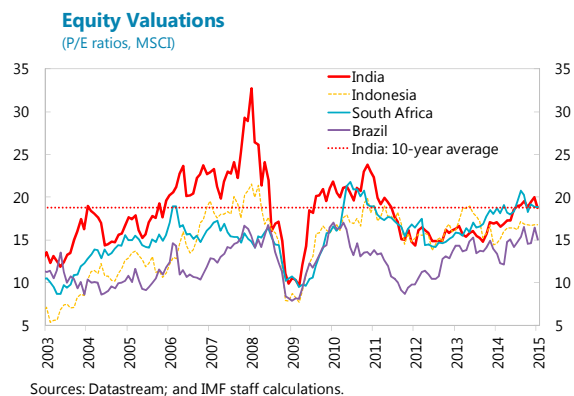
CONTEXT: REVIVING GROWTH AMID STRUCTURAL CHALLENGES

1. While India's external vulnerabilities have moderated since September 2013 due to effective policy actions and strengthened external buffers, risks remain. India was hit hard during the post-May 22, 2013 taper tantrum period, in line with other emerging markets, due to concerns about its weak growth prospects, high inflation, and large external imbalances. In response, the authorities implemented wide-ranging policies to contain market volatility, correct imbalances and build buffers against external shocks. Notably, against the background of still-limited policy space, they ran pro-cyclical fiscal and monetary policy stances. As a result, India's underlying vulnerabilities have receded more than those of most emerging markets. Notwithstanding this, weaknesses in corporate financial positions and bank asset quality remain, as do long-standing structural impediments.



2. The decisive outcome of the national elections has buoyed sentiment and boosted expectations of economic reforms. The Bharatiya Janata Party scored a landslide victory in India's parliamentary elections in May 2014. The new government has initiated economic reforms, including diesel price deregulation and raising natural gas prices, taken steps towards more flexible labor markets, commenced reforms in the coal sector, and is enhancing financial inclusion (see Text Table 1 on policy reforms undertaken in fiscal year 2014/15). Nonetheless, much remains to be done to raise potential growth, particularly in areas of reforming factor and product markets, many of which are on the concurrent list (areas where the central government and states can legislate), and thus will require consensus building to implement. Some states have initiated reforms on the concurrent list, such as labor market reforms, and have requested presidential assent, a modality that could enable states to reform at a faster pace.

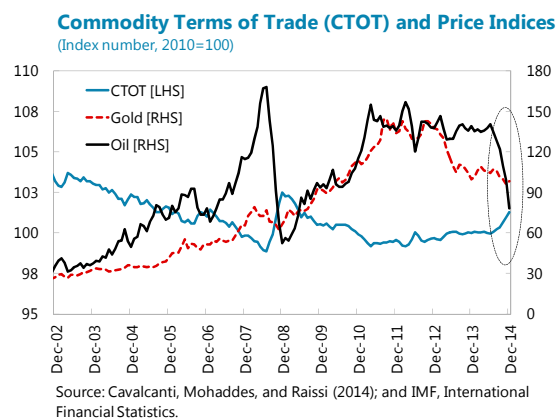
3. The recovery is strengthening gradually. Real GDP growth had slowed sharply to around 4½ percent in 2012/13 and 2013/14, as a result of growing imbalances, binding supply constraints, and subdued sentiment. However, as vulnerabilities receded and sentiment revived, growth rebounded to 5½ percent in H1 2014/15, driven by a revival in exports, and a rebound in industrial activity. Also, CPI inflation has receded from 11.2 percent in November 2013 to 5 percent in December 2014. This slowing of inflation was underpinned by several policy actions, including the Reserve Bank of India (RBI) raising the repo rate by a cumulative 75 bps between September 2013 and January 2014, limited increases in agricultural procurement prices, the release of food grain stocks, lower oil prices, and favorable base effects. India's improved near-term growth prospects and lower external vulnerabilities have led to sizable capital inflows, appreciation of the rupee, and a rise in equity prices to record highs.



4. Past Fund advice and the authorities' macroeconomic policies have been broadly aligned, but progress on structural reforms has been partial. The fiscal deficit target set by the authorities was met in 2013/14, which staff had endorsed, and staff also supports the authorities' intentions regarding the pace of medium-term consolidation. Diesel prices were deregulated and LPG subsidies were capped, leading to a lower fuel subsidy bill. The stance of monetary policy was tightened in 2013/14 to reduce inflation, consistent with Fund advice. The RBI has moved to make the containment of inflation its primary objective, with headline CPI inflation now the principal nominal anchor for monetary policy. Almost all key recommendations of the 2012 FSAP Update have been implemented (Text Table 2). Progress on product and labor market reforms has been limited, though some labor market reforms have been initiated by the center and a few states.

OUTLOOK AND RISKS

5. Though India's near-term growth outlook has improved, its medium-term prospects remain constrained by longstanding structural weaknesses. In the near term, growth is expected to rebound, helped by increased political certainty, several policy actions, lower commodity (oil and non-oil) import prices, improved business and consumer confidence, and reduced external vulnerabilities.¹ There are encouraging indications that new investment project announcements have started to pick up, specifically in the power and transport sectors, which should help broaden the



¹ See R. Anand and V. Tulin (2014), "Disentangling India's Investment Slowdown," IMF WP 14/47.

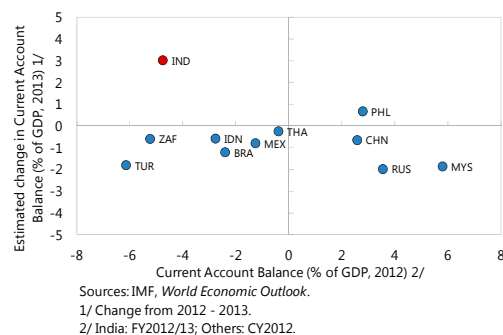
recovery as projects are implemented. Real GDP growth (at factor cost) is forecast to rise to 5½ percent in 2014/15 (up from 4¾ percent achieved in 2013/14), further accelerating to 6¼ percent in 2015/16, as a result of the revival in industrial and investment activity. In the presence of supply-side bottlenecks and structural challenges, and assuming no substantial legislative changes, medium term growth is projected to remain at around 6¾ percent, considerably below the 8 percent average achieved during 2002–07 (see Box 1 on potential growth).

6. Inflationary pressures remain, despite recent moderation in headline inflation. CPI inflation declined to 5 percent in December 2014, reflecting economic slack and favorable base effects, the tight monetary stance, lower global commodity prices, as well as government efforts to contain food inflation. Staff projects CPI inflation to move up to about 6¼ percent by end-2014/15 and hover slightly above 6 percent over the course of 2015/16 (close to the RBI's inflation objective of 6 percent by January 2016), as growth picks up, slack dissipates, and favorable base effects unwind.

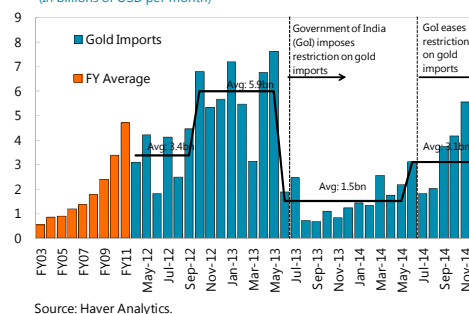
7. The current account deficit (CAD) has narrowed considerably and is expected to remain contained and comfortably financed. Around half of the 3 percentage points of GDP decline in the CAD in 2013/14 was attributable to the fall in gold imports, owing to higher import duties and administrative measures, with weak domestic demand and revival in exports also contributing to the narrowing deficit. The CAD is expected to remain at around 1¾ percent of GDP in 2014/15 (helped by significantly lower oil import prices), widening to about 2½ percent of GDP over the medium term as domestic demand strengthens. Sustained lower global oil prices and the resulting large positive shock to India's terms of trade should help contain the deficit.² As domestic inflation has moderated and international gold prices have fallen, import demand for gold is not expected to return to 2013/14 levels, and should not lead to a large widening of the CAD even with the government's recent withdrawal of various administrative measures.

8. Credit growth is currently anemic, reflecting weakened public sector bank (PSB) balance sheets and lower corporate demand for bank credit, and is posing

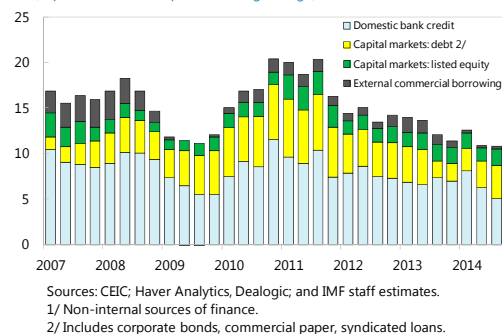
Selected EMs: Current Account Balance



Momentum in Gold Imports
(in billions of USD per month)



India's Corporate Sector Financing Sources, Net 1/
(in percent of GDP, 4-quarter moving average)



² All macroeconomic projections in this report are based on oil-price assumptions contained in the January 2015 *World Economic Outlook Update*.

headwinds to growth. Private banks (holding about one-quarter of banking system assets) are well-capitalized, profitable, have low NPLs and limited exposure to troubled sectors, and thus will be able to continue to contribute to credit expansion. However, problems are concentrated in public banks, where asset quality and capital adequacy positions are at a lower level than in private sector banks. Given diminished profitability, in order to maintain current capital adequacy ratios (CAR), public banks will need to improve their capital base to extend sufficient credit to support growth.³ Any further deterioration in asset quality could thereby constrain banks' credit supply. Nonetheless, reflecting buoyant investor sentiment, capital markets (corporate bonds and equities) should be able to help contribute to financing growth.

9. Notwithstanding recent improvements, downside economic risks remain (Annex I). On the external side, despite the reduction in imbalances and strengthening of buffers, the spillover impact from global financial market volatility to India could be very disruptive, including from any unexpected developments in the course of U.S. monetary policy normalization, particularly against the backdrop of recent large capital inflows (see Selected Issues Chapter I). Risks also emanate from a prolonged period of weak global growth, which could dampen Indian exports. Domestic risks include a supply-driven spike in inflation (possibly leading to higher gold imports), increased weaknesses in corporate financial positions, including from significant unhedged foreign exchange exposures (see Box 2) and further deterioration of bank asset quality, as well as slower-than-expected progress in addressing supply-side bottlenecks, which could weigh on growth and stoke inflation. On the upside, expedited structural reforms and faster implementation of cleared investment projects could lead to stronger growth, as would sustained low global energy prices.

Authorities' Views

10. There was broad alignment in the macroeconomic projections of staff and the authorities. The authorities project growth at about 5½ percent in the current fiscal year, given the better-than-expected monsoon and favorable services sector output, and at slightly over 6 percent in 2015/16, owing to a pickup in global demand, the recovery of mining, and stronger investment. CPI inflation is projected by the authorities to decline somewhat faster than the RBI's glide path to attaining the 6 percent objective by January 2016, reflecting their implementation of comprehensive structural measures to tackle food inflation. They considered that India's CAD should remain contained in the neighborhood of 2 percent of GDP, as gold imports are not expected to revert to previous highs, reflecting stronger fundamentals.

11. The authorities believe they are well prepared for a reprise of global financial market volatility, should it materialize. Fundamentals are stronger, reserves are higher, and markets seem to be distinguishing India from other major EM economies. They recognize risks to the outlook, including lower global growth as well as higher oil prices stemming from geopolitical events. However, they also note that unhedged foreign exchange exposure of corporates—which have

³ Staff analysis indicates that to finance credit growth in the range of 15–20 percent to support the recovery and maintain CAR at about 11 percent at public sector banks, capital injection of 0.1–0.2 percent of GDP will be required in the near term, in addition to the amount allocated in the 2014/15 Union Budget.

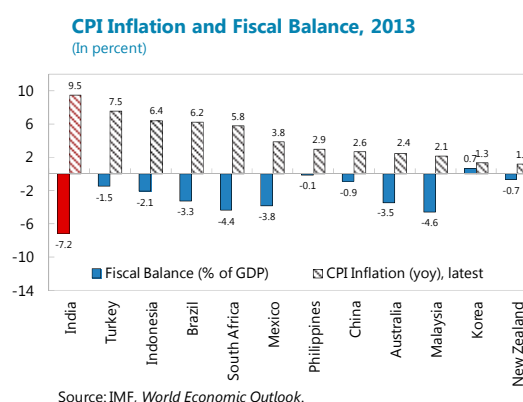
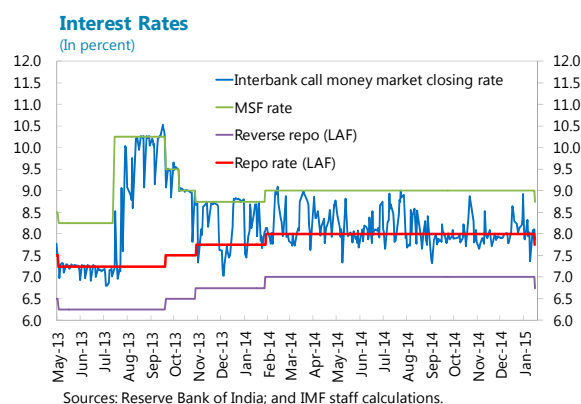
increased during 2014—may not be the major vulnerability some had feared. They perceived the external volatility of 2013 as having acted as a natural experiment, revealing greater resilience by corporate India than previously believed. They agreed with staff that rupee exchange rate flexibility is an important policy tool that helps contain external risks, and noted that they had enhanced the RBI's stock of international reserves for precautionary purposes.

POLICIES: NURTURING THE RECOVERY WHILE MAINTAINING MACROECONOMIC STABILITY

To secure the recovery and maintain macroeconomic stability, staff recommends a comprehensive medium-term policy framework (including measures in the monetary, fiscal, financial and structural areas) that would raise actual and potential growth, increase policy space, and limit vulnerabilities.

A. Combating Inflation and Strengthening the Monetary Policy Framework

12. Since September 2013, to tackle persistently-high inflation, the RBI raised the policy repo rate, tightened liquidity, and took steps to enhance monetary transmission. The repo rate was raised to combat inflation and maintain market stability, and has been kept on hold at 8 percent between January 2014 and January 2015, supported by open market operations to sterilize FX intervention. The RBI also took steps to enhance monetary transmission by lowering the cap on bank access to its overnight liquidity adjustment facility (LAF), shifting liquidity injection toward term repos, and paring back sector-specific liquidity facilities⁴. More recently, the RBI reduced the policy repo rate by 25 basis points (January 2015), reflecting disinflationary impulses.



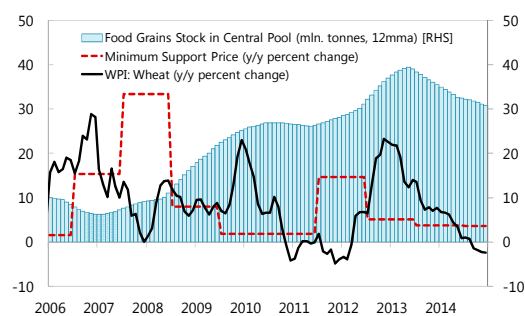
13. Monetary policy needs to remain tight to reduce inflation and inflation expectations on a durable basis. High inflation has been a key source of vulnerability, discouraging financial saving, eroding external competitiveness and exacerbating external imbalances, as well as spurring inequality

⁴ The recalibration of the liquidity facilities, while primarily aimed at reducing banks' passive dependence on the RBI for cash and treasury management to enhance monetary transmission, has resulted in an effective further slight tightening of the monetary stance by raising the average cost of central bank liquidity to above the repo rate.

(see Box 3).⁵ While inflation has recently dipped due to favorable base effects and falling energy prices, one-year-ahead inflation expectations (as measured by the RBI's survey) remain above the RBI's January 2016 inflation objective. Furthermore, potential adverse supply shocks could give rise to large second-round effects on core inflation.⁶ In the absence of supply-side measures to raise potential output and constrain food price inflation, maintaining a tight monetary stance is needed to achieve the RBI's 6 percent CPI inflation objective by 2016, particularly given the narrowing output gap and possible spikes in domestic food and fuel prices.⁷ The evolution of the monetary policy stance should continue to be data dependent, while recognizing uncertainties regarding the strength and lags associated with the monetary transmission mechanism. Nonetheless, the authorities should continue to stand ready to tighten the stance if inflationary pressures gather pace, particularly given the large upside risks to inflation. To lower CPI inflation over the medium term to 4 percent, if that is the objective ultimately adopted by the authorities, a tight monetary policy stance will need to be accompanied by further structural reforms, which will boost potential output and increase food production (see Selected Issues Chapter II).

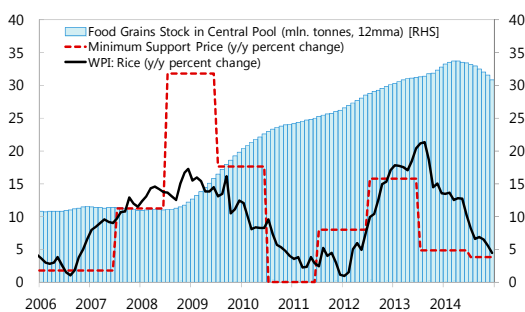
14. Continued progress is needed to further strengthen the monetary policy framework and move towards flexible inflation targeting. The RBI has shifted policy formulation to focus on containing inflation (with headline CPI inflation as a de-facto nominal anchor) and strengthened policy communication, including through publication of two-year-ahead inflation forecasts and associated confidence bands. Staff views the medium-term 4 percent inflation target set out by the Patel Committee report as broadly appropriate. However, in view of India's large weight on food in its CPI basket and structurally-high food inflation, achieving this target will require ramping up food supply commensurate with strong consumption demand. The associated band (+/- 2 percent) is appropriate in light of India's susceptibility to food supply and external shocks (see Selected Issues Chapter III). Staff supports further efforts to enhance the monetary framework along the lines set out in the Patel

Wheat: Prices and Central Pool Stocks



Sources: CEIC; Haver Analytics; Food Corporation of India; and IMF staff calculations.

Rice: Prices and Central Pool Stocks



Sources: CEIC; Haver Analytics; Food Corporation of India; and IMF staff calculations.

⁵ Low and stable inflation is the best way for monetary policy to support growth over the medium term—see K. Mohaddes and M. Raissi (2014), "Does Inflation Slow Long-Run Growth in India?," IMF WP 14/222.

⁶ IMF staff analysis indicates that food inflation propagates rapidly into non-food inflation in India—see IMF (2014), *India: Selected Issues*, IMF Country Report No. 14/58.

⁷ Staff analyses are based on a Bayesian structural VAR and calculations using a Taylor rule (embedded in a structural forecasting and policy analysis model customized to India)—see R. Anand, D. Ding and V. Tulin (2014), "Food Inflation in India: Role for Monetary Policy," IMF WP 14/148.

Committee Report including: increasing the operational autonomy of the RBI; institutionalization and setting the target zone for headline CPI inflation; and establishment of a Monetary Policy Committee and accountability framework (see Selected Issues Chapter IV).

Authorities' Views

15. The authorities noted that monetary policy needs to strike a balance between the primary objective of reducing inflation and limiting the adverse impact on growth, while preserving financial stability. The RBI recognized the effectiveness of supply-side measures to help contain inflation, and noted that going forward, implementation of growth-friendly fiscal consolidation and additional supply-side measures would constitute pre-conditions for monetary easing. They also noted that upside risks to inflation remain, including from spikes in oil prices, price pressures from input costs, deficient rainfall, as well as from ongoing excess demand for protein-rich food items.

16. The authorities emphasized that India has not yet adopted a flexible inflation targeting regime. They consider the current regime to be a transitional one, and noted that discussions are on-going between the RBI and the government on the final contours of the new monetary policy framework, as indicated by the Finance Minister in the Budget speech on the need for a stronger monetary policy framework. In the meantime, the RBI has indicated a CPI inflation "glide path" to the achievement of a medium-term target for CPI inflation of 4 percent (+/- 2 percentage points).

B. Consolidating the Fiscal Position

17. Fiscal consolidation has continued, in line with the government's deficit reduction path. The authorities have demonstrated their commitment to consolidation, in particular in light of the negative output gap, leading to pro-cyclical fiscal tightening to restore fiscal space. The 2013/14 fiscal deficit of 4.5 percent of GDP (authorities' definition) over-performed relative to the government's target of 4.7 percent of GDP, and the primary deficit has narrowed by 2 percentage points of GDP since 2010/11. However, this consolidation was achieved largely as a result of cuts in capital spending. The 2014/15 Budget targets a central government deficit of 4.1 percent of GDP (authorities' definition, equivalent to about 4½ percent of GDP in IMF terms). Despite sluggish revenues and delayed disinvestment, this year's deficit target is expected to be achieved in part due to further expenditure compression. Nonetheless, declining global oil prices, in conjunction with the recent diesel-price deregulation and capping of LPG subsidies, are expected to help lower the fuel subsidy bill. To help meet the 2014/15 deficit target, energy excise duties were increased and non-plan expenditure was restrained.

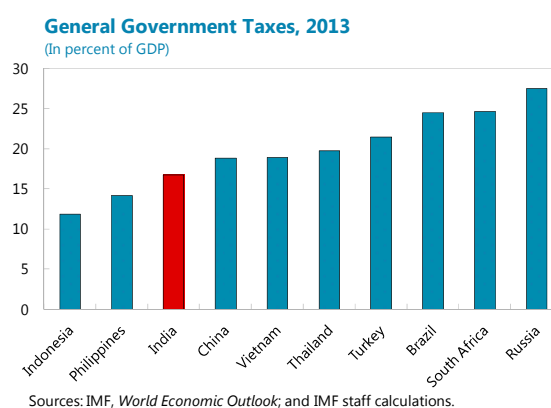
18. Looking forward, medium-term fiscal targets appear to be challenging. The medium-term consolidation path aims for the central government deficit to narrow further to 3 percent of GDP by 2016/17, but detailed measures underpinning this path have not yet been articulated.⁸ Achieving the 3 percent target for 2016/17 will require a comprehensive set of measures.

⁸ As a result, staff's medium-term fiscal projections, which are on the basis of current policies and assume no major legislative changes, forecast less fiscal adjustment.

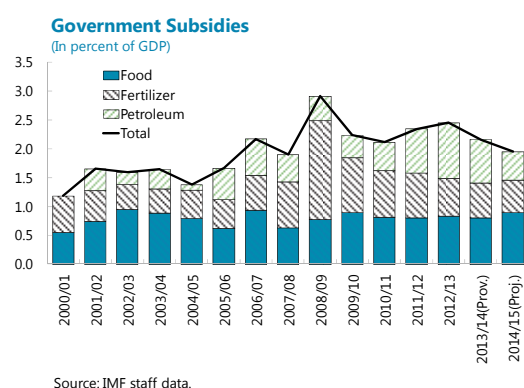
Overhauling the subsidy regime to contain leakages in food subsidies and further reducing petroleum and fertilizer subsidies is estimated to yield around ½ of one percent of GDP in fiscal savings. Given the narrowness of current Indian tax bases, further revenue gains can be achieved by instituting tax administration reforms, including by reorganizing tax administration along functional lines, by merging indirect and direct tax boards. Such measures on the revenue and expenditure side should be undertaken, in order to increase growth-enhancing capital spending, while continuing on an overall fiscal consolidation path.

19. While the authorities' commitment to fiscal consolidation is welcome, the quality of consolidation should be improved to be more growth enhancing. Significant tax reforms and further rationalization of subsidies will be required to create the fiscal space for higher growth-enhancing capital spending and social expenditures. Specifically, staff recommends the following measures:

- *Tax reform.* India's revenue-to-GDP ratio is considerably below its peers. A well-designed goods and service tax (GST) should be implemented, with minimal exemptions and a moderate single rate, as it would create a single Indian market, enhance the efficiency of internal movement of goods and services, and thereby boost GDP growth (see Box 4). Progress towards a revised direct tax code, with smaller and streamlined deductions, would also help. Efforts to improve tax administration, including along the lines outlined in the Tax Administration Reform Commission (TARC) reports, should continue.



- *Subsidy reform.* Overhauling the subsidy regime should entail further reducing fuel (LPG and kerosene) subsidies and tackling fertilizer subsidies. Untargeted food subsidies should also be pared back, including by rationalizing the list of eligible beneficiaries and reforming the inefficient Food Corporation of India.⁹ In addition, moving to direct cash transfers using India's unique identification system (Aadhaar) will help reduce leakages and improve governance in the food distribution system. An approach based on three pillars, namely direct benefit transfers, increased financial inclusion, and use of the Aadhaar system to better target beneficiaries, should yield large savings. The forthcoming recommendations of the Expenditure Management Commission should also be helpful in identifying additional savings.



⁹ The Food Security Act (2013)—which will provide subsidized rice, wheat and coarse cereals to 67 percent of the Indian population—is not expected to add significantly to the 2014/15 fiscal subsidy burden, as it has been implemented in only eleven of the Indian states and union territories thus far.

- *Fiscal responsibility legislation.* The government's medium-term consolidation path should be underpinned by a strengthened Fiscal Responsibility and Budget Management Act. In particular, the design of future fiscal responsibility legislation could be enhanced by using a rule that provides room for countercyclical fiscal policy—such as capping nominal expenditure growth in addition to a deficit rule with built-in flexibility (see Selected Issues Chapter V).

Unless such comprehensive fiscal measures are instituted, fiscal adjustment will likely be met through expenditure compression (including lower capital spending) or an underfunding of important social programs, as has occurred in recent years, which will undermine efforts to enhance economic growth and inclusiveness. In contrast, success in achieving the authorities' medium-term fiscal goals would support business confidence, reinforce the efforts of the RBI's tight monetary stance in fighting inflation, lower public sector financing costs, and reduce overall fiscal vulnerabilities.

20. India's public debt is projected to decline over the medium term and remains on a sustainable path. India's relatively high nominal GDP growth means that public debt (with a favorable maturity structure, currency composition as well as a captive domestic investor base) remains on a downward path and is sustainable (see debt sustainability analysis (DSA) of Annex II). Under the baseline, the public debt-to-GDP ratio is forecast to decline gradually to about 58½ percent over the medium term from its current level of 65½ percent. While the baseline scenario already uses conservative growth assumptions, large negative growth shocks represent one of the major risks to the declining debt trajectory.

Authorities' Views

21. Staff and the authorities broadly share a common outlook on the path for fiscal consolidation, with the authorities noting that they are sticking with fiscal adjustment in the midst of an economic slowdown. Fiscal adjustment in 2014/15 is likely to be accomplished through expenditure compression, but the authorities do not expect a repeat of previous years' sharp reduction in capital spending. Noting recent IMF research suggesting that infrastructure spending can be sufficiently growth-enhancing to offset some of the direct cost incurred, they emphasize that they are making a strong effort to preserve the investment budget, carving out fiscal space for it by reducing lower-priority capital spending items. The authorities pointed out that in August 2014 they liberalized the project appraisal and approval process in line Ministries, which should accelerate the pace of public investment approvals, and introduced zero-based budgetary principles to better prioritize planned spending. The authorities also noted that the Expenditure Management Commission is expected to propose a number of rationalization measures on the recurrent spending side, such as a transition to direct benefit transfers, including by linking them to the unique identification number (Aadhaar) system. Even if capital spending at the central government level, in the end, faces some reduction to meet the overall deficit target, the authorities are confident that capital spending at the state level will remain healthy, ensuring that—at the general government level—compression of capital spending would be kept to a minimum.

22. The authorities concurred with staff that enhanced revenue mobilization is a priority over the medium term. Once implemented, they expect that the GST will gradually boost revenue indirectly not only by promoting faster economic growth, but also by helping move economic

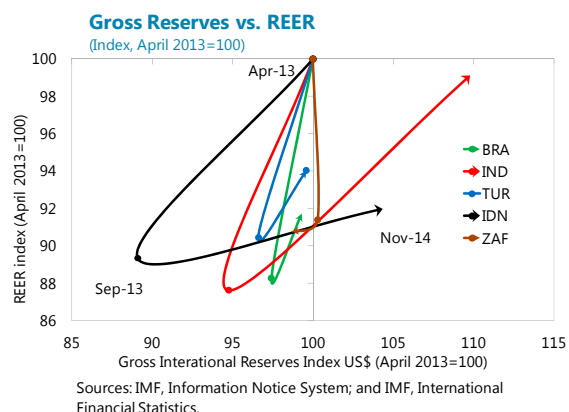
activity to the formal sector, thereby expanding the tax base and improving compliance. The authorities noted staff's proposal on enhancing fiscal responsibility, and considered that, perhaps in the context of discussions surrounding a renewed fiscal rule, some flexibility regarding the fiscal deficit target could be introduced. The authorities disagreed with staff on the desirability of merging direct and indirect tax boards, arguing that functional specialization remains necessary.

C. Maintaining External Stability

23. India's external position is broadly consistent with medium-term fundamentals and desirable policy settings, while reserves are assessed to be adequate (Box 5).

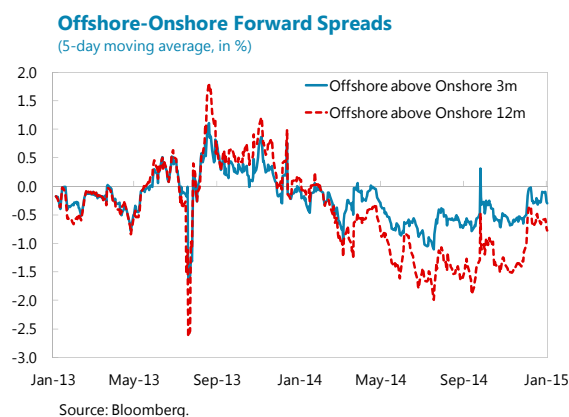
International reserves have increased by about \$30 billion over the last year to reach US\$320 billion as at end-December 2014 (standing at 148 percent of the Fund's reserve adequacy metric).

In addition, the RBI has intervened in the forward market, which has resulted in a net long forward position of US\$13.2 billion as of end-November 2014. The build-up of reserves since the second half of 2013/14 was driven by robust foreign institutional investor (FII) flows in conjunction with the sharp CAD correction (largely due to the contraction in gold imports), as well as inflows of about US\$34 billion of non-resident Indian (NRI) deposits and overseas borrowings by banks, facilitated by a concessional foreign exchange (FX) swap facility offered by the RBI.¹⁰ Based on a range of methodologies, staff assesses the external position to be broadly in line with fundamentals (see Box 6 and Selected Issues Chapter VI).



24. The foreign exchange intervention strategy of the RBI (in both spot and forward markets) is guided by the need to enhance growth, reduce inflation, limit volatility, and build buffers for precautionary purposes. The RBI's forward FX purchases have helped it cover forward FX liabilities and maintain tight monetary conditions to contain inflation.

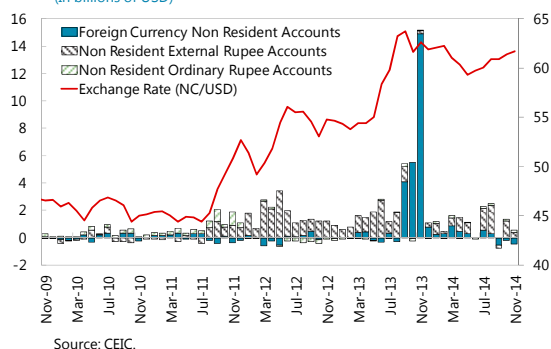
Reflecting this forward intervention and the interest rate differential between India and the United States, forward premia increased, creating arbitrage opportunities, thereby generating financial market distortions. Given India's increased and adequate reserve buffers, greater exchange rate flexibility would encourage private sector entities to limit excessive risk taking. Foreign exchange intervention should be limited to preventing disruptive movements in the exchange rate and checking any self-fulfilling momentum that is divorced from exchange rate fundamentals.



¹⁰ The magnitude of the FX swaps is fully disclosed through the Special Data Dissemination Standard (SDDS) template on both the RBI and IMF websites.

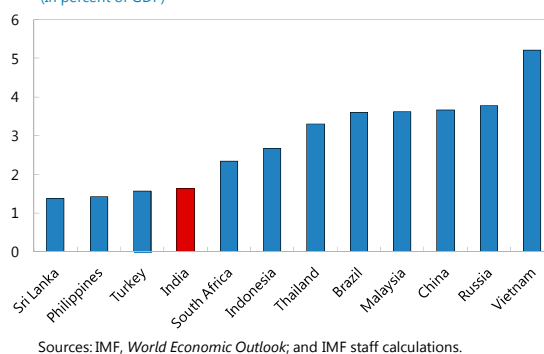
25. If global financial market volatility resurfaces, a comprehensive and well-communicated set of policies will be needed. In this event, staff would recommend exchange rate flexibility (as a key shock absorber), allowing for an orderly depreciation of the rupee, with judicious FX intervention (both in the spot and forward markets, and via liquidity provision through swaps) to minimize disruptive movements in the currency. Also, to make it more costly to short the rupee, temporarily bolster the capital account position, and contain the inflationary impact of exchange rate depreciation, a tightening of the monetary stance could be considered. Greater liberalization of non-debt creating capital inflows would be warranted, while measures to limit capital outflows should be avoided as they could undermine investor confidence and intensify outflows. The measures used successfully by India during the post-May 2013 period—including offering FX swaps to banks to attract NRI deposits and providing dollar liquidity to oil-marketing companies to limit depreciation—could be used again in the event of the re-emergence of external pressures (see Selected Issues Chapter VII for an analysis of Indian and EM responses to recent bouts of global financial market volatility).¹¹ The RBI should also further explore options to increase the availability of bilateral and multilateral swap lines.¹²

NRI Deposits Flows
(In billions of USD)



26. The current account deficit financing mix could be improved by enhancing the environment for attracting stable, non-debt creating capital flows, particularly FDI. India's financial account has traditionally been dominated by portfolio equity and FDI flows. However, the composition of CAD financing has recently shifted toward more debt flows, particularly in the form of NRI deposits and external commercial borrowing (including by highly-leveraged Indian corporates and those with unhedged FX

FDI Inflows, 2013
(In percent of GDP)



exposures). Given that portfolio debt flows have been volatile in recent years and the exchange rate has been sensitive to these flows and changes in global risk aversion, attracting more stable sources of financing would reduce vulnerabilities. A conducive business environment is necessary to attract more FDI, along with further liberalization of FDI in specific sectors and simplification of procedures.

¹¹ The RBI introduced two foreign exchange swap schemes in September 2013—one to encourage new foreign exchange deposits into India by non-resident Indians (NRI) with a minimum term of three years; and one to encourage long-term overseas foreign exchange borrowing by banks. Under both swap schemes, the RBI agreed to sell to banks on a forward basis and until November 30, 2013, U.S. dollars against rupees at concessional rates, which gives rise to multiple currency practices (MCP) relating solely to capital transactions. These MCPs are not subject to Fund approval because the Fund has declined to assert jurisdiction over MCPs relating solely to capital transactions (see BUFF/85/34).

¹² India has a swap line with the Bank of Japan of US\$50 billion, and the BRICS' Contingency Reserve Arrangement will enable India to draw US\$6 billion (and another US\$12 billion with a Fund program).

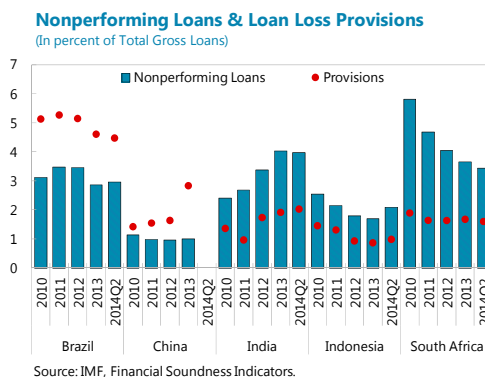
In addition to having permitted FDI in railways, infrastructure and defense sectors, going forward, higher FDI limits in sectors such as construction and insurance could lead to increased FDI flows. Nonetheless, further liberalization of external commercial borrowing should proceed cautiously and be carefully monitored by the RBI, given the potential risks to corporate balance sheets.¹³

Authorities' Views

27. The authorities noted that while India's external vulnerabilities are reduced, they intend to further rebuild their external buffers. The authorities are somewhat concerned about the risks of disorderly monetary policy normalization in advanced countries, as well as loss of export competitiveness due to prolonged use of unconventional monetary policies by advanced countries. They welcomed IMF staff analysis showing that India and other EMs have been affected by unconventional monetary policies of advanced economies, and noted that despite building greater resilience to external shocks, they would likely be adversely affected by a disorderly reversal of such policies in the future. The authorities reiterated that they are not targeting any specific level of the rupee exchange rate, and attributed foreign exchange purchases over the past year to a desire to rebuild their external buffers. They acknowledge some tension between their foreign exchange intervention and the focus on reducing inflation, and regard the financial market distortions from their intervention policy as minimal. They noted that significant progress has been made in creating a conducive business environment to attract foreign direct investment flows.

D. Preserving Financial Sector Stability

28. Past weak growth and delayed infrastructure investment projects have placed pressure on bank asset quality. While the banking sector is generally sound, weak growth and supply-side bottlenecks have led to a deterioration in asset quality, particularly at public sector banks (PSBs). System-wide, gross non-performing assets (NPAs) have increased to 4.1 percent of total advances at end-fiscal year 2013/14, with PSBs' NPAs reaching 4.7 percent, notwithstanding sales of NPAs to asset restructuring companies (ARCs, see Box 7). Also, restructured loans (as a share of total advances) increased slightly from 5.8 to 5.9 percent of total advances over the last fiscal year.¹⁴ Nonetheless, concerns over evergreening remain, as more than 90 percent of those sales of NPAs to ARCs were financed by banks via issuance of security receipts.



29. Corporate vulnerability indicators show signs of stabilization but remain elevated.

Although the share of debt held by firms with an interest coverage ratio below one fell by

¹³ To encourage foreign-currency-risk-free borrowings for corporates under the external commercial borrowing (ECB) facility, since September 2014 the RBI has permitted recognized non-resident ECB lenders to extend loans in Indian rupees, funded through swaps undertaken with an eligible bank in India.

¹⁴ The RBI's December 2014 *Financial Stability Report* shows an increase in gross NPAs across all scheduled commercial banks to 4.5 percent of gross advances, with stressed assets (the sum of gross NPAs and restructured assets) increasing by 0.7 percent to 10.7 percent between March and September 2014 for all scheduled commercial banks, and by 1 percent for PSBs, reaching 12.9 percent over the same period.

2.5 percent to 13.8 percent during 2013/14, the shares of loss-making companies and those with a leverage ratio above two have increased slightly to 22.9 and 31.4 percent, respectively (see Selected Issues Chapters VIII and IX).¹⁵ As noted in the RBI's *2013/14 Annual Report*, sectors subject to greater stress—infrastructure, textiles, engineering, metals and products, chemicals, and mining—make up 36 percent of NPAs as of March 2014. Also, as noted in a recent speech by the RBI's Deputy Governor, based on the indicative data, the hedge ratio for external commercial borrowings and foreign currency convertible bonds (excluding natural hedges) declined sharply from about 34 percent of borrowings in 2013/14 to about 15 percent in July–August 2014.¹⁶

30. Weaknesses have been more pronounced in public sector banks, which represent three-quarters of banking system assets. These challenges include larger capital needs and weaker asset quality, which stem in part from large exposure to infrastructure in the last few years. The profitability of PSBs remains weak, due to lower operating efficiency. Nonetheless, new capital injections for India's banks (to meet Basel III requirements and additional capital requirements due to restructured loans being reclassified as NPAs) are likely to be moderate (see Box 8). A multi-pronged approach is needed to remedy long-standing structural issues in the PSBs, including weak corporate governance. Such an approach should entail further disinvestment by the government, while improving corporate governance and human resource policies, consistent with key recommendations of the Nayak Committee report.¹⁷ Staff welcomes the government's intention to reduce its shareholdings in PSBs down to 52 percent and thereby allow the public banks to strengthen their equity capital base.

31. The RBI has made further progress in financial sector reforms since the 2014 Article IV consultation. Efforts have focused on strengthening regulation, including important progress on implementing Basel III, identifying Domestic Systemically Important Banks and imposing capital surcharges on them, improving the resolution of impaired assets, and expanding access to finance.

- The RBI has recently tightened prudential regulations, including requiring ARCs to provide at least 15 percent equity towards purchases of NPAs, while phasing out (by April 1, 2015) the ability for many types of loans to be categorized as rescheduled (and thereby face lower provisioning requirements).
- In addition, from July 2014, the RBI has allowed the move of infrastructure and coal sector loans into five-year term loans with the ability of rollover, which improves the asset-liability structure of banks. Going forward, the health of the Indian banking system would be best served by ending the forbearance provided by the current restructuring mechanism for all types of loans.

¹⁵ See also P. Lindner and S. Jung (2014), "Corporate Vulnerabilities in India and Banks' Loan Performance," IMF WP 14/232.

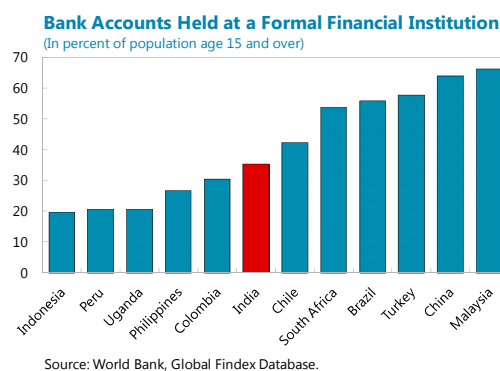
¹⁶ The speech is available at http://www.rbi.org.in/scripts/BS_SpeechesView.aspx?Id=919. In April 2014, the RBI introduced incremental provisioning and capital requirements for banks' exposures to entities with unhedged foreign exchange exposures.

¹⁷ In order to improve governance, the government intends to separate the positions of CEO and chairman at PSBs (in line with the Nayak Committee's recommendations), except for State Bank of India (SBI). The government also intends to revise the appointment process for membership of PSBs' boards.

- The RBI has taken steps to remove information asymmetries and enable banks to improve credit risk management through the establishment of a large borrower database (beginning May 2014).
- The RBI intends to subject RBI-regulated non-bank financial corporations (NBFCs) to more stringent regulatory norms (in line with those for banks), which will help strengthen the stability of this fast-growing part of the financial sector.¹⁸ Although NBFCs' asset growth has significantly outpaced bank asset growth since 2011, their assets correspond to only about 13 percent of bank assets. NBFCs are generally well regulated, with the largest 480 NBFCs (representing around 90 percent of total NBFC assets) subject to RBI regulation and supervision.¹⁹

32. Over the past year, a number of measures were enacted which improved corporate governance, enhanced the securities market regulator's (SEBI) enforcement powers, and increased transparency of participatory notes (P-Notes). Measures expanding the rights of minority investors helped improve India's standing in the World Bank's "Protecting Minority Investors rank" from about 30th in 2013 to 7th as at June 2014. A recent amendment to the SEBI Act equipped the regulator with powers of search and seizure; in cases crossing state lines, recourse is now available to a single court in Mumbai, rather than to civil courts in all involved states. Foreign investors' ownership of P-Notes was streamlined by restricting the types of investors who can own such notes.²⁰ Also, brokers which sell P-Notes now have to provide SEBI with the names of their beneficiaries. India is currently re-negotiating the double-taxation treaties with several countries, partly in order to rationalize such investments, and as a follow on to measures enacted in 2014 to ease the registration burden for foreign institutional investors (FIIs). Interagency discussions on expanding and improving the liquidity of the corporate bond market are continuing, while SEBI is also considering steps to encourage more debt-for-equity swaps.

33. Enhancing financial inclusion has been a key priority for the government.²¹ The RBI has issued guidelines to set up differentiated banks (such as payments



¹⁸ This includes the largest NBFCs, deposits-taking NBFCs, or those involved in leasing, lending, or securities investments. The RBI decided to: (i) increase capital minimum requirements from Rs 2.5 million to Rs 20 million (by March 2017); (ii) require asset finance companies to receive ratings (by March 2016); (iii) require NBFCs with assets above Rs 5 billion, and all deposit-taking NBFCs to maintain a minimum Tier-1 capital ratio of 10 percent (by March 2017); and require systemically important and deposit-taking NBFCs to provision more (in line with banks). Most of the new requirements will be phased in over time.

¹⁹ However, government-owned NBFCs are not subject to full RBI supervision.

²⁰ P-Notes are a type of derivative instrument which foreign investors can buy through an entity registered in a country with which India has a double taxation agreement (usually Mauritius, Cyprus, or Singapore), relieving them from the need to register with SEBI or pay Indian capital gains taxes, and have provided anonymity to such investors.

²¹ Indian banks are subject to sectoral lending requirements (priority sectors include agriculture, SMEs), but these are undertaken primarily on a commercial basis, and lead to higher credit offtake and higher growth. Staff analysis finds that enhanced financial inclusion and access to finance leads to higher economic output and lower inequality (see Selected Issues Chapter X).

banks) which focus more narrowly on the provision of basic financial services, using new technologies, while investing only in relatively safe assets such as government securities. Two new banking licenses were allocated in April 2014, with the provision that at least 25 percent of new branches have to be in rural areas. The government has launched an ambitious scheme (Jan Dhan Yojana) to provide bank accounts for each poor Indian family. Each account would include a debit card, accident and life insurance coverage, and an overdraft facility (to motivate active use of the accounts).

34. To maintain financial stability and enhance the ability of the financial sector to contribute to growth, staff supports the following measures:

- The RBI should further strengthen regulation for banks' credit quality classification and require increased provisioning (particularly for all types of restructured assets under the Corporate Debt Restructuring framework) to strengthen financial stability.²² Furthermore, bolstering capital buffers in public sector banks remains essential to ensure the banking sector's ability to support the recovery, while allowing the PSBs to meet their Basel III obligations.
- Given the increased unhedged FX exposures of large corporates, strengthened monitoring of the extent of corporate vulnerabilities is warranted.
- Staff continues to endorse the 2012 FSAP's recommendation to reduce group exposure limits in line with international norms.
- The RBI should continue its focus on improving debt recovery by banks, including by providing incentives to swiftly deal with delinquent borrowers (including through enhancing supervision) and promoters. Efforts are needed to improve the insolvency legal and institutional framework, particularly on the implementation side of the Companies Act 2013. This includes building a larger corps of specialized judges and a cadre of insolvency and workout experts in the private sector, to facilitate faster insolvency resolution
- Steps to update India's regulatory architecture, drawing upon the recommendations by the Financial Sector Legislative Reform Commission (FSLRC) and those in consonance with global regulatory reform, should continue.²³
- The Statutory Liquidity Requirement should continue to be reduced as the fiscal deficit declines, which will free up resources for lending to the private sector.
- Measures to enhance the corporate bond market should be taken, by improving liquidity in the secondary market and developing a robust bond holder protection mechanism.
- The emphasis on financial inclusion could also be facilitated by new technologies (for example, Aadhaar-based KYC compliance and Aadhaar-supported direct benefit transfers), including by utilizing mobile phone payments technology.

²² The RBI's December 2014 *Financial Stability Report* finds that provisions would not be able to cover expected losses from credit risk under certain adverse macroeconomic conditions (based on an analysis of the 60 largest banks).

²³ To revamp financial sector laws, the government set up the FSLRC in March 2011. The Commission in its report has given wide-ranging recommendations, both legislative and nonlegislative, on the institutional, legal, and regulatory framework and operational changes in the Indian financial sector. The draft Indian Financial Code has been proposed and includes provisions that aim at replacing existing financial laws.

Authorities' Views

35. The authorities emphasized the strong actions taken over the past year to strengthen the regime for tackling stressed assets. They noted that they are balancing the need to instill greater payment discipline in borrowers against the challenges faced by banks and infrastructure firms that are over-leveraged, in some cases due to lack of government action to clear projects in a timely manner. The authorities have created a database of large borrowers and placed pressure on “willful defaulters.” At the same time, they recognized the challenges inherent in the ARC mechanism, and an effort is underway to reform the bankruptcy and insolvency framework.

36. The authorities view the slowdown in private sector credit growth as primarily due to weak demand for bank loans, rather than impaired balance sheets of banks. In their view, the build-up of excess capacity in some sectors during the boom years means that the current recovery could continue with sluggish credit growth. In addition, they noted that oil marketing companies’ demand for bank credit has fallen in light of much-reduced oil prices. Furthermore, some corporates are shifting to non-bank financing sources, reflecting in part their lower funding costs. On the supply side, lenders are now more cautious than previously, given the RBI’s efforts to rein in bad lending practices, but banks—including the public sector banks—remain well capitalized and liquid.

E. Structural Policies to Boost Growth and Employment

37. Addressing long-standing supply bottlenecks, especially in the energy, mining and power sectors, as well as labor and product market reforms, are crucial to achieving faster growth and job creation. The strong mandate given to the government in May 2014 provides an opportunity to continue to unlock the productive potential of the country. Key reforms, including those to factor markets (land, labor, natural resources), are:

- *Reforms to the power sector and rationalizing natural resource allocation.* Addressing structural challenges in the power sector and natural resource allocation (in particular allowing further private sector participation in coal mining, including for commercial mining) and pricing are critical to boosting investment and potential growth.²⁴
- *Easing land acquisition.* As part of ongoing efforts to enhance the pace of land clearances, in December 2014 the government approved an ordinance to simplify and clarify the process of acquiring land under the Land Acquisition, Rehabilitation and Resettlement Act 2013.
- *Strengthening the business climate.* Ongoing efforts to streamline and expedite land and environmental clearances should continue, as should simplification of procedures to improve India’s business climate. The authorities’ efforts to improve India’s ranking on the World Bank’s Doing Business indicators are welcome, particularly in the underperforming areas of resolving insolvency, enforcing contracts, and trade across borders. Adopting the recommendations of the Tax Administration Reform Commission would do much to improve the business climate.

²⁴ The government has recently (December 2014) initiated deregulation of the coal industry (through the Coal Mines Ordinance) by opening commercial mining to private sector participation, and raised administered natural gas prices (which should incentivize natural gas production).

- *Improving labor market flexibility.* Recent steps by some states (for example, Rajasthan) to increase labor market flexibility are welcome and should be complemented by further reforms at the national level. Such reforms are key to increasing employment in the formal sector, broadening the manufacturing base, and harnessing India's demographic dividend. More flexible labor markets would boost female labor force participation, which has been falling in recent years (see Selected Issues Chapters XI and XII on India's progress in meeting the Millennium Development Goals and employment of women).²⁵
- *Reorienting expenditure towards growth enhancing and social spending.* Structural fiscal reforms (including tax and subsidy reforms) will create the fiscal space for expenditure on health and education, as well as on much-needed public infrastructure.
- *Agricultural reforms.* Reforms in agriculture, in particular to reduce inefficiencies in the public system for food procurement, distribution and storage, as well as lessen impediments to inter-state movement of agricultural produce, should be instituted. Factors hampering agricultural productivity, including inadequate irrigation infrastructure, should be addressed.

Authorities' Views

38. There is broad agreement that structural reforms will be needed to achieve higher potential growth. The authorities noted that efforts to improve the business climate have gathered new momentum under the current government. The Prime Minister has set the target of dramatically improving India's ranking in the World Bank's Doing Business survey, and a "Make in India" campaign has been launched to attract investment. They emphasized steps being taken, both at the center and in the states, to ease labor market restrictions, and pointed to plans for a simplification of the Land Acquisition, Rehabilitation and Resettlement Act.

STAFF APPRAISAL

39. Policy actions have reduced external vulnerabilities, though risks remain. India was hit hard by global liquidity tightening during the post-May 22, 2013 taper tantrum period. In response, the authorities' implemented wide-ranging policies to contain market volatility, accelerate project approvals, correct imbalances and build buffers against external shocks. While India's underlying vulnerabilities have receded, there remains little room for countercyclical macroeconomic policies to respond to domestic and external shocks.

40. India's economic outlook has improved. The near-term growth outlook is favorable, helped by greater political certainty, several policy actions, improved business confidence, and reduced external vulnerabilities. Growth appears to have bottomed out and is expected to strengthen gradually as a result of the revival in industrial and investment activity, and steps taken to alleviate supply-side bottlenecks. India's persistently-high inflation has moderated recently, due to favorable base effects, a tight monetary stance, lower global commodity prices, and government efforts to contain food

²⁵ See also R. Anand, V. Tulin and N. Kumar (2014), "India: Defining and Explaining Inclusive Growth and Poverty Reduction," IMF WP 14/63.

inflation. Nonetheless, inflation remains a key concern given its ingrained nature and elevated inflation expectations. Tight fiscal and monetary policies are needed to continue to narrow macroeconomic imbalances.

41. Notwithstanding brighter economic prospects, downside risks remain. On the external side, despite the strengthening of buffers and reduced vulnerabilities, spillovers from weak global growth and global financial market volatility could be very disruptive, including from any unexpected developments in the course of U.S. monetary policy normalization. Domestic risks include heightened weaknesses in corporate balance sheets and worsening bank asset quality, as well as slower-than-expected progress in addressing supply-side bottlenecks, which could weigh on growth. On the upside, expedited structural reforms and faster implementation of cleared investment projects could lead to stronger growth, as would a further decline in global energy prices.

42. Monetary policy needs to remain tight to consolidate recent gains in reducing inflation. In the absence of supply-side measures to raise potential output and constrain food price inflation, maintaining a tight monetary stance is needed to durably bring down inflation and achieve the RBI's 6 percent CPI inflation objective by 2016. To lower inflation durably over the medium term, a tight monetary policy stance will need to be accompanied by further structural reforms. Continued progress is needed to further strengthen the monetary policy framework and move towards flexible inflation targeting.

43. While continuing fiscal consolidation is welcome, the quality of fiscal adjustment should be improved. Recent fiscal consolidation has been achieved largely as a result of cuts in capital spending, while tax revenues have stagnated. The October 2014 diesel-price deregulation and capping of LPG subsidies are welcome and are expected to help lower the fuel subsidy bill. The medium-term fiscal targets are broadly appropriate, but appear challenging in the absence of clearly articulated measures that would underpin the targeted fiscal adjustment. Significant tax reforms (including through introduction of the GST and better tax administration) and rationalizing subsidies (including through further reductions in fuel and fertilizer subsidies and untargeted food subsidies) will be required to create the fiscal space for higher growth-enhancing capital spending and social expenditures.

44. The external position is broadly consistent with medium-term fundamentals, while reserves are assessed to be adequate. Given India's increased and adequate reserve buffers, greater exchange rate flexibility would be welcome and thereby encourage private sector entities to limit excessive risk taking. Foreign exchange intervention should be limited to preventing disruptive movements in the exchange rate. If global financial market volatility resurfaces, exchange rate flexibility should be an important shock absorber. The current account deficit financing mix could be improved by enhancing the environment for attracting stable, non-debt creating capital flows, particularly FDI. Further liberalization of external commercial borrowing should proceed cautiously, given the potential vulnerabilities of corporate balance sheets.

45. While the Indian banking system is well capitalized, slow growth and heightened corporate vulnerabilities have led to a deterioration in bank asset quality. The RBI should further strengthen regulation for banks' credit quality classification, require increased provisioning, continue to monitor corporates' FX unhedged exposures, and reduce group exposure limits in line with international norms to bolster financial stability. Furthermore, augmenting capital buffers in public sector banks remains essential to ensure the banking sector's ability to provide adequate credit to support the recovery, while allowing public banks to meet Basel III capital requirements. Over the medium term, the authorities should implement their plan to reduce the public shareholding in public sector banks to 52 percent, and improve corporate governance at public banks.

46. Reforms to labor and product markets, as well as alleviating long-standing supply bottlenecks, are crucial to achieving faster, more inclusive growth. Tackling structural challenges in the power sector and natural resource allocation and pricing, are critical to boosting investment and potential growth. Ongoing efforts to streamline and expedite land and environmental clearances should continue, as should simplification of procedures to improve India's business climate. Further reforms to increase labor market flexibility are key to increasing employment in the formal sector and broadening India's manufacturing base.

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

Text Table 1. Key Policy Actions 2014/15¹**Food Inflation**

Smaller minimum support price (MSP) increases for cereal crops for 2014/15: paddy by 3.8% and wheat by 3.6%; imposed restrictions on state governments that offer additional bonuses over MSP to remove cascading. Approved sale of 10 million tons of wheat in the domestic open market. In January 2015, the government revised food grain buffer stock norms and mandated sale of excess stocks.

Brought onion and potato within the purview of stockholding limits under the Essential Commodities Act, 1955 to empower states to undertake de-hoarding operations to control prices. Authorized National Agricultural Cooperative Marketing Federation to import onion to augment domestic supply.

Advised state governments to delist fruits and vegetables from the Agriculture Produce Marketing Committee (APMC) Act, 1998 to allow farmers the freedom to sell their produce in alternative markets.

Proposed Rs. 5 billion price stabilization fund and creation of a National Common Market for agricultural commodities; set up a committee to consider restructuring of Food Corporation of India to improve its operational efficiency.

Fiscal Policy

Raised rail passenger fares by 14.2 percent and freight rates by 6.5 percent; deregulated diesel price (October 2014) and raised excise duty on petrol and diesel on four occasions (most recently in January 2015); announced revised formula for natural gas price fixation; raised gas prices to \$5.61/mmbtu from \$4.20/mmbtu, with a provision to revise prices every six months; fixed LPG subsidy on a per cylinder basis; and re-launched modified Direct Benefit Transfer (DBT) Scheme in LPG in 54 districts in November 2014, to cover whole country (676 districts) beginning 1st January, 2015.

Announced a 10 percent cut in non-plan expenditure; set up an Expenditure Management Commission to streamline government spending.

Ease of Doing Business

Amended Apprentices Act to redefine small factories (up to 40 workers) and freed those from furnishing separate labor returns; introduced electronic portal to allot Labour Identification Number (LIN) to facilitate online compliance on labor laws; activated random inspection scheme; allowed women to work on night shifts; raise overtime hours limit; advised states to allow self inspection of boilers; and introduced online system for environment and forest approval.

Rajasthan state government amended (though presidential assent) its state labor laws: (i) Industrial Disputes Act to allow companies employing less than 300 people (previously 100) to undertake retrenchments without permission; (ii) Contract Labor Act to free up companies employing 50 or less from (previously, 20); Factories Act to raise the bar to 20 workers (previously, 10) to be categorized as manufacturing; and (iv) Apprentices Act to allow third party training of apprentices. Madhya Pradesh, Haryana and Maharashtra states have evinced interest in carrying out similar changes.

Structural Policy

Allowed 100 percent FDI in railway infrastructure and construction development sector; raised FDI in defense to 49 percent from 26 percent, with provision to approve FDI above 49 percent on a case-by-case basis. Introduced ordinance to raise FDI in insurance sector to 49 percent from 26 percent (December 2014).

Issued an ordinance to facilitate re-auction of cancelled coal blocks for captive use; undertakes to open up the sector to commercial allocation at a later date.

In January 2015 the now-dismantled Planning Commission was replaced with the NITI (National Institution for Transforming India) Aayog, which will be a think-tank for the central and state governments with several key objectives: to evolve national development priorities; to foster cooperative federalism and develop mechanisms to formulate plans at village level; and to focus on technology upgrades.

Announced national strategy for "Make-in-India" to boost manufacturing (October 2014).

¹Prepared by Sudip Mohapatra.

Text Table 1. Key Policy Actions 2014/15 (Concluded)

Infrastructure Initiatives
Plan to complete work on industrial corridors; build 100 smart cities, link key cities with bullet trains; initiate "Sagarmala project" to set up 10 coastal economic regions (CERs) and implement "digital India Project".
SEBI notified regulations for Real Estate Investment Trusts (REITs) and Infrastructure Investment Trusts (InvITs); RBI allowed banks to raise long-term bonds with a minimum maturity of 5 years to finance infrastructure sector. Road Ministry empowered to amend "Model Concession Agreement" to expedite road projects.
Financial Sector
RBI grants "in-principle" approval to two new banks and will consider giving licenses "on tap" in future (April 2014); issued guidelines on differentiated bank licenses for payment banks and small banks to allow a wider pool of financial institutions to enter the banking sector.
Launched Pradhan Mantri Jan Dhan Yojana (PMJDY) scheme to open 100 million bank accounts for poor families; account holder to benefit from a debit card, accident and life insurance cover and an overdraft facility; accounts to be linked to Aadhaar numbers for future cash transfers under various social security schemes.
RBI extended the transitional period for full implementation of Basel III Capital Regulations to March 31, 2019, instead of March 31, 2018; and issued the final guidelines on the Liquidity Coverage Ratio, to be introduced in a 5-year phased manner starting with a minimum requirement of 60 percent from January 1, 2015.
RBI introduced a framework for revitalizing distressed assets with guidelines for refinancing of project loans, sale of NPAs and other measures, and issued guidelines for flexible restructuring/refinancing long-term project loans and take-out financing under 5/25 rule against existing and fresh loans to infrastructure and core industry projects. RBI issued new guidelines against "non-cooperative borrowers", defined as willful defaulters with loan amounts of Rs 50 million or more.
Set up four Task Forces to assist the government in preparing the roadmap for the establishment of new agencies as per the recommendations of FSLRC committee report. Government allowed Public Sector Banks (PSBs) to raise capital to meet their additional capital requirements under Basel III (due by 2019) by diluting the government's shareholding in PSBs to 52 percent in a phased manner (issued December 2014).
Monetary Policy
RBI accepted Patel Committee recommendations to anchor CPI headline inflation with a "glide path" for achieving 8 percent CPI headline inflation by January 2015 and 6 percent by January 2016. RBI shifted to a bi-monthly cycle of monetary policy review and provided one-year-ahead inflation forecasts. Government supportive of formal adoption of a new monetary policy framework for flexible inflation targeting.
RBI raised repo rate by 25 bps to 8 percent in January 2014, and then reduced the rate by 25 bps in January 2015; reduced SLR by 100 bps to 22 percent of NDTL; raised limit for liquidity under 7-day and 14-day term repos to 0.75 percent of NDTL and reduced liquidity under overnight repos (LAF) to 0.25 percent of NDTL; reduced HTM ceiling to 24 percent of NDTL; and reduced liquidity under export credit refinance (ECR) to 15 percent of eligible export credit outstanding.
Balance of Payments Measures
Removed quantitative restrictions on import of gold under 80:20 scheme (November 2014).
Share of long-term investors in government dated securities, within the overall limit of US\$ 30 billion for FII investment, was reduced by US\$ 5 billion. Restricted FII investment in T-bills and Government-dated securities to those with a residual maturity of more than three years.
Raised the limit for individual remittances to \$125,000 from \$75,000; restored the limit of Overseas Direct Investments by corporates to 400 percent of net worth.
Risk Management
RBI allowed free canceling and rebooking of forward contracts for all current and capital account transactions with a residual maturity of one year or less; relaxed hedging of currency risk by exporters and importers under the past performance route; allowed FIIs to hedge the coupon receipts falling due during the next 12 months and rebooking of cancelled contracts in case of contracted exposures; and allowed all resident individuals, firms and companies to book foreign exchange derivative contracts up to US\$ 250,000.

Text Table 2. India FSAP Main Recommendations and Risks: December 2014 Update¹

Policy recommendations	Risks identified on mission
Addressing system-wide risks	Actions since 2013 Article IV Mission (Nov. 2012)
<p>Enhance RBI monitoring of corporate indebtedness, refinancing risk, and foreign exchange exposures. (¶13 - FSSA)</p>	<p>Further risk reduction. Banks were directed to check their corporate customers' unhedged FX-exposures and to appropriately reserve against those in line with formulas provided by the Reserve Bank of India (RBI) and to exchange information about them. Non-compliance can be penalized by supervisors.</p> <p>In order to get a comprehensive overview of the exposures of larger corporates, the RBI is setting up the "large borrower's database." Banks are supposed to provide information on corporates whose total exposure exceeds Rs 50 million (including ECBs extended by Indian overseas bank offices and branches). This database is up and running now, albeit data quality and operational issues have to be ironed out before the data can be fully relied upon. The data will inform the RBI about corporate exposures, but will be also shared with the banks. It is intended for the system to later be merged with the information compiled about FX-exposures. Since December 2013, banks also have to report accounts past due between 61-90 days, and have to set up a joint lenders' committee for those with exposures in excess of Rs 1 billion.</p>
<p>Improve the performance and financial strength of public financial institutions and subject them to full supervision and regulation. (¶20)</p>	<p>Further reduction of vulnerabilities and risks. A law is being drafted to remove members of boards of public banks who are related to supervisory agencies.</p> <p>The Nayak Committee published its report on the governance of banks in May 2014, recommending significant changes to governance in public sector banks (PSBs). The authorities stated that they are closely looking at the report's recommendations, with an eye to implementing a number of those. The announced intention of the Government of India to reduce its shareholdings in PSBs to 52 percent will be supportive in that process.</p> <p>The mission was informed that some of the public financial institutions are non-bank financial corporations (NBFCs), which are not subject to RBI oversight. RBI has recommended that they be made subject to RBI oversight. No change in the law is needed for that.</p> <p>It should be noted that the FSLRC will restructure India's financial supervisory system completely, likely leading to greater centralization.</p>

¹Prepared by Peter Lindner.

Text Table 2. India FSAP Main Recommendations and Risks: December 2014 Update (Continued)**Financial sector oversight**

Strengthen oversight of banks' overseas operations through Memorandums of Understanding (MOUs) with host countries, onsite inspections, and supervisory colleges. (¶135)

Additional risk reduction. Additional MOUs are being negotiated and signed. RBI has hosted supervisory colleges for Indian banks with a major international presence. Overseas offices of five large Indian banks representing 86 percent of total overseas assets have been inspected so far.

Enhance formal statutory basis for the autonomy of regulators in carrying out their regulatory and supervisory functions. (¶135, 41, 46)

Additional risk reduction. See point 2 above ("Further reduction of vulnerabilities and risks").

The RBI notes that it currently cannot revoke the license of a PSB, since they are organized as state-owned enterprises, outside the Companies' Act. The RBI is asking the government to change that. This would necessitate a change in the relevant legislation.

Tighten the definition of large and related party concentration (short-term) and reduce exposure limits to align them with international practices. (¶135)

No additional risk reduction. The authorities are committed to bring India in line with the 'Final Standard' for connected counterparties (disseminated by the Basel Committee for Banking Supervision in April 2014) by January 2019. However, they noted that India's current limits, which are above the international norms, are needed in order to facilitate financing particularly for infrastructure purposes. The RBI will soon issue a discussion paper on this subject.

Enhance specialized expertise available to the supervision function by developing programs to accredit and retain skilled supervisors. (¶137)

Some risk reduction is taking place. The RBI's human resources department is working on setting up a new certification system for supervisors. Also, a more structured and quantitative approach is being employed, based on a more intensive use of models. The U.S. Federal Reserve's approach to the accreditation of bank-internal credit models is being used. New training programs are being devised in cooperation with the World Bank's Financial Sector Development Program, as well as collaborative programs with other external agencies.

A particular challenge exists with regards to the training of NBFC supervisors, because of the variety of business models and issues that prevail in that area.

Continue to strengthen coordination and information sharing mechanisms among domestic supervisors via MOUs and formal frameworks. (¶149, 67)

Further reduction in risk. A Financial Stability and Development Council (FSDC) has been set up to strengthen financial stability, financial sector development, and inter-regulatory coordination. A subcommittee headed by the RBI Governor was also set up, with same membership as FSDC.

An inter-regulatory committee to help the banking sector to comply with Basel III norms was set up in March 2014, with a number of working groups focused on issues of financial inclusion, monitoring of financial conglomerates, and other issues. The inter-regulatory committee has initiated work on a repository which will capture all accounts of an individual or other entity.

Regulators are also working across agencies on specific issues and companies, when they span the purview of several agencies. A MOU between the RBI, SEBI, and other agencies was signed to facilitate the supervision of conglomerate entities. The RBI was also enabled to receive information directly from entities associated with banks.

The supervision of commodities exchanges was shifted to the Ministry of Finance from the Ministry of Corporate Affairs in order to make supervision more comprehensive, and avoid regulatory arbitrage (2013).

Text Table 2. India FSAP Main Recommendations and Risks: December 2014 Update (Continued)

Provide a lead supervisor with legal backing for conducting consolidated supervision with authority to inspect subsidiaries and affiliates. (¶49)	Additional risk reduction. Section 29a of the Banking Law was amended, which enables banking supervisors to inspect companies associated with any bank. The Law's provisions also enable a joint inspection of enterprises associated with banks by the RBI and other relevant regulators.
Expedite passage of Insurance Law (Amendment) Bill. (¶43)	Not passed yet.
Implement corrective action ladder for insurers. (¶45)	No change.
Enact legislation formalizing the New Pension Scheme and the Pension Fund Regulatory and Development Authority. (¶33)	Significant risk reduction. The new Pension Law (PFRDA) was passed.
Plan for the reduction in the Statutory Liquidity Ratio (SLR) and review the use of the hold-to-maturity category, incorporating changing global liquidity requirements. (¶51)	Some changes. The authorities want to keep the SLR as a monetary tool. Five percentage points of the SLR can be used for repo with the RBI for up to 30 days, representing high quality liquid assets; an additional two percentage points can be used to access the Marginal Standing Facility (MSF).
Strengthen resolution tools by granting stronger powers to supervisors to resolve nonviable entities in an orderly fashion. (¶53)	Some risk reduction. Work on this is in the planning stage. An internal working group had produced a plan on the resolution regime for financial institutions, while a task force under the FSLRC has been set up to work on an interagency basis. The RBI Governor has made this issue a priority. Vulnerabilities therefore still persist. The working group on resolution has also made recommendations for the resolution of NBFCs.
Develop and periodically test arrangements to deal with a major disruption to the financial system. (¶54, 66)	Some risk reduction. Work on this, both at the level of the Ministry of Finance and the RBI, is progressing. A crisis management group has been set up inside the RBI, while the inter-regulatory committee of the FSDC has set up an early warning group. Crisis arrangements for the payments system have been tested. A core settlement guarantee fund was set up at the Clearing Corporation of India (CCIL); SEBI also issued more granular norms for stress testing and the harmonization of default waterfalls across clearing corporations.
Broadening markets and services	
Ease investment directives and limits to encourage investments in corporate and infrastructure bonds by institutional investors. (¶34, 62)	Additional measures implemented. Taxes on FX-bonded debt were reduced; three types of investment limits for foreign investors were consolidated into one limit of \$51 billion; and new infrastructure investment schemes were implemented, one focused on foreigners. The one-year lock-in period for foreigners was removed. New guidelines were issued for insurers and pension funds, which should increase their participation in those markets. Corporate and infrastructure bonds can be used as collateral in repo with banks. Bonds issued for purposes of infrastructure financing are exempt from CRR and can be deducted from SLR requirements. Pension funds can now invest now in corporate and infrastructure bonds with a minimum rating of AA. In addition to a number of other measures providing greater flexibility for institutional investors when investing and trading bonds, mutual funds can now also use AA-rated corporate bonds in repo transactions. SEBI has also provided guidelines for the trading of bonds on stock exchanges.

Text Table 2. India FSAP Main Recommendations and Risks: December 2014 Update (Concluded)

Consider further easing restrictions on bond market investments by foreign institutional investors (FIIs). (¶159)

Some progress. Limits on foreign institutional investor (FII) investments in GSecs and T-bills together were combined into one, and increased to \$30 billion.

Financial market infrastructure

Require Central Counterparty Clearinghouses to strengthen their liquidity risk management procedures to enable them to better cover losses in the event of a member's failure. (¶166)

Notable risk reduction. Credit lines of Rs 27 billion are now available to Central Counterparty Clearinghouses for their settlement with the RBI, and Rs 63 billion in lines at designated settlement banks. US\$ 750 million in lines were made available for FX clearing.

SEBI advised the Central Counterparties (CCPs) to effectively measure, monitor, and manage liquidity risk, in line with the CPSS-IOSCO Principles for Financial Market Infrastructures. SEBI requires CCPs to test the adequacy of their clearing arrangement.

The issue of the RBI providing liquidity support to CCPs of stock exchanges will be looked at in the future.

Consider replacing the commercial bank settlement model for corporate securities and derivatives with a central bank settlement model. (¶166)

Some progress. A committee of SEBI and the RBI is working on this issue. A working group favors the current settlement model of CCIL, where clearing corporations and clearing banks settle via their central bank accounts.

Enact comprehensive modern corporate insolvency law and upgrade SARFAESI (Securitization and Reconstruction of Financial Assets and Enforcement of Security Interest) Act 2002 and other existing laws governing insolvencies. (¶169)

Partial progress. New insolvency statutes have been passed as part of the Companies Act. Its passing should be beneficial for the insolvency process, decreasing uncertainty and increasing credit availability particularly for small- and medium-sized enterprises.

The Government of India has set up a committee to devise an entrepreneur-friendly bankruptcy framework.

Box 1. Potential Growth in India¹

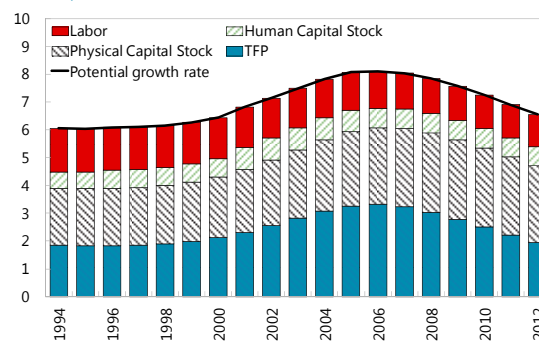
Staff estimates suggest India's potential output growth is about 6¾ percent in the medium term. A range of empirical approaches used to estimate potential growth indicate that India's trend growth peaked at about 8 percent just before the Global Financial Crisis of 2008, but has declined in recent years to around 6–7 percent. Similarly, the Reserve Bank of India has also recently lowered its estimate of potential growth to about 7 percent.

India's potential growth slowdown in recent years appears to have been driven largely by the decline in trend total factor productivity (TFP) growth. Specifically, the contribution of TFP is estimated to have declined from about 3 percentage points during the high-growth period of 2002–07 to about 2 percentage points during 2011–13. A sector-based growth analysis reveals that the slowdown was more pronounced in sectors affected by regulatory and infrastructure bottlenecks, pointing to the importance of addressing supply-side constraints.

Against the background of weakened potential growth and with actual GDP growth falling below 5 percent in both 2012/13 and 2013/14, excess supply has emerged. However, given the limited policy space, tight fiscal and monetary policies have had to be put in place to rein in India's persistently-high inflation and current account deficit pressures. Rebuilding policy space will enable room for credible counter-cyclical aggregate demand management policies going forward.

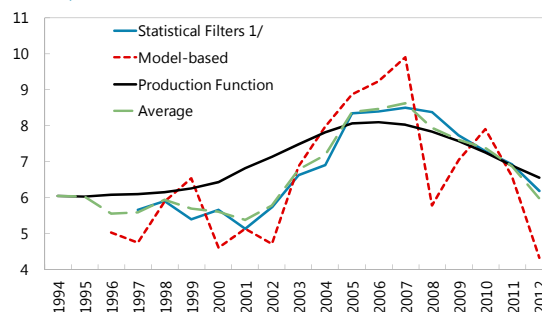
Raising India's potential growth will require a multi-pronged strategy to improve factor productivity, including through productivity-enhancing capital investment. Reforms to strengthen the business climate as well as factor market reforms (land, labor, natural resources) are crucial to revitalize India's growth and better utilize its large and young labor force.

India: Estimated Contributions to Trend Growth
(In percent)



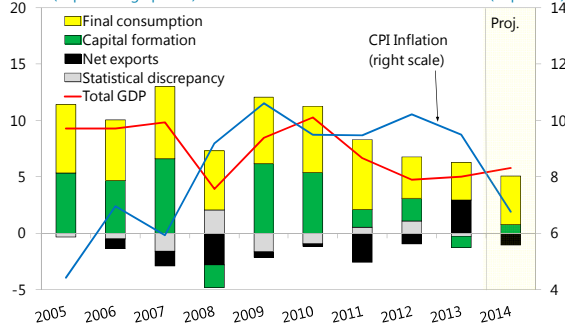
Sources: Anand et al., "Potential Growth in Emerging Asia," IMF WP 2014/2.

India: Trend Growth Estimates
(In percent)



Sources: Anand and others, "Potential Growth in Emerging Asia," IMF WP 2014/2. 1/ Hodrick-Prescott, Baxter-King, Christiano-Fitzgerald and Kalman filters applied.

India: GDP Growth Contributions and Inflation
(In percentage points)



Sources: Haver Analytics; and IMF staff estimates.

¹ Prepared by Volodymyr Tulin.

Box 2. Balance-Sheet Analysis (BSA) of the Indian Economy¹

The balance-sheet matrix depicts gross asset and liability positions of different sectors of the Indian economy, and is used to assess risks and cross-sector spillovers. The BSA for India is based on the flow of funds data as published by the Reserve Bank of India—consisting of 2011/12 data on the sources and uses of funds of the following sectors: (i) Banking, (ii) Other Financial Institutions, (iii) Private Corporate Business, (iv) Government, (v) Rest of the World, and (vi) Households. Of these six sectors, flows from the rest of the world constitute only 9 percent of total inter-sectoral financial flows (indicating the relatively-closed nature of the Indian economy), while the banking sector and other financial institutions form about 40 percent of total inter-sectoral financial flows (highlighting a mainly bank-based financial system).

The banking system is mostly exposed to the government (representing 50 percent of their assets). This is primarily due to the fact that banks have been restricted by regulation in their use of funds, including from reserve requirements as well as the regulation to invest a portion of their funds in government securities and lend to “priority sectors”. Other financial institutions (OFIs) are of two types: (i) term-lending institutions which obtain most of their funds from banks and intermediate them to corporates; or (ii) insurance funds, public provident fund, or unit trusts that are mainly financed by households (magnitudes of exposures are reflected in the Table below).

The linkage between the financial and real sectors comes from households’ financial savings as well as physical investment made by deficit sectors: private corporate sector and government.

An important financial asset of the household’s portfolio is bank deposits, which is, in turn an important source of funds for banks. Apart from statutory requirement in the use of funds, the two assets where banks can actually exercise choice are: excess reserves and loans to corporates (affected by monetary and fiscal policies as well as portfolio choice of saving households). The liabilities of corporates amount to 30 percent of India’s total inter-sectoral financial borrowings as at end 2011/12, and are mainly financed from the rest of the world sector (23 percent), the banking system (18 percent), or OFIs (15 percent). There has been a marked increase in leverage of the private non-financial corporate sector since early 2000s, reflecting easy global and domestic financial conditions. Corporates have resorted to market financing, including external borrowing (in the form of External Commercial Borrowings and Foreign Currency Convertible Bonds), partly reflecting lower financial savings by households (resulting from elevated inflation and inflation expectations, and higher gold purchases), and higher government financing requirements.

We identify the following risks and cross-sector spillover channels from our BSA. The main risk is the weakness in corporate balance sheets (including a large exposure to rest of the world). Further corporate stress could emerge from a surge in global financial market volatility (affecting one of the main sources of funds for corporates), adding to banks’ non-performing assets (NPAs), raising capital concerns and reducing lending in the medium term. Further deterioration in banks’ asset quality, especially in public banks, could constrain credit supply given the high share of government in banks’ portfolio of assets. Despite the fact that a captive domestic investor base mitigates the impact of any real interest rate shocks, the share of government in the asset portfolio of banks is very high and should be gradually reduced over time (alongside further fiscal consolidation).²

¹ Prepared by Sonali Jain-Chandra and Mehdi Raissi.

² Data gaps, including on the currency composition and maturity profile of different sectors’ assets/liabilities, constrain a deeper analysis of risks and spillovers.

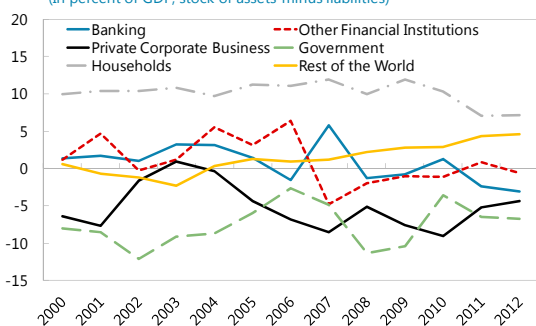
Box 2. Balance-Sheet Analysis (BSA) of the Indian Economy (Concluded)

Financial Accounts by Sector (Flow of Funds)

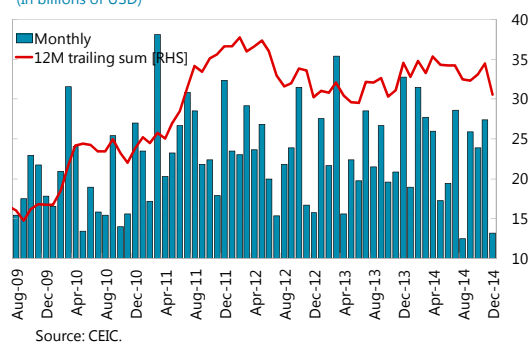
Billions of rupees; end-2011

FOF (India)		Banking Sector	Other Financial Institutions	Private Corporate Business Sector	Government	Rest of the World	Households	Sector not elsewhere classified	Total
Banking Sector	Asset		111	2461	5955	1267	2720	146	12660
	Liability		882	1011	2062	1461	6723	2416	14555
Other Financial Institutions	Asset	1054		2446	1090	73	560	571	5794
	Liability	1048		240	192	131	2319	923	4853
Private Corporate Business Sector	Asset	1011	228		272	530	3	5658	7702
	Liability	2456	2041		3	3144	226	5830	13700
Government	Asset	2059	19	3		100	8	1545	3734
	Liability	6007	1485	0		185	199	1326	9202
Rest of the World	Asset	782	0	3144	116		0	0	4042
	Liability	-678	0	473	8		0	373	176
Households	Asset	6357	2696	226	351	0		0	9630
	Liability	2720	88	3	8	0		0	2819
Total	Asset	11263	3054	8280	7784	1970	3291	7920	43562
	Liability	11553	4496	1727	2273	4921	9467	10868	45305

Financial Accounts: Flow of Funds by Sector (In percent of GDP; stock of assets minus liabilities)

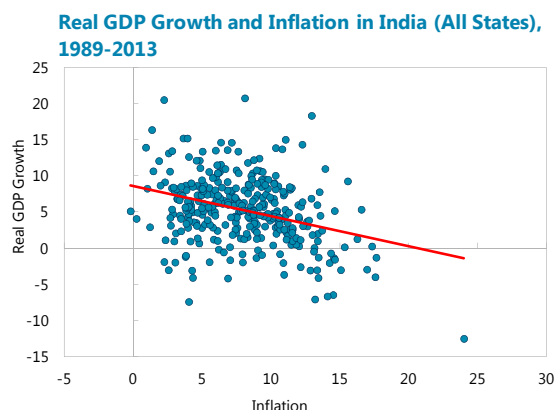


Monthly External Commercial Borrowing/ Foreign Currency Convertible Bonds Flows (In billions of USD)



Box 3. Does Inflation Slow Long-Run Growth in India?¹

Is there a non-linear long-run relationship between consumer price index industrial workers (CPI-IW) inflation and GDP growth in India? The inflation-growth trade-off and the role of monetary policy in India have received renewed interest among policy makers and academics in recent years as persistently-high inflation and weak growth have co-existed. The conventional view is that inflation at low levels “greases the wheels” of the economy, while at high levels it negatively affects the economy’s allocative efficiency and growth. In other words, while the short-run Phillips Curve postulates that inflation tolerance could be associated with higher growth, persistently-high inflation, especially beyond a certain threshold, (by itself) could be a drag on economic growth in the long run. We provide a re-examination of the inflation-growth relationship in a sample of 14 Indian states over the period 1989–2013, and estimate the threshold level of inflation beyond which growth is more severely undermined.



A key finding is that there are significant negative long-run effects of persistently-elevated inflation on growth in India, and a growth-inhibiting inflation threshold of 5.5 percent. Our findings suggest that, on average, there is a negative long-run relationship between inflation and growth in India. Statistically-significant inflation-growth threshold effects are found for states with persistently-elevated inflation rates of above 5.5 percent. Specifically: (i) at low enough levels of inflation (below 3 percent) we do not observe any statistically-significant effects of inflation on output growth; (ii) average growth is higher for those states and periods which experienced inflation below 5.5 percent; and (iii) when inflation is greater than 3 percent, we observe a negative and statistically-significant effect of inflation on long-run growth (with this negative effect being larger when inflation is above 5.5 percent).

This suggests the need for the authorities to balance the short-term growth–inflation trade-off, in light of the long-term negative effects on growth of persistently-high inflation. Inflation in India is driven by both supply and demand-side factors (including the National Rural Employment Guarantee Act, supply bottlenecks, food and energy price pressures, and elevated inflation expectations). Nonetheless, inflation remains one of the most important problems facing India’s economy. Therefore, the authorities (via supply-side reforms as well as monetary policy) should strengthen their anti-inflation efforts in order to avoid any negative long-run effects of excessive inflation on growth.

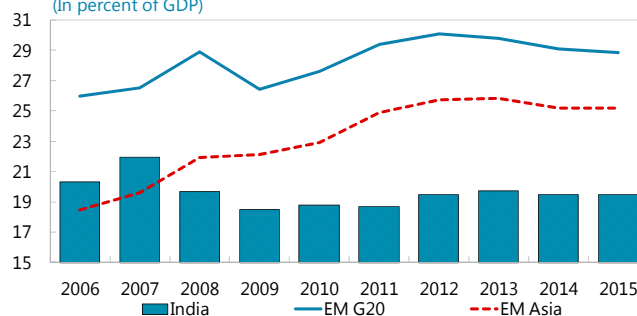
¹ Prepared by Mehdi Raissi. Based on K. Mohaddes and M. Raissi (2014), “Does Inflation Slow Long-Run Growth in India?,” IMF WP/14/222.

Box 4. Goods and Services Tax and Tax Administration in India¹

India's government sector is under-resourced, as revenue as a share of GDP has stagnated, after falling sharply in 2008, and is now well below EM peers. Moreover, revenue ratios at the general government level mask a concern about the central government, which retains own revenue of only about 9 percent of GDP, after statutory transfers to India's states. Against this backdrop, India is moving towards introduction of a new goods and services tax, as well as considering measures to improve tax administration.

General Government Revenue

(In percent of GDP)



Source: Oct 2014 Fiscal Monitor.

Goods and services tax (GST). A well-functioning GST will enhance tax compliance, and over time, following the creation of a single market, boost growth, perhaps by as much as 1–1½ percent of GDP (see NCAER report: <http://bit.ly/1rYbdCv>). However in the near term, the GST may not add substantially to revenue, as it would replace a number of central and state level indirect taxes. Further, the center is expected to guarantee compensation—for a limited time—to states which lose revenue. The GST design being contemplated is also fairly complex, with a dual administration arrangement that involves the tax authorities of both the center and the states separately taxing a single transaction. Issues that will require further work include crediting across interstate borders, settlement of revenue sharing, and building capacity in states to tax services.

Revenue administration. There is also scope for garnering revenue through improved tax administration. Despite a population of 1.2 billion, there are only about 40 million direct taxpayers, both corporate and individual. A broader tax base and better compliance management could yield additional revenues. In 2013, the Ministry of Finance established a high-level tax administration reform commission (TARC). The TARC reports propose a thorough modernization of the revenue administration framework in India, to enhance revenue performance, improve the business climate by simplifying procedures, and tilt the corporate culture of India's revenue administration toward customer service (<http://bit.ly/1vpnVER>). Key recommendations are:

- Reorganization of revenue administration along functional lines—to promote better data sharing and a comprehensive understanding of tax payers' businesses—by merging the central boards of direct and indirect taxes and customs
- More sophisticated use of integrated data bases and information technology
- Making the large taxpayer unit mandatory, instead of voluntary as at present
- Changing some tax policies to capture better-off individuals, including in the currently untaxed rural sector by taxing high income (over Rs 5 million, or about \$83,000) farmers
- Raising the quality of tax administration professionals through skill development
- Improved dispute resolution processes that are faster, less adversarial and more collaborative and customer focused
- Strengthening the tax policy function in the Ministry of Finance by creating a Tax Council, headed by the Chief Economic Advisor.

The reform of revenue administration in India would be a multi-year endeavor, but it should reduce fiscal vulnerabilities by closing some of the revenue gap with EM peers.

¹ Prepared by Thomas Richardson.

Box 5. Assessing Reserve Adequacy in India¹

India's international reserves have increased by \$45 billion since September 2013 to reach \$320 billion as at end-December 2014. The build-up of reserves is mainly driven by three factors. The first is the sharp fall in India's current account deficit (CAD)—the CAD narrowed to 1.7 percent of GDP in 2013/14, a 3 percentage point of GDP reduction from the previous year, and is projected to remain at about 1.8 percent of GDP in 2014/15. Second is the inflow of about \$34 billion of non-resident Indian deposits and overseas borrowings by banks, facilitated by a concessional FX swap facility offered by the Reserve Bank of India (RBI) following the U.S. quantitative easing taper tantrum of summer 2013. The third factor is robust foreign institutional investor (FII) inflows—FIIs have made about \$48 billion in net purchases of Indian equities and debt between September 2013 and December 2014.

Given that any sudden stops or reversal of capital inflows could expose India to significant risks, holding an adequate level of international reserves is essential for the country to reduce its vulnerability. India is susceptible to surges in global financial market volatility (which could be triggered by monetary policy normalization in advanced economies) as well as commodity-price shocks, and should hold reserves for precautionary purposes. However, there is little consensus in the literature on what constitutes an adequate level of reserves from a precautionary perspective. This Box analyses international reserves in India using the reserve optimizing model of Jeanne and Ranciere (2011), and compares the findings with those of the IMF's risk-weighted metric (2013).² The results show that India's international reserve levels are adequate to cover a broad set of risks.

The Reserve Optimizing Model of Jeanne and Ranciere (2011): This model describes reserve accumulation as an optimization problem in which risk-averse policy makers choose the level of reserves to provide optimal insurance against a sudden stop in consumption, given the cost of holding reserves. When a sudden stop occurs, external debt cannot be rolled over and output falls below its long-run growth path. More reserves mitigate the fall in output and help smooth national consumption. However, there is a cost to holding reserves as they yield a lower return than other assets in the economy. In this model the optimal level of reserves is determined by the size and probability of the sudden stop, the potential loss in output and consumption, the opportunity cost of holding reserves, and the degree of risk aversion. Based on a calibrated version of this model to Indian data, the optimal level of reserves in India is estimated to be just above the projected actual holdings in 2014 (text chart).

IMF's Risk Weighted Approach (2013) employs a metric that reflects the relative risk levels of different potential sources of balance of payments pressure—the relative risk weights are based on tail event outflows associated with periods of exchange market pressure in different countries—and assess how large a stock of reserves might be needed relative to this risk weighted measure, to cover for outflows from different sources. For India the metric is constructed as 30% of short-term debt + 15% of other portfolio liabilities + 5% of M2 + 5% of exports. Coverage in the region of 100-150 percent of the metric can be regarded as adequate. India's reserve coverage against the proposed adequacy range of 100-150 percent (dashed lines) is shown below. In 2014, the projected level of reserves in India is at 148 percent of the IMF's reserve adequacy metric (text chart).

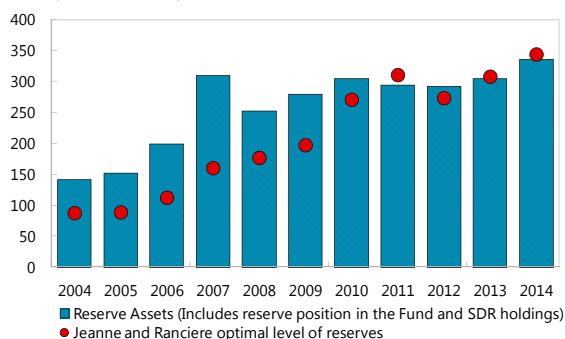
¹ Prepared by Mehdi Raissi.

² See O. Jeanne and R. Ranciere, (2011), "The Optimal Level of International Reserves For Emerging Market Countries: A New Formula and Some Applications," *Economic Journal*, Vol. 121 (555), pages 905-930; and International Monetary Fund, (2013), "Assessing Reserve Adequacy—Further Considerations," IMF Policy Paper, February (Washington: International Monetary Fund).

Box 5. Assessing Reserve Adequacy in India (Concluded)

Model-based Optimal Level of Reserves

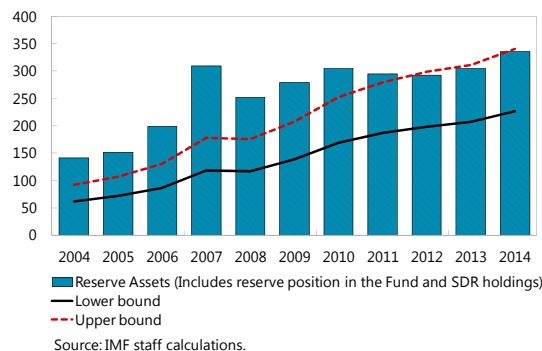
(In billions of USD)



Source: Staff calculations based on Jeanne and Ranciere (2011).

Reserves Against Risk-weighted Metric

(In billions of USD)



Source: IMF staff calculations.

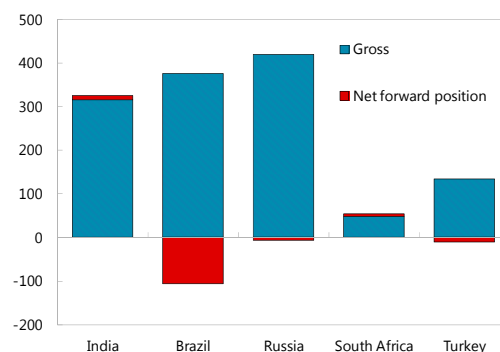
Overall, India's level of foreign reserves is adequate to cover a broad set of risks. However no one measure can fully capture the range of factors that bear on a country's resilience against shocks. Moreover, international reserves are only one part of a country's defense against shocks. As a complement to these approaches, regression analysis of observed reserve holdings against a range of precautionary variables can be used to infer the degree to which India's actual reserve levels are consistent with those of peers. While it could be argued that a sound macroeconomic and prudential policy framework is probably more important than reserves in limiting country vulnerabilities, the present uncertainties in global financial markets due to the prolonged use of accommodative monetary policies by advanced economies may warrant holding higher level of reserves than suggested by the IMF's reserves adequacy framework.

Assessments of reserve adequacy should also take into account any given country's off-balance sheet buffers/liabilities.

The RBI has purchased about \$64 billion in both spot and forward markets between April and November 2014, and has managed to balance its longer-dated FX liabilities incurred during fiscal year 2013/14. As at end-November 2014, the net outstanding forward FX purchases of the RBI stood at \$13.2 billion—a significant reduction from last year; this number also compares favorably with net reserve holdings of other EMs (text chart).

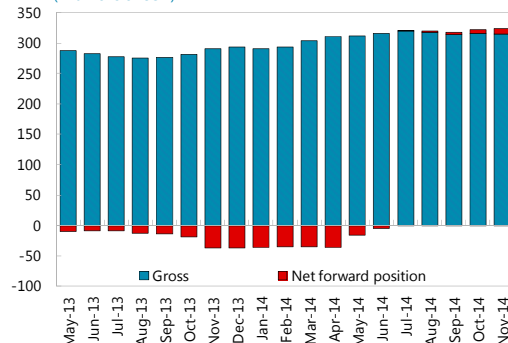
Reserves (as of November 2014)

(In billions of USD)



Indian Reserves

(In billions of USD)



Box 6. External Sector Assessment¹

Staff assesses that India's external position is broadly consistent with medium-term fundamentals and desirable policy settings.

Current Account and Exchange Rates

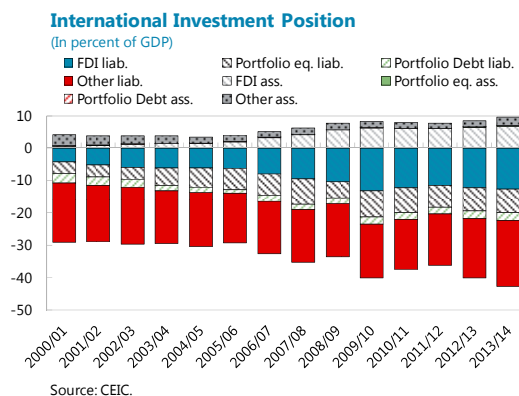
After a major adjustment in fiscal year (FY) 2013/14, the current account deficit (CAD) is projected to widen slightly to about 2 percent of GDP in FY2014/15 as domestic demand strengthens. The EBA CA regression estimates a norm of about -4.2 percent of GDP for India in FY2014/15. However, in staff's judgment, global financial markets could not be counted on to reliably finance a deficit of that size, in light of India's current (albeit reduced) vulnerabilities. Given the risks associated with global financial market volatility, staff assesses that a smaller CAD of about 2½ percent of GDP is a more appropriate norm. This level is higher than the estimated underlying CAD of about 2 percent of GDP in FY2014/15. The CA gap is therefore estimated to be in a range of -1 to +1 percent of GDP.

The real effective exchange rate appreciated by about 5 percent between March and October 2014, in comparison with a 7 percent depreciation during FY2013/14. The EBA REER regression approach estimates a slight gap of about +2 percent for the 2014 average REER. Staff assesses the REER gap for 2014 to be in the range of -5 to +5 percent, and is in line with the CA gap assessment. The EBA ES (external sustainability) approach estimates a CA norm of about -1.7 percent of GDP, as the CA consistent with holding the NFA-to-GDP ratio at its current level (-25.6 percent of GDP).²

Capital Account Flows and International Investment Position

India's financial account has been dominated by portfolio equity and FDI flows. However, the composition of CA financing has recently shifted toward more debt flows, particularly in the form of NRI deposits and external commercial borrowings. The financing mix should be improved by enhancing the environment for attracting stable non-debt-creating capital flows.

India's net international investment position (NIIP) deteriorated to -17 percent of GDP in FY2013/14, from -12 percent in FY2010/11. While both assets and liabilities have risen steadily over the last decade, external debt has increased sharply in the last three years. However, external debt at 23 percent of GDP as at end-September 2014 remains moderate when compared to other emerging markets. Furthermore, the maturity profile of external debt is favorable as the share of long-term external debt in total debt is about 80 percent and the ratio of short-term external debt to FX reserves is low. With CA deficits of about 2½ percent of GDP projected for the medium term, India's NIIP-to-GDP ratio will remain broadly stable.



¹ Prepared by Mehdi Raissi.

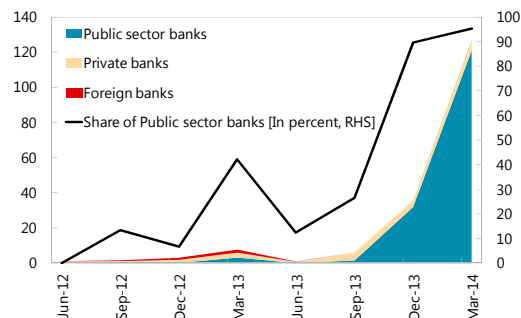
² However as noted in the IMF's 2014 Pilot External Sector Report, such a norm is of little interest, as India's net external position is only moderately negative and is not on a deteriorating trend.

Box 7. Asset Reconstruction Companies: A Solution to India's NPAs?¹

Asset Reconstruction Companies (ARCs) carry out acquisitions of non-performing assets (NPAs) from Indian banks and other financial institutions for the purpose of asset recovery through aggregation of debts, debt work-outs, or asset sales. ARCs specialize in working out difficult debts, an area of limited expertise for most banks. Since pursuing a restructuring requires the consent of holders of 60 percent of secured debt, through acquisition of advances from various creditors, ARCs are better positioned to help initiate restructurings. Since the fourth quarter of 2013, sales of NPAs by banks to ARCs grew at an unprecedented pace albeit from a low base, amounting to more than Rs 120 billion during the fourth quarter of FY2013/14.

NPA Sales to ARCs

(In billions of Indian rupees, at Transfer Prices)



Sources: Reserve Bank of India; and IMF staff calculations.

The acquisition of impaired assets by ARCs is usually carried out through special purpose vehicles, which are financed through the issue of security receipts (SRs), of which most—up to 95 percent—were held by the banks that had sold the assets, and the remainder by the ARCs. Regulatory changes implemented in late 2013 and early 2014 made NPA sales more attractive for both banks and ARCs.²

In the first half of 2014, the share of ARC capital backing newly acquired NPAs averaged only around eight percent. In turn, the NPA disposal to ARCs became attractive for banks because of relatively high prices paid for impaired assets of up to 60 percent of their face value (versus a historical 25 percent). However, strong concerns over the effectiveness of ARCs in cleaning up bank balance sheets and reducing their credit risks remain, as banks, through their subscription to the SRs issued against the transferred impaired assets, effectively remained responsible for the bulk of the remaining risk. Indeed, some bank analysts have begun to add the value of a bank's SRs to their disclosed stressed assets. Estimates suggest that the amount of SRs held by banks represent about 0.3 percent of advances.³

The RBI's August 2014 amendments to the ARCs regulatory framework aim to address the misaligned incentive structure of the ARC mechanism. The most important changes include: (i) ARCs will have to supply 15 percent equity into each SPV; (ii) ARCs will have to charge fees on net asset values, not the value of the SRs issued; and (iii) ARC assets will have to be revalued after six months, rather than 12 months. These measures should help the pricing of NPA sales to ARCs better reflect the true economic value of the underlying claims, rather than accounting considerations or skewed risk-return tradeoffs previously faced by ARCs.

¹ Prepared by Peter Lindner.

² Important changes were the easing of accounting rules regarding NPAs sold to ARCs, permitting the sale of early-stage NPAs, and a number of measures which improved the economics of ARCs.

³ With gross NPAs across the scheduled commercial banks at 4.1 percent of outstanding advances (as of March 2014), this represents a notable number. For some PSBs, those numbers are higher. For instance, in the case of Bank of India, SRs amount to 1.1 percent of advances.

Box 8. Potential Capital Needs of India's Commercial Banks¹

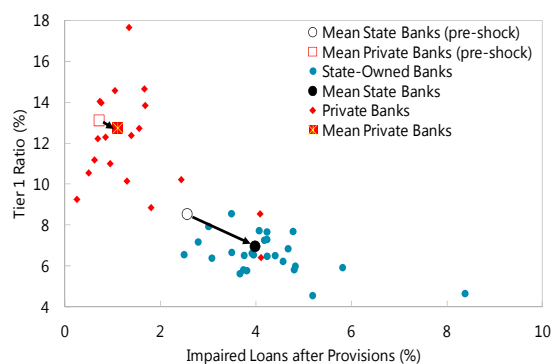
India's banks are likely to require additional capital injections over the next several years, reflecting their challenging operating environment, combined with the RBI's revised guidance on the implementation of Basel III capital requirements. The challenges on the business front are embodied in banks' increased restructured advances, which comprised 5.9 percent of the banking systems' gross advances, and 7.2 percent of the PSBs advances as of March 2014. Although not considered non-performing, restructured assets indicate that borrowers are experiencing difficulties in servicing debt and thus imply subpar asset quality. The rapid rise of restructured assets in recent years has raised concerns about the financial strength of many Indian banks. Here we stress-test the banks' capital position to a sudden deterioration in loan quality and evaluate the impact of Basel III capital requirements.

A stress test of banks' balance sheets indicates that the PSBs are vulnerable to a change in classification of a significant share of restructured loans as non-performing assets (NPAs). Each bank's balance sheet was stressed individually, based on 45 percent of restructured advances moving to NPAs, and those NPAs being provisioned against loss at a minimum 60 percent.^{2,3} All banks are assessed with regards to their Tier 1 capital ratio and the ratio of impaired loans net of provisions.

As of March 2014, the average Tier 1 ratio was about 4.5 percentage points higher for private banks compared to public sector banks.

Furthermore, private banks' impaired-loans-to-provisions ratio was almost 1.84 percentage points lower. Post-stress, the average Tier 1 ratio decreased by about 1.6 percentage points for the PSBs, and by less than 0.4 percentage points for the private banks. Mean impaired loans after provisions increased by more than 1.4 percentage points for PSBs, and by less than 0.4 percentage points for private banks (Figure). This is reflective of the weaker capital positions and the higher levels of stressed assets in PSBs.

Loan Impairments vs. Tier 1 Ratio, March 2014 (post-shock)



Sources: Bankscope; Reserve Bank of India; and IMF staff calculations.

Capital injections by the government required to meet PSBs' Basel III requirements will likely be moderate, provided the private sector supplies a considerable share (Table). The capital needs of banks will increase with faster credit growth, and given that banks will be required to hold at least the March 2019 regulatory minimum for Tier 1 capital ratio of 5.5 percent of risk-weighted assets, or 8 percent including the 2.5 percent capital conservation buffer (CCB). In addition, most banks will likely hold an extra cushion in excess of the required minimum (we simulate an excess of 1 and 2 percentage points of additional capital). The highlighted cells reflecting results of scenarios deemed most relevant. With simulations based on return on assets (ROA) of 0.9 percent for the PSBs (in line with 2012-13 average ROA), the recapitalization cost for the central government is estimated to be between 0.8 to 1.1 percent of FY 2018/19 GDP, under the assumption of unchanged public-private ownership shares. However, if the government were to provide the full amount of required capital injection, the estimate rises to between 1.2 to 1.7 percent of 2018/19 GDP. In a scenario where government ownership is reduced to 52 percent over time, the required capital injection is in the range of 0.7 to 1 percent of 2018/19 GDP.⁴

¹ Prepared by Peter Lindner. Based on P. Lindner and S. Jung (2014), "Corporate Vulnerabilities in India and Banks' Loan Performance," IMF WP 14/232.

Box 8. Potential Capital Needs of India's Commercial Banks (Concluded)

Table. Indian Banks' Recapitalization Costs under Basel III: Additional Capital Requirements as Percent of FY 2019 GDP^{1/2/}

<i>Return on Assets-Based Simulations</i>							
Total Capital in 2019 (%) ^{3/}	Credit Growth (Multiple of GDP)			Total Capital in 2019 (%) ^{3/}	Credit Growth (Multiple of GDP)		
	Slow (GDP)	Base (1.4*GDP)	Fast (1.8*GDP)		Slow (GDP)	Base (1.4*GDP)	Fast (1.8*GDP)
Minimum Common Equity Tier1				Minimum Common Equity Tier1 plus CCB			
Government's Share				Government's Share			
5.5 (0)	0.00	0.01	0.12	8 (0)	0.11	0.45	1.04
6.5 (1)	0.01	0.09	0.40	9 (1)	0.28	0.79	1.47
7.5 (2)	0.05	0.28	0.82	10 (2)	0.55	1.14	1.90
Total for Public Sector Banks				Total for Public Sector Banks			
5.5 (0)	0.00	0.01	0.16	8 (0)	0.16	0.66	1.56
6.5 (1)	0.01	0.13	0.58	9 (1)	0.39	1.18	2.21
7.5 (2)	0.07	0.41	1.23	10 (2)	0.81	1.71	2.87
Total for Private Banks				Total for Private Banks			
5.5 (0)	0.00	0.00	0.00	8 (0)	0.00	0.01	0.06
6.5 (1)	0.00	0.00	0.01	9 (1)	0.00	0.03	0.16
7.5 (2)	0.00	0.00	0.03	10 (2)	0.01	0.09	0.31

Source: RBI, Bankscope, IMF staff calculations.

1/ Simulations based on 2012 data (except ROA and ROE, where 2011 and 2012 averages are used).

2/ A 15 percent transition rate from restructured loans to NPAs is assumed.

3/ Numbers equal Equity Tier 1 ratio plus Capital Conversion Buffer plus additional cushion of zero, 1, or 2 percentage points.

Additional Tier 1 (AT1) capital will have to be raised beyond CET1 requirements. AT1 capital can be raised in the form of bonds which are either convertible into equity, or will have to take haircuts, in the event that pre-specified CET1 ratios are breached. In the scenarios deemed more likely, for PSBs those requirements will amount to less than ½ of one percent of GDP. However, it is recommended that supervisors make sure that sales to non-institutional investors appropriately disclose the risks related to loss absorption inherent in those bonds.

Under scenarios which assume moderate credit growth, and a continued challenging operating environment similar to 2012/13, total required capital injections from the government are likely to manageable. Under current equity market valuations, and the government's announced intention to reduce its share in all PSBs to 52 percent, lower capital injections by the government may be needed. In addition, further reforms, especially to enhance the operating performance and the credit culture of the PSBs will help reduce the capital injection needs.

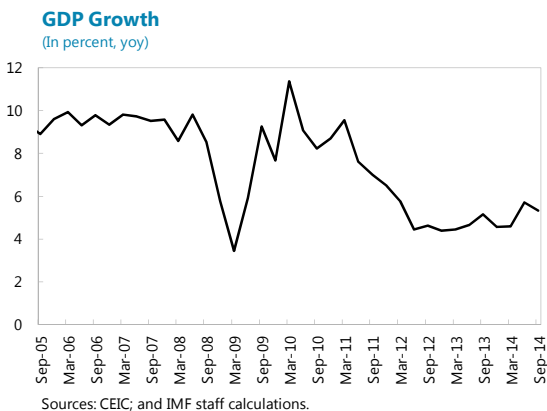
² The average provisioning ratio of private sector banks is slightly above 60 percent; this provisioning ratio was used as a minimum. If a bank's provisioning ratio for 2012/13 exceeded 60 percent, the actual number was used.

³ Historically, about 15 percent of restructured advances have moved into NPAs, with this number moving close to 20 percent in recent months. The authorities have used a maximum 30 percent transition rate in their stress tests.

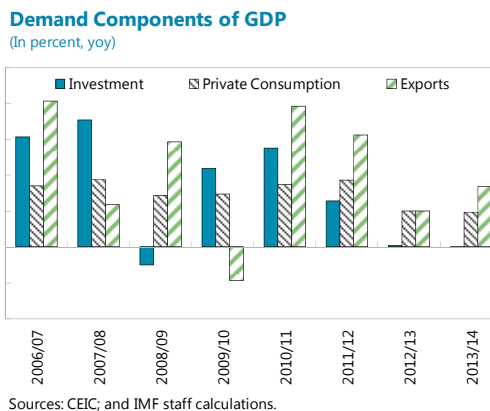
⁴ Simulations use stock values at end-March 2014, and flow variables averaged across fiscal years 2012 and 2013.

Figure 1. India: Growth and Activity

The economy appears to have turned the corner, driven by increasing investment and industrial activity. Growth has bottomed out after a sharp investment-led decline....

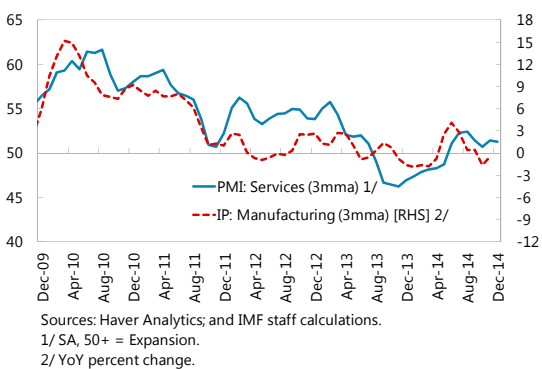


...driven in part by a revival in exports.



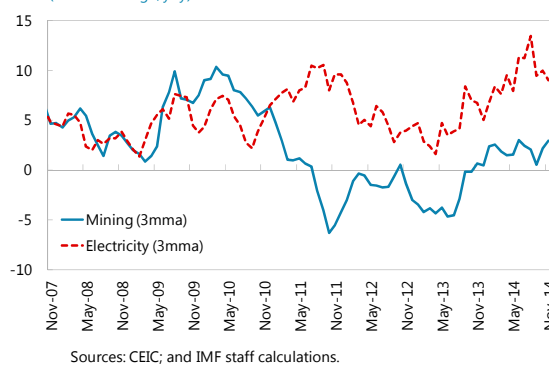
High frequency indicators point to continuation of the recovery, and...

Activity: Manufacturing and Services



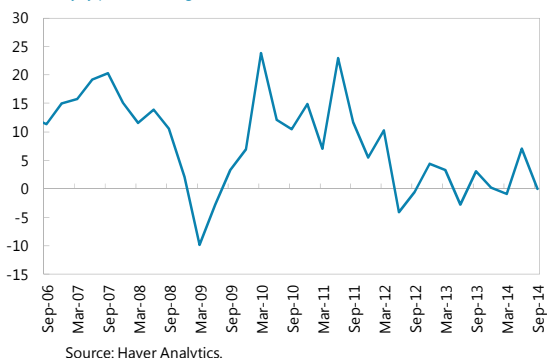
...a pick-up in the energy sector.

Production: Mining & Electricity
(Percent change, yoy)



Investment growth is tepid ...

Gross Fixed Capital Formation, Real
(yoy percent change)



...while new projects have come on stream, and stalled projects have started to get resolved.

Investment
(In billions of Rupees)

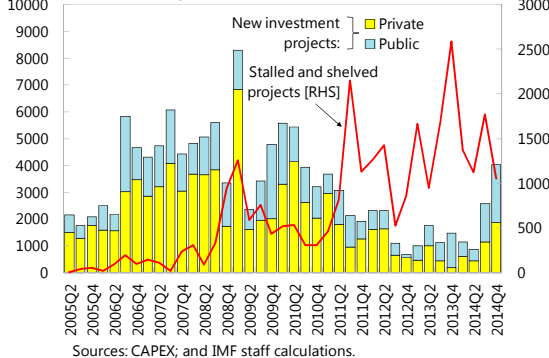


Figure 2. India: External Vulnerabilities

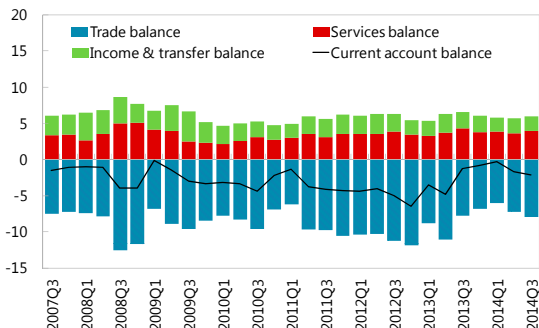
External vulnerabilities have diminished significantly since September 2013.

The current account deficit has narrowed considerably.

Measures to curb gold imports have been effective.

Current Account Balance

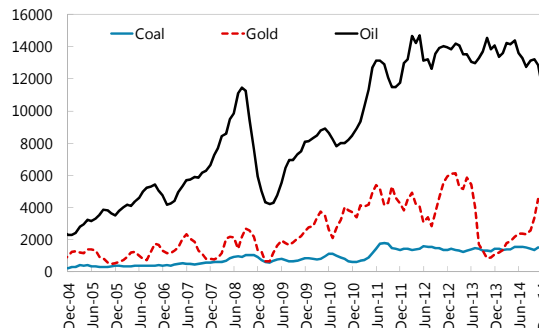
(In percent of GDP)



Sources: CEIC; and IMF staff calculations.

Imports: Principle Commodities

(In millions of US Dollars, 3mma)



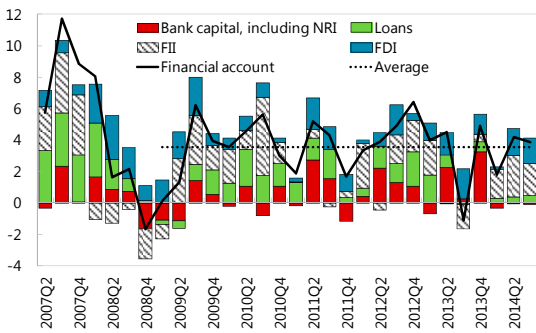
Sources: CEIC; and IMF staff calculations.

With higher capital flows, the current account deficit is expected to be financed with relative ease,...

...with FII flows being buoyant.

Financial Account

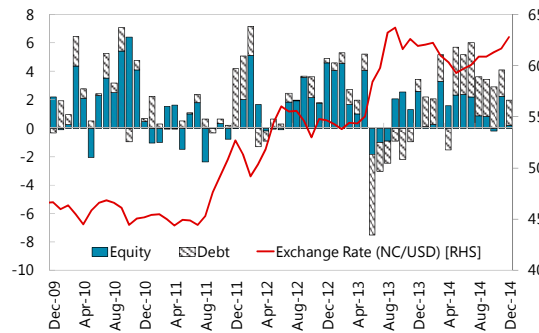
(In percent of GDP)



Sources: CEIC; and IMF staff calculations.

FII Flows - Equity and Debt

(In billions of USD)



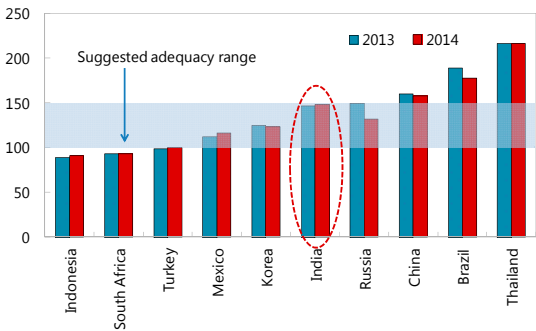
Source: CEIC.

Reserve coverage is adequate, with reserves...

...covering around twice short-term external debt.

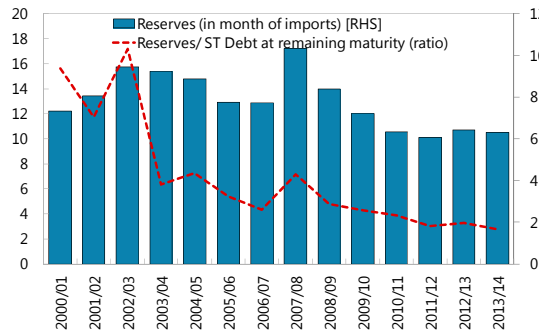
Estimated Reserve Adequacy

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



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

Reserves Coverage



Source: IMF staff calculations.

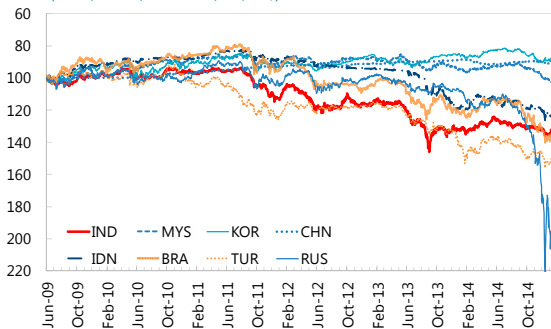
Figure 3. India: Financial Markets

Financial markets have been buoyant over the last year, after a period of global financial market-led volatility.

Following a large depreciation after May 2013, the rupee has stabilized since September 2013.

Portfolio inflows have resumed strongly, first with equity inflows and more recently with debt inflows.

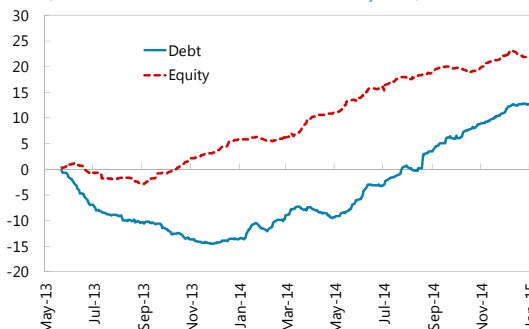
Exchange Rate
(Index, June 1, 2009=100, NC/US\$)



Sources: Bloomberg; and IMF staff calculations.

Debt and Equity Inflows

(In billions of US Dollars, cumulative since 22 May, 2013)

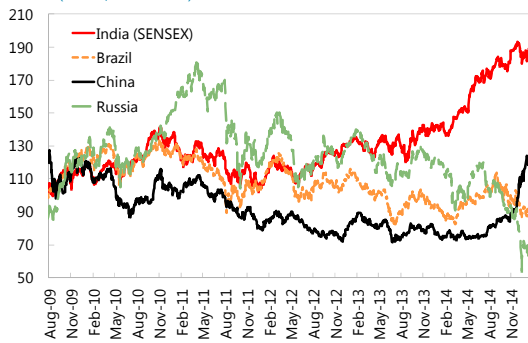


Source: Bloomberg.

The stock market index has been rising steadily,...

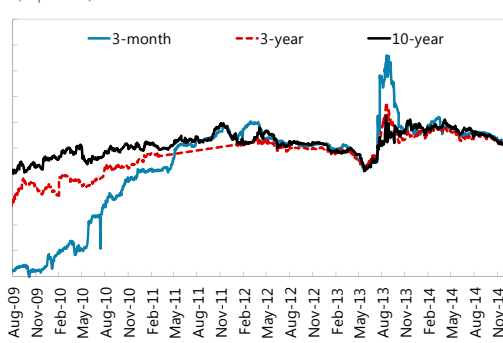
...bond yields have stabilized...

Stock Market Indices
(June 1, 2009 = 100)



Source: Bloomberg.

Bond Yields
(In percent)

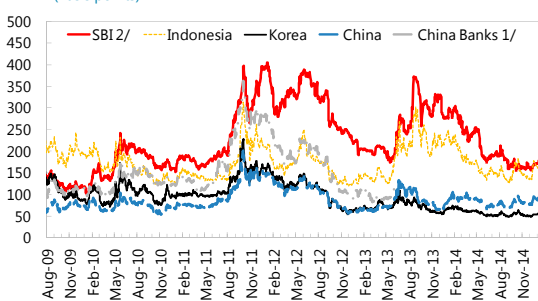


Source: Bloomberg.

...and spreads on the proxy CDS for the Indian sovereign have fallen.

India's nominal depreciation has not been accompanied by real depreciation due to its high inflation differential.

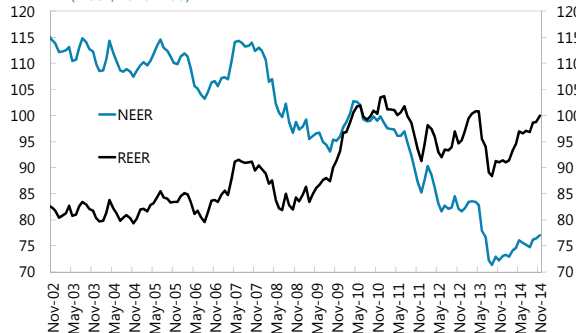
Credit Default Swap: SBI versus Sovereigns
(Basis points)



Source: Bloomberg.

1/ Average of Bank of China and China Development Bank.
2/ SBI is used as proxy for Government of India.

Nominal and Real Effective Exchange Rates
(Index, 2010=100)



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

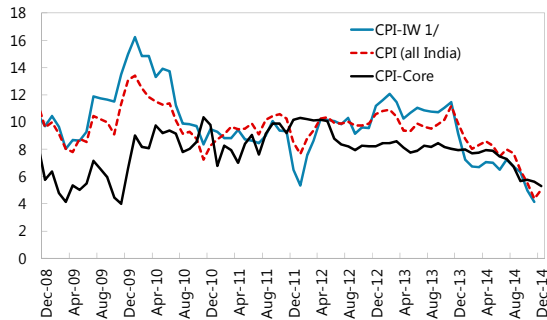
Figure 4. India: Monetary Developments

Despite recent moderation, India's inflation remains a concern.

Inflation has declined, reflecting economic slack and favorable base effects.

Inflation

(In percent, yoy)



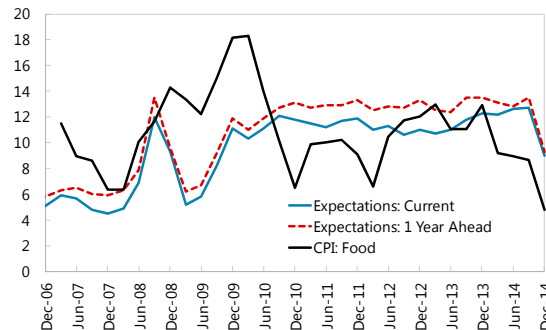
Sources: CEIC; and IMF staff calculations.

1/ Industrial Workers

Inflation expectations remain elevated...

Household Inflation Expectations and Food Inflation

(In percent)

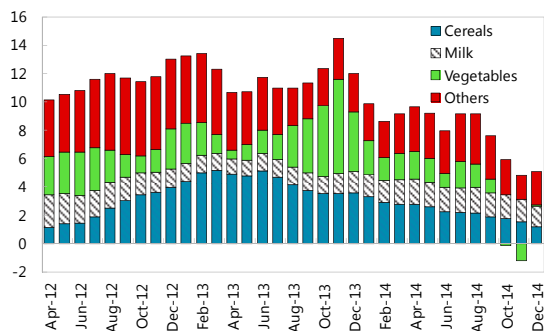


Sources: CEIC; Haver Analytics; and IMF staff calculations.

...while food inflation has moderated in recent months.

CPI Food Inflation: Contributions

(In percent, yoy)

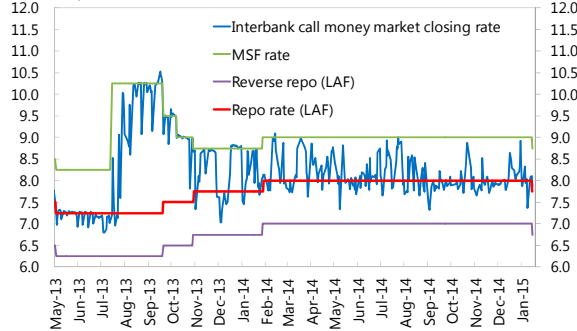


Sources: CEIC; and IMF staff calculations.

The policy rate was raised by 75 bps between September 2013 and January 2014, then lowered by 25 bps in January 2015...

Interest Rates

(In percent)

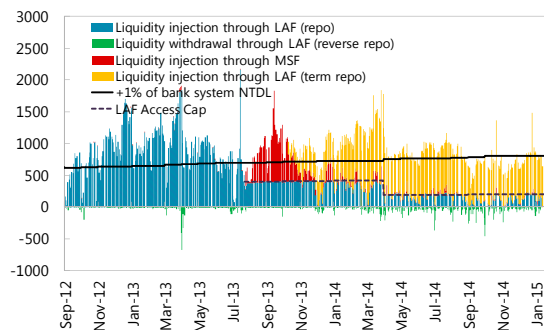


Sources: Reserve Bank of India; and IMF staff calculations.

...and exceptional liquidity measures were unwound and liquidity facilities recalibrated to improve monetary transmission.

Daily Liquidity Operations

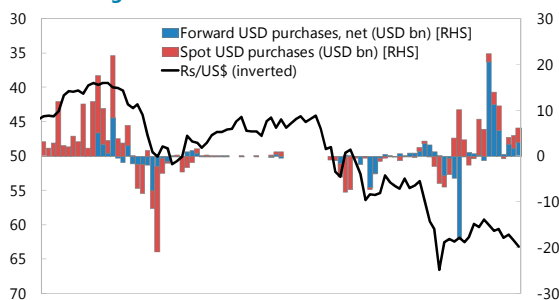
(In billions of Rupees)



Source: CEIC.

Reserve buffers have been built over the past year.

Exchange Rate and Intervention



Sources: CEIC; Bloomberg; and IMF staff calculations

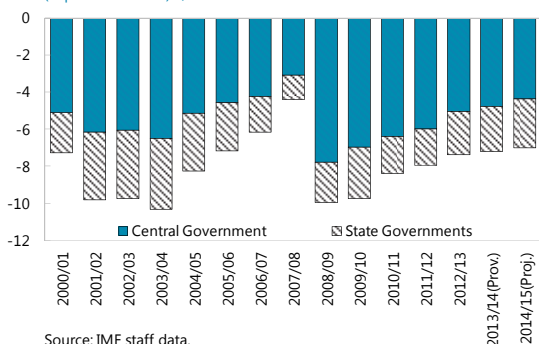
Figure 5. India: Fiscal Sector Developments

Fiscal consolidation has continued in recent years, despite the presence of a negative output gap.

The fiscal deficit has been slowly declining, but remains high.

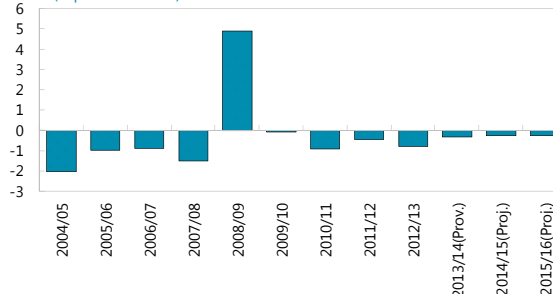
Following the large post-global crisis fiscal expansion, the impulse has been only slightly negative.

Government Balance
(In percent of GDP) 1/



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

General Government Fiscal Impulse 1/
(In percent of GDP)

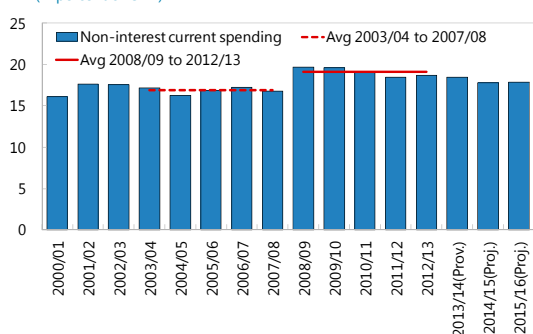


Source: IMF staff calculations.
1/ Defined as difference between current and previous year budget deficits, using business cycle-adjusted revenues.

Current spending has fallen, but still remains above pre-crisis average.

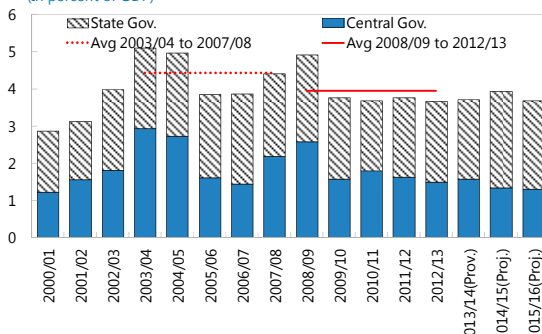
However, capital spending has been squeezed and remains considerably below the pre-crisis average.

General Government Non-interest Current Spending
(In percent of GDP)



Source: IMF staff data.

Capital Spending
(In percent of GDP)

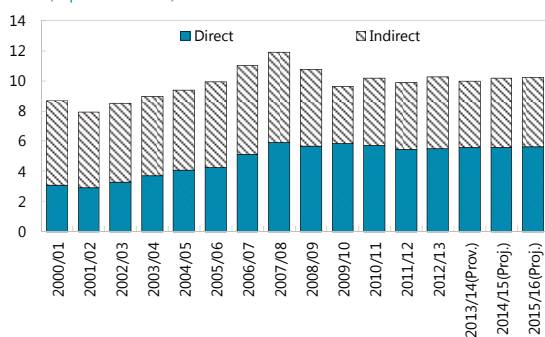


Source: IMF staff data.

Revenue mobilization has stalled.

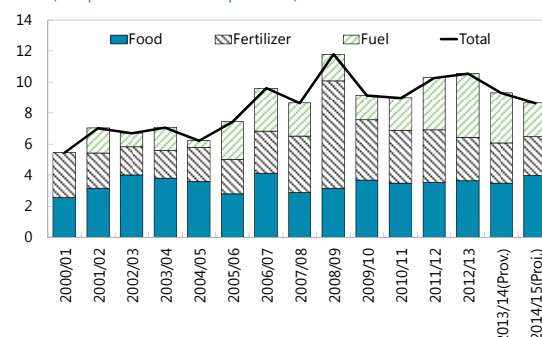
While the recent deregulation of diesel prices will help, further comprehensive subsidy reform is needed.

Central Government Revenue
(In percent of GDP)



Source: IMF staff data.

Government Subsidies
(As a percent of Current Expenditure)



Sources: IMF staff data.

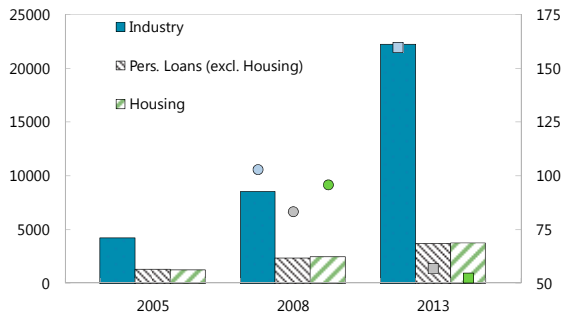
Figure 6. India: Corporate and Banking Sectors

Corporate sector stresses remain high, which have caused a deterioration in bank asset quality.

Loans to industry have accounted for most of the increase in bank loans

Loans by Sector

(In billions of Rupees; dots denote cumulative percentage growth, RHS) 1/

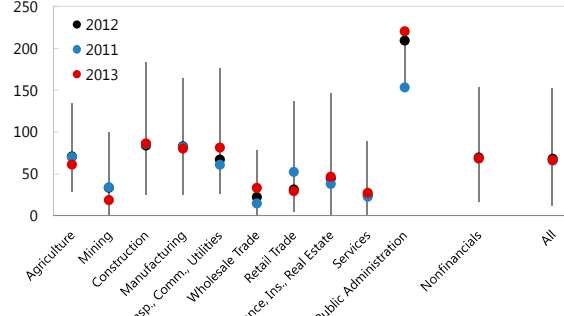


Sources: Reserve Bank of India; and IMF staff calculations.
1/ Circles represent growth from 2005-08; squares, 2008-13.

Leverage has been rising, in particular in transportation, utilities and wholesale trade sectors.

Leverage Ratios by Sector

(Ratio of Debt to Equity - Median, 25th and 75th percentiles by sector)

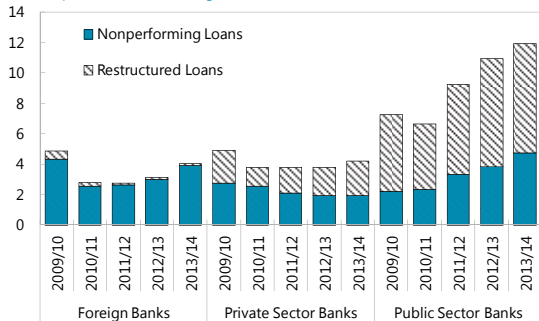


Sources: IMF, Corporate Vulnerability Utility; and IMF staff calculations.

These increases have led to significant increases in NPAs (and restructured loans), with...

Nonperforming & Restructured Loans

(In percent of outstanding advances)

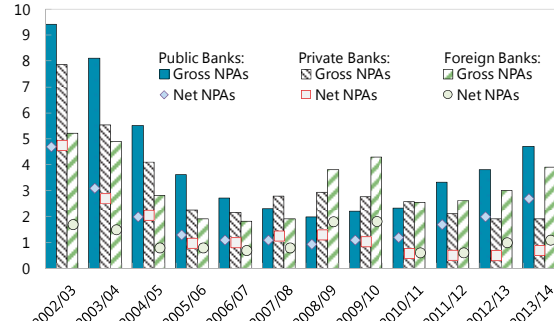


Sources: Reserve Bank of India; and IMF staff calculations.

...public sector banks bearing the brunt of the increase.

Commercial Banks NPAs

(In percent of outstanding advances)

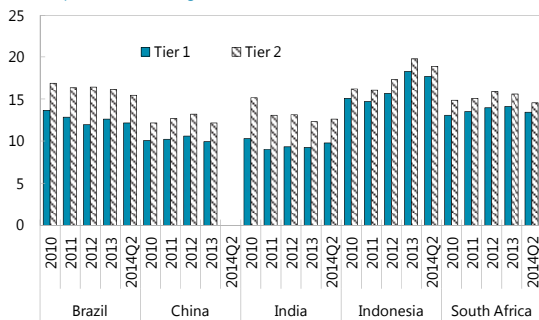


Sources: Reserve Bank of India; and IMF staff calculations.

Relative to other EMs, Indian banks' capital positions are not as strong.

Capital Adequacy Ratios 1/

(In percent of risk-weighted assets)

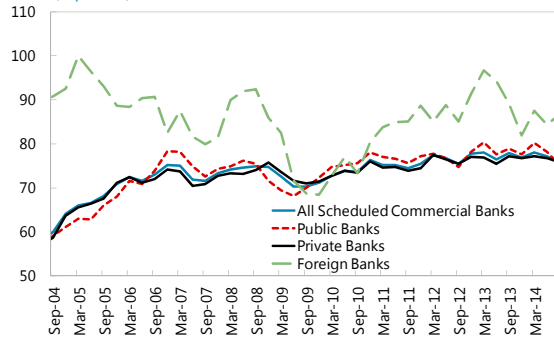


Source: IMF, Financial Soundness Indicators.
1/ India 2010 are Q3.

Loan-to-deposit ratios have stabilized over the past fiscal year.

Loan to Deposit Ratio

(In percent)

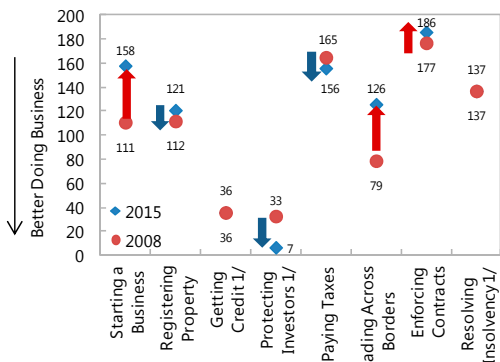


Sources: CEIC; and IMF staff calculations.

Figure 7. India: Business Environment and Governance

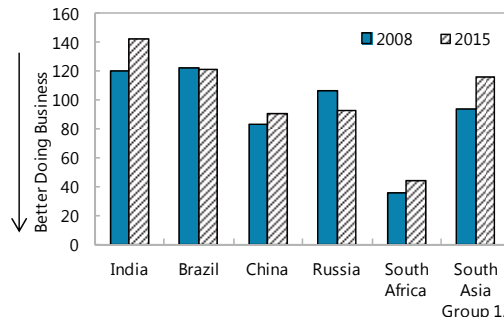
India plans to be among the top 50 countries on the World Bank's "Ease of Doing Business" list, a significant improvement from its current ranking.

Evolution of Doing Business Indicators Ranking: India



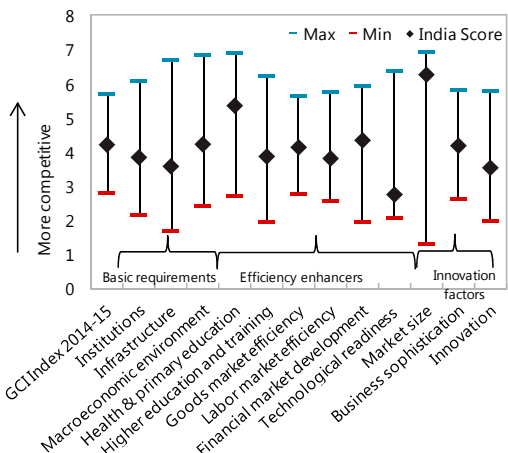
Sources: World Bank, *Doing Business Report* (2015 and 2008)
1/ Some methodological changes apply to 2015 numbers.

Ease of Doing Business Ranking: BRICS and South Asia



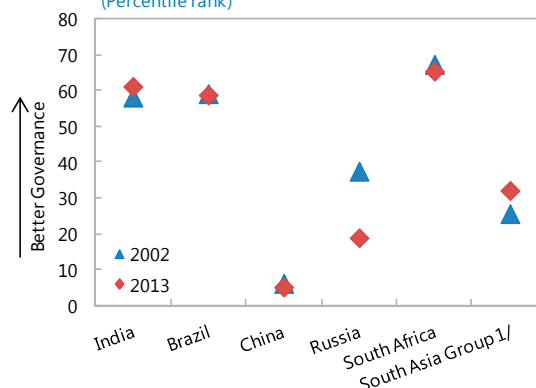
Sources: World Bank, *Doing Business Report* (2015 and 2008).
1/ South Asia Group includes Bhutan, Maldives, Nepal, Pakistan and Sri Lanka.

2014-15 India Scores in Global Competitiveness Index and Pillars



Source: World Economic Forum Global Competitiveness Report (2014-15).

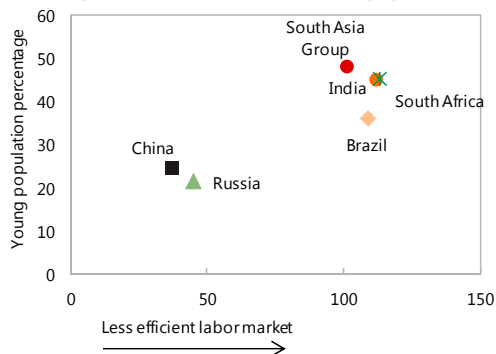
Voice and Accountability: BRICS (Percentile rank)



Source: Worldwide Governance Indicators (2014).
1/ South Asia Group includes Bhutan, Maldives, Nepal, Pakistan and Sri Lanka.

Labor Market Efficiency Ranking and Young Population Ratio: BRICS and South Asia

(Young population ratio: in percent of working-age population) 1/

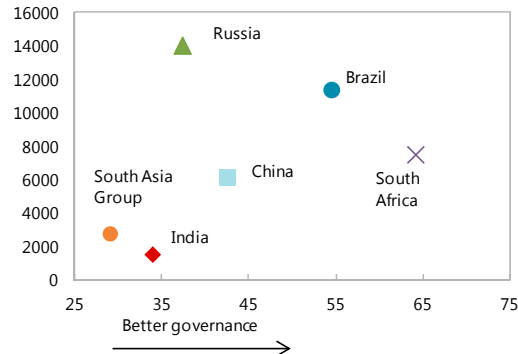


Sources: World Development Indicators (2014) and World Economic Forum Global Competitiveness Report (2014-15).

1/ Young, defined as people younger than 15; working-age population as 15-64.
2/ South Asia Group includes Bhutan, Nepal, Pakistan and Sri Lanka.

Regulatory Quality and GDP Per Capita: BRICS and South Asia, 2013

(Percentile rank; in US Dollars)



Sources: Worldwide Governance Indicators (2014) and World Development Indicators (2014).

1/ Regulatory quality reflects perceptions of the ability of the government to formulate and implement sound policies and regulations that permit and promote private sector.
2/ South Asia Group includes Bhutan, Maldives, Nepal, Pakistan and Sri Lanka.

Table 1. India: Millennium Development Goals, 1990–2012 1/

	1990	2000	2005	2006	2008	2009	2010	2011	2012
Eradicate extreme poverty and hunger 2/									
Income share held by lowest 20%	...	...	8.6	...	...	...	8.5	...	...
Malnutrition prevalence, weight for age (% of children under 5)	...	...	40.3	43.5	...	...	...	...	...
Poverty gap at \$1.25 a day (PPP) (%)	...	...	10.5	...	...	...	7.5	...	4.8
Poverty headcount ratio at \$1.25 a day (PPP) (% of population)	...	...	41.6	...	...	...	32.7	...	23.6
Poverty headcount ratio at national poverty line (% of population)	...	...	37.2	...	...	...	29.8	...	21.9
Prevalence of undernourishment (% of population)	...	21.1	21.5	20.1	19.1	18.9	18.5	17.4	17.0
Achieve universal primary education 3/									
Literacy rate, youth total (% of people ages 15-24)	...	...	...	81.1	...	...	...	...	...
Persistence to grade 5, total (% of cohort)	...	59.0	...	...	...	...	...	...	...
Primary completion rate, total (% of relevant age group)	...	72.9	...	...	98.3	99.6	...	96.5	...
School enrollment, primary (% net)	78.2	81.2	...	...	93.4	93.9	93.9	93.3	...
Promote gender equality 4/									
Proportion of seats held by women in national parliament (%)	5.0	9.0	8.3	8.3	9.1	10.8	10.8	11.0	11.0
Ratio of girls to boys in primary and secondary education (%)	...	78.7	...	...	95.1	97.4	97.4	98.4	...
Ratio of young literate females to males (% ages 15-24)	...	...	...	84.1	...	...	...	...	...
Share of women employed in the nonagricultural sector (% of total nonagricultural employment)	12.7	16.6	18.1	...	...	19.1	19.3	...	...
Reduce child mortality 5/									
Immunization, measles (% of children ages 12-23 months)	56.0	59.0	59.0	71.0	74.0	74.0	74.0	74.0	74.0
Mortality rate, infant (per 1,000 live births)	88.4	66.5	55.9	53.9	50.1	48.3	46.4	44.7	42.9
Mortality rate, under-5 (per 1,000)	125.9	91.4	74.7	71.6	65.8	62.9	60.2	57.5	55.0
Improved maternal health 6/									
Births attended by skilled health staff (% of total)	...	42.5	...	46.6	52.3	...	...	...	...
Maternal mortality ratio (modeled estimate, per 100,000 live births)	560.0	370.0	280.0	...	...	...	220.0	...	...
Combat HIV/AIDS, malaria, and other diseases 7/									
Contraceptive prevalence (% of women ages 15-49)	...	46.9	...	56.3	54.8	...	...	...	...
Incidence of tuberculosis (per 100,000 people)	217.0	216.0	209.0	205.0	196.0	191.0	185.0	180.0	176.0
Prevalence of HIV, female (% ages 15-24)	...	...	...	...	...	...	...	...	...
Prevalence of HIV, total (% of population ages 15-49)	0.1	0.4	0.4	0.4	0.3	0.3	0.3	0.3	0.3
Tuberculosis cases detected under DOTS (%)	...	...	...	...	...	...	...	...	...
Ensure environmental sustainability 8/									
CO2 emissions (metric tons per capita)	0.8	1.1	1.3	1.3	1.5	1.7	1.7	...	...
Forest area (% of land area)	21.5	22.0	22.8	22.8	22.9	23.0	23.0	23.1	23.1
GDP per unit of energy use (constant 2005 PPP \$ per kg of oil equivalent)	5.0	5.9	7.0	7.2	7.4	7.3	7.7	8.0	...
Improved sanitation facilities (% of population with access)	17.7	25.5	29.9	30.7	32.5	33.4	34.2	35.1	36.0
Improved water source (% of population with access)	70.3	80.6	85.7	86.7	88.7	89.7	90.7	91.6	92.6
Nationally protected areas (% of total land area)	4.7	5.0	5.0	5.0	5.0	5.0	5.1	...	5.2
Develop a global partnership for development 9/									
Debt service (PPG and IMF only, % of exports of G&S, excl. workers' remittances)	29.1	15.8	9.7	3.0	4.7	2.4	1.7	1.8	1.8
Fixed line and mobile phone subscribers (per 100 people)	0.0	0.3	8.0	14.5	29.5	44.1	62.4	73.2	69.9
Internet users (per 100 people)	0.6	3.1	4.5	3.6	3.2	3.1	2.9	2.7	2.5
Personal computers (per 1,000 people)	...	...	...	...	...	...	...	...	...
Total debt service (% of exports of goods, services and income)	0.0	0.5	2.4	2.8	4.4	5.1	7.5	10.1	12.6
Unemployment, youth female (% of female labor force ages 15-24)	34.9	17.5	14.9	8.6	9.7	6.0	6.8	6.4	6.8
Unemployment, youth male (% of male labor force ages 15-24)	...	10.3	10.4	...	...	...	11.5	...	11.6
Unemployment, youth total (% of total labor force ages 15-24)	...	10.1	9.8	...	...	...	9.8	...	10.4
General indicators									
Fertility rate, total (births per woman)	3.9	3.1	2.8	2.8	2.6	2.6	2.6	2.5	2.5
GNI per capita, Atlas method (current US\$)	390.0	460.0	740.0	820.0	1,050.0	1,170.0	1,290.0	1,450.0	1,550.0
GNI, Atlas method (current US\$) (billions)	340.5	475.4	830.1	941.3	1,229.1	1,392.8	1,555.6	1,769.4	1,913.2
Gross capital formation (% of GDP)	24.9	24.1	34.3	35.9	35.5	36.3	36.5	36.4	34.7
Life expectancy at birth, total (years)	58.5	62.2	64.1	64.5	65.1	65.4	65.7	66.0	66.2
Literacy rate, adult total (% of people ages 15 and above)	...	...	...	62.8	...	...	...	...	...
Population, total (millions)	868.9	1,042.3	1,127.1	1,143.3	1,174.7	1,190.1	1,205.6	1,221.2	1,236.7
Trade (% of GDP)	15.2	26.4	41.3	45.3	52.3	45.5	48.3	54.1	54.7

Source: World Bank, *World Development Indicators*, 2012.

1/ In some cases the data are for earlier or later years than those stated.

2/ Halve, between 1990 and 2015, the proportion of people whose income is less than 1.25 dollar a day.

3/ Ensure that, by 2015, children everywhere, boys and girls alike, will be able to complete a full course of primary schooling.

4/ Eliminate gender disparity in primary and secondary education preferably by 2005 and to all levels of education no later than 2015.

5/ Reduce by two-thirds, between 1990 and 2015, the under-five mortality rate.

6/ Reduce by three-quarters, between 1990 and 2015, the maternal mortality ratio.

7/ Have halted by 2015, and begun to reverse, the spread of HIV/AIDS. Have halted by 2015, and begun to reverse, the incidence of malaria and other major diseases.

8/ Integrate the principles of sustainable development into country policies and programs and reverse the loss of environmental resources. Halve, by 2015, the proportion of people without sustainable access to safe drinking water. By 2020, to have achieved a significant improvement in the lives of at least 100 million slum dwellers.

9/ Develop further an open, rule-based, predictable, non-discriminatory trading and financial system. Address the Special Needs of the Least Developed Countries. Address the Special Needs of landlocked countries and small island developing states. Deal comprehensively with the debt problems of developing countries through national and international measures in order to make debt sustainable in the long term. In cooperation with developing countries, develop and implement strategies for decent and productive work for youth. In cooperation with pharmaceutical companies, provide access to affordable, essential drugs in developing countries. In cooperation with the private sector, make available the benefits of new technologies, especially information and communications.

Table 2. India: Selected Economic Indicators, 2010/11–2015/16 1/

I. Social Indicators						
GDP (2012/13)						
Nominal GDP (in billions of U.S. dollars):	1,859					
GDP per capita (U.S. dollars):	1,503					
Population characteristics (2012/13)						
Total (in billions):	1.2					
Urban population (percent of total):	32					
Life expectancy at birth (years):	65					
Poverty (percent of population)						
Headcount ratio at \$1.25 a day (2010):	32.7					
Undernourished (2011):	17.5					
Income distribution (2010, WDI)						
Richest 10 percent of households:	28.8					
Poorest 20 percent of households:	8.5					
Gini index (2010):	33.9					
II. Economic Indicators						
	2010/11	2011/12	2012/13	2013/14 Prel.	2014/15 Proj.	2015/16 Proj.
Growth (in percent)						
Real GDP (at factor cost)	8.9	6.7	4.5	4.7	5.6	6.3
Industrial production	8.2	2.9	1.1	-0.1	...	...
Prices (percent change, period average)						
Consumer prices - Combined	9.5	9.5	10.2	9.5	6.7	6.3
Saving and investment (percent of GDP)						
Gross saving 2/	33.8	31.4	30.0	29.7	29.8	30.4
Gross investment 2/	36.5	35.5	34.7	31.4	31.6	32.1
Fiscal position (percent of GDP) 3/						
Central government deficit	-6.4	-6.0	-5.1	-4.8	-4.4	-4.1
General government deficit	-8.4	-8.0	-7.4	-7.2	-7.1	-6.8
General government debt 4/	67.5	66.8	66.6	65.5	64.3	62.6
Structural balance (% of potential GDP)	-8.9	-8.4	-7.5	-7.1	-6.9	-6.7
Structural primary balance (% of potential GDP)	-4.3	-3.9	-3.0	-2.4	-2.1	-1.9
Money and credit (y/y percent change, end-period)						
Broad money	16.1	13.5	13.6	13.2	14.0	14.7
Credit to commercial sector 5/	21.3	17.8	13.5	13.7	10.1	...
Financial indicators (percent, end-period)						
91-day treasury bill yield (end-period) 6/	7.3	9.0	8.2	8.9	8.2	...
10-year government bond yield (end-period) 6/	8.0	8.6	8.0	8.9	7.7	...
Stock market (ytd percent change) 5/	10.9	-10.5	8.2	18.8	22.8	...
External trade 7/						
Merchandise exports (in billions of U.S. dollars)	256.2	309.8	306.6	318.6	338.3	357.8
(Annual percent change)	40.4	20.9	-1.0	3.9	6.2	5.8
Merchandise imports (in billions of U.S. dollars)	383.5	499.5	502.2	466.2	492.8	518.7
(Annual percent change)	27.5	30.3	0.5	-7.2	5.7	5.3
Terms of trade (G&S, annual percent change)	-3.4	-5.9	-0.5	2.2	2.0	3.2
Balance of payments (in billions of U.S. dollars)						
Current account balance	-48.1	-78.2	-88.2	-32.4	-37.5	-39.4
(In percent of GDP)	2.8	-4.2	-4.7	-1.7	-1.8	-1.7
Foreign direct investment, net	11.8	22.1	19.8	21.6	26.6	29.9
Portfolio investment, net (equity and debt)	30.3	17.2	26.9	4.8	25.2	28.3
Overall balance	13.1	12.8	3.8	15.5	36.6	50.1
External indicators						
Gross reserves (in billions of U.S. dollars, end-period)	304.8	294.4	292.0	304.2	340.8	390.9
(In months of imports) 8/	6.3	6.1	6.4	6.3	6.6	7.1
External debt (in billions of U.S. dollars, end-period)	317.9	360.8	409.5	442.3	495.2	542.9
External debt (percent of GDP, end-period)	18.6	19.2	22.0	23.5	24.2	23.6
Of which: Short-term debt 9/	7.0	7.4	8.9	9.7	10.1	10.1
Ratio of gross reserves to short-term debt (end-period) 9/	2.6	2.1	1.8	1.7	1.6	1.7
Debt service ratio 10/	4.7	5.1	5.6	5.7	5.3	5.6
Real effective exchange rate 11/						
(based on annual average level)	11.6	-8.5	-14.1	-2.4	4.6	...
Exchange rate (rupee/U.S. dollar, end-period) 6/	45.0	50.3	54.4	61.0	61.8	...
Memorandum item (in percent of GDP)						
Fiscal balance under authorities' definition	-4.8	-5.7	-4.8	-4.5	-4.1	-3.9

Sources: Data provided by the Indian authorities; 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. Subsidy related bond issuance classified as expenditure.

4/ Includes combined domestic liabilities of the center and the states, inclusive of MSS bonds, and external debt at year-end exchange rates.

5/ For 2014/15, as of December 2014.

6/ For 2014/15, as of 29 January 2015.

7/ On balance of payments basis.

8/ Imports of goods and services projected over the following 12 months.

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

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

11/ For 2014/15, as of January 2015.

Table 3. India: Balance of Payments, 2010/11–2015/16 1/
(In billions of U.S. dollars)

	2010/11	2011/12	2012/13	2013/14	2014/15	2015/16
				Prel.	Proj.	Proj.
Current account balance	-48.1	-78.2	-88.2	-32.4	-37.5	-39.4
Merchandise trade balance	-127.3	-189.8	-195.7	-147.6	-154.5	-161.0
Merchandise exports	256.2	309.8	306.6	318.6	338.3	357.8
Merchandise imports	383.5	499.5	502.2	466.2	492.8	518.7
Oil	106.0	155.0	164.0	164.8	...	...
Non-oil	263.8	334.4	326.7	285.4	...	...
Non-factor services balance	44.1	64.1	64.9	73.0	72.1	77.5
Receipts	124.6	142.3	145.7	151.5	159.3	175.1
<i>Of which</i> : software services	53.1	62.2	65.9	69.4	...	...
Payments	80.6	78.2	80.8	78.5	87.1	97.6
Income, net	-18.0	-16.0	-21.5	-23.0	-22.8	-28.4
Transfers, net	53.1	63.5	64.0	65.3	67.7	72.4
Capital account balance	63.7	67.8	89.3	48.8	74.1	89.5
Direct investment, net	11.8	22.1	19.8	21.6	26.6	29.9
<i>Of which</i> : direct investment in India	29.0	33.0	27.0	30.8	36.9	46.1
Portfolio investment, net	30.3	17.2	26.9	4.8	25.2	28.3
Government borrowing, net	4.9	2.3	1.0	1.0	0.8	0.5
Commercial borrowing, net	12.2	10.3	8.5	11.8	19.3	16.9
Short-term credit, net	12.0	6.7	21.7	-5.0	2.5	2.6
NRI deposits, net	3.2	11.9	14.8	38.9	12.3	13.8
Other capital, net 2/	-10.8	-2.7	-3.4	-24.3	-12.6	-2.6
Errors and omissions	-2.6	-2.4	2.7	-0.9	0.0	0.0
Overall balance	13.1	-12.8	3.8	15.5	36.6	50.1
Valuation changes 3/	-12.7	-2.4	6.2	3.3	0.0	0.0
Increase in gross reserve stock (including valuation changes)	-25.8	10.4	2.3	-12.2	-36.6	-50.1
Memorandum items:						
Foreign exchange reserves	304.8	294.4	292.0	304.2	340.8	390.9
In months of next year's imports (goods and services)	6.3	6.1	6.4	6.3	6.6	7.1
Current account balance (percent of GDP)	-2.8	-4.2	-4.7	-1.7	-1.8	-1.7
Merchandise trade balance (percent of GDP)	-7.5	-10.1	-10.5	-7.9	-7.5	-7.0
Direct investment in India (percent of GDP)	1.7	1.8	1.5	1.6	1.8	2.0
Overall balance (percent of GDP)	0.8	-0.7	0.2	0.8	1.8	2.2
Gold Imports	40.5	56.5	53.8	28.7	35.0	37.0
GDP in USD	1,708.5	1,880.1	1,858.7	1,876.8	2,047.5	2,303.4

Sources: CEIC Data Company Ltd; and IMF staff estimates and projections.

1/ Data are for April-March fiscal years.

2/ Net other capital is sum of net banking capital (RBI format), rupee debt, and net other capital (RBI format) less net NRI deposits.

3/ Calculated as difference between the stock of reserves and the overall balance of BOP.

Table 4. India: Reserve Money and Monetary Survey, 2010/11–2014/15 1/

	2010/11	2011/12	2012/13	2013/14	2014/15	
					June	November
Reserve money	(In billions of rupees, end-period)					
Reserve money	12,963	14,144	14,890	16,457	17,192	17,497
Net domestic assets of RBI	-323	-578	-690	-1,568	-1,512	-1,893
Claims on government (net)	3,164	5,171	5,854	6,560	6,645	5,568
Center	3,940	5,344	5,905	6,976	6,640	5,558
States	-776	-173	-51	-417	5	11
Claims on commercial sector	18	40	28	85	81	42
Claims on banks	51	88	217	418	231	626
Other items (net)	-3,556	-5,877	-6,790	-8,632	-8,469	-8,129
Net foreign assets of RBI	13,286	14,722	15,581	18,025	18,704	19,390
	(Contribution to twelve-month reserve money growth)					
Reserve money	17.2	9.1	5.3	10.5	9.7	8.2
Net domestic assets of RBI	8.5	-2.0	-0.8	-5.9	-3.7	-1.5
Claims on government (net)	13.2	15.5	4.8	4.7	-0.9	-6.3
Net foreign assets of RBI	8.7	11.1	6.1	16.4	13.5	9.7
Monetary survey	(In billions of rupees, end-period)					
Broad money (M3)	65,041	73,848	83,898	94,973	97,738	102,129
Currency with public	9,118	10,237	11,411	12,483	13,020	13,084
Deposits	55,886	63,583	72,455	82,470	84,712	88,958
Non-bank deposits at RBI	37	28	32	20	7	87
Net domestic assets	51,108	58,411	67,532	75,734	78,043	81,768
Domestic credit	61,404	73,474	83,717	94,384	96,470	98,663
Net credit to government	19,037	23,551	27,039	29,959	30,884	31,222
<i>Of which:</i> RBI	3,164	5,171	5,854	6,560	6,645	5,568
Credit to commercial sector	42,367	49,923	56,679	64,425	65,586	67,442
<i>Of which:</i> commercial bank lending	39,421	46,119	52,605	61,390	60,949	62,844
Nonfood	38,778	45,305	51,640	60,415	59,805	61,769
Other items (net)	-10,296	-15,064	-16,186	-18,650	-18,427	-16,895
Net foreign assets	13,933	15,438	16,367	19,239	19,696	20,362
	(Twelve-month percent change)					
Broad money (M3)	16.1	13.5	13.6	13.2	11.8	11.2
Net domestic assets	18.3	14.3	15.6	12.1	10.5	11.9
Domestic credit	19.9	19.7	13.9	12.7	10.2	8.6
Net credit to government	16.9	23.7	14.8	10.8	5.5	4.0
Credit to commercial sector	21.3	17.8	13.5	13.7	12.6	10.9
<i>Of which:</i> commercial bank lending	21.5	17.0	14.1	16.7	12.8	11.3
Nonfood	21.3	16.8	14.0	17.0	13.0	11.4
Net foreign assets	8.7	10.8	6.0	17.6	17.3	8.7

Sources: CEIC Data Company Ltd.; IMF International Financial Statistics; and Fund staff calculations.

1/ Data are for April–March fiscal years.

Table 5. India: Central Government Operations, 2010/11–2015/16 1/

	2010/11	2011/12	2012/13	2013/14	2014/15	2015/16
				Est.	Proj.	Proj.
	(In percent of GDP)					
Revenue	9.0	8.7	9.0	9.2	9.1	9.3
Taxes	7.4	7.0	7.4	7.2	7.3	7.4
Income tax	5.7	5.5	5.5	5.6	5.6	5.6
Excise tax	1.8	1.6	1.7	1.5	1.6	1.6
Customs duties	1.7	1.7	1.6	1.5	1.5	1.6
Other taxes	0.0	0.0	0.0	0.0	0.0	0.0
Less: States' share	2.8	2.8	2.9	2.8	3.0	2.9
Grants	0.0	0.0	0.0	0.0	0.0	0.0
Other revenue 2/	1.6	1.6	1.6	2.0	1.9	1.9
Property income	0.9	0.8	0.7	1.0	0.9	0.9
Sale of goods and services	0.3	0.3	0.2	0.3	0.2	0.2
Miscellaneous and unidentified revenue	0.5	0.5	0.6	0.7	0.8	0.8
Expenditure	15.5	14.7	14.0	14.0	13.6	13.3
Expense 3/	13.7	13.1	12.5	12.4	12.2	12.1
Compensation of employees 4/	1.2	1.1	1.1	1.1	1.1	1.1
Interest	3.0	3.0	3.1	3.3	3.3	3.3
Subsidies 5/	2.1	2.3	2.4	2.2	1.9	1.7
Food	0.8	0.8	0.8	0.8	0.9	0.9
Fertilizer	0.8	0.8	0.6	0.6	0.6	0.6
Petroleum	0.5	0.8	1.0	0.8	0.4	0.2
Grants	1.9	2.0	1.8	1.8	3.1	3.1
Other expense 6/	5.5	4.7	4.2	4.1	2.9	3.0
Net acquisition of nonfinancial assets	1.8	1.6	1.5	1.6	1.4	1.3
Gross Operating Balance	-4.6	-4.4	-3.6	-3.2	-3.1	-2.8
Net lending / borrowing (overall balance)	-6.4	-6.0	-5.1	-4.8	-4.4	-4.1
Net financial transactions	-6.4	-6.0	-5.1	-4.8	-4.4	-4.1
Net acquisition of financial assets	-1.8	-0.2	-0.4	-0.3	-0.4	-0.3
Domestic	-1.8	-0.2	-0.4	-0.3	-0.4	-0.3
Currency and deposits	-0.3	0.0	-0.2	-0.1	-0.2	-0.1
Loans	0.2	0.0	0.0	0.1	0.1	-0.1
Share and other equity	-1.7	-0.2	-0.3	-0.2	-0.3	-0.2
Net incurrence of liabilities	4.6	5.8	4.7	4.5	4.0	3.7
Domestic	4.3	5.7	4.6	4.4	4.0	3.7
Debt securities 7/	4.2	4.8	4.1	4.1	3.6	3.7
Other accounts payable	0.1	0.8	0.5	0.3	0.4	0.0
Foreign	0.3	0.1	0.1	0.0	0.0	0.0
Loans	0.3	0.1	0.1	0.0	0.0	0.0
Memorandum items:						
Balance under authorities' definition	-4.8	-5.7	-4.8	-4.5	-4.1	-3.9
Primary balance	-3.4	-3.0	-2.0	-1.4	-1.1	-0.7
Central government debt 8/	52.2	51.6	51.4	50.1	48.5	46.3

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

1/ Data for April - March fiscal years

2/ In 2010/11 and subsequent years, auctions for wireless spectrum are classified as sale of nonfinancial assets.

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 6. General Government Operations, 2010/11–2015/16 1/

	2010/11	2011/12	2012/13	2013/14	2014/15	2015/16
				Est.	Proj.	Proj.
	(In percent of GDP)					
Revenue	18.8	18.7	19.5	19.8	19.6	19.7
Taxes	16.1	16.1	16.8	16.7	16.7	16.7
Grants	0.0	0.0	0.0	0.0	0.0	0.0
Other revenue	2.7	2.6	2.7	3.0	2.9	2.9
Expenditure	27.2	26.7	26.9	27.0	26.7	26.4
Expense	23.5	22.9	23.2	23.3	22.7	22.7
<i>of which:</i> interest	4.5	4.4	4.5	4.8	4.8	4.8
Net acquisition of nonfinancial assets	3.7	3.8	3.7	3.7	4.0	3.7
Gross Operating Balance	-4.7	-4.2	-3.7	-3.5	-3.1	-3.1
Net lending (+)/borrowing (-) (fiscal balance)	-8.4	-8.0	-7.4	-7.2	-7.1	-6.8
Net financial worth, transactions	-8.4	-8.0	-7.4	-7.2	-7.1	-6.8
Net acquisition of financial assets	-0.8	-0.1	-0.3	-0.1	-0.2	-0.3
Domestic	-0.8	-0.1	-0.3	-0.1	-0.2	-0.3
Currency and deposits	0.2	-0.1	-0.3	-0.2	-0.2	-0.1
Loans	0.7	0.2	0.3	0.3	0.3	-0.1
Equity and investment fund shares	-1.7	-0.2	-0.3	-0.2	-0.3	-0.2
Net incurrence of liabilities	7.6	7.9	7.1	7.1	6.8	6.4
Domestic	7.3	7.7	7.0	7.0	6.8	6.4
Debt securities	5.3	6.3	5.8	6.0	5.0	5.0
Other accounts payable	1.9	1.4	1.3	1.0	1.7	1.4
Foreign	0.3	0.1	0.1	0.0	0.0	0.0
Loans	0.3	0.1	0.1	0.0	0.0	0.0
Memorandum items:						
Primary balance	-3.9	-3.5	-2.9	-2.4	-2.2	-2.0
Nondefence capital expenditure	2.9	3.0	3.0	3.0	3.3	3.1
State and union territory governments' balance 2/	-2.0	-2.0	-2.4	-2.5	-2.7	-2.6
General government debt 3/	67.5	66.8	66.6	65.5	64.3	62.6

Sources: Data provided by the Indian authorities; state level data from the RBI Study on State Finances; and Fund staff amalgamate and prepare projections.

1/ The consolidated general government comprises the central government (CG) and state governments. Data for April-March fiscal year.

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 7. India: Macroeconomic Framework, 2010/11–2019/20 1/

	2010/11	2011/12	2012/13	2013/14	Prel.	Projections				
					2014/15	2015/16	2016/17	2017/18	2018/19	2019/20
Growth (percent change)										
Real GDP (at factor cost)	8.9	6.7	4.5	4.7	5.6	6.3	6.5	6.6	6.7	6.7
Non-agricultural sector	9.0	7.0	5.0	4.7	6.0	6.7	7.0	7.1	7.2	7.2
Prices (percent change, period average)										
Consumer prices	9.5	9.5	10.2	9.5	6.7	6.3	6.0	6.0	5.7	5.6
Saving and investment (percent of GDP)										
Gross saving 2/	33.8	31.4	30.0	29.7	29.8	30.4	30.4	30.5	30.3	30.2
Gross investment 3/	36.5	35.5	34.7	31.4	31.6	32.1	32.5	32.7	32.7	32.7
Fiscal position (percent of GDP)										
Central government balance 4/	-6.4	-6.0	-5.1	-4.8	-4.4	-4.1	-4.0	-3.9	-3.9	-3.7
General government balance 4/	-8.4	-8.0	-7.4	-7.2	-7.1	-6.8	-6.6	-6.5	-6.4	-6.1
General government debt 5/	67.5	66.8	66.6	65.5	64.3	62.6	61.3	60.4	59.5	58.5
External trade (percent change, BOP basis)										
Merchandise exports (in U.S. dollar terms)	37.3	23.7	-1.0	3.9	7.9	8.2	8.2	8.2	8.2	8.2
Merchandise imports (in U.S. dollar terms)	26.7	31.1	0.5	-7.2	8.5	11.0	9.5	9.5	9.3	9.3
Balance of payments (in billions of U.S. dollars)										
Current account balance	-45.9	-78.2	-88.2	-32.4	-37.5	-39.4	-50.9	-59.9	-70.5	-82.2
(in percent of GDP)	-2.7	-4.2	-4.7	-1.7	-1.8	-1.7	-2.0	-2.2	-2.4	-2.5
Foreign direct investment, net	9.4	22.1	19.8	21.6	26.6	29.9	32.6	35.6	38.8	42.4
Portfolio investment, net (equity and debt)	30.3	17.2	26.9	4.8	25.2	28.3	30.8	33.7	36.6	40.1
Overall balance	12.9	-13.1	3.4	15.2	36.6	50.1	45.4	43.9	43.8	44.2
External indicators										
Gross reserves (in billions of U.S. dollars, end-period)	304.8	294.4	292.0	304.2	340.8	390.9	436.3	480.2	523.9	568.1
(in months of imports) 6/	6.3	6.1	6.4	6.3	6.6	7.1	7.3	7.5	7.5	7.5
External debt (in billions of U.S. dollars, end-period)	317.9	360.8	409.5	442.3	495.2	542.9	590.3	643.9	703.2	769.3
External debt (percent of GDP, end-period)	18.6	19.2	22.0	23.6	24.2	23.6	23.5	23.5	23.6	23.6
Of which : short-term debt 7/	7.0	7.4	8.9	9.7	10.1	10.1	10.1	10.3	10.6	10.7
Ratio of gross reserves to short-term debt (end-period) 7/	2.6	2.1	1.8	1.7	1.6	1.7	1.7	1.7	1.7	1.6
Debt service (percent of current account receipts)	4.7	5.1	5.6	5.7	5.3	5.6	6.3	6.6	7.1	7.1
GDP in billion US\$	1708.5	1880.1	1858.7	1876.8	2047.5	2303.4	2509.0	2740.6	2983.0	3264.4

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 authority's definition.

Table 8. India: Indicators of External Vulnerability, 2010/11–2014/15 1/

	2010/11	2011/12	2012/13	2013/14	2014/15	Vintage 2/
Financial indicators						
General government debt (percent of GDP)	67.5	66.8	66.6	65.5	64.3	(Projection)
Broad money (percent change, 12-month basis)	16.1	13.5	13.6	13.2	11.1	(December 2014)
Private sector credit (percent change, 12-month basis)	21.3	17.8	13.5	13.7	10.1	(December 2014)
91 day T-bill yield (percent; end-period)	7.3	9.0	8.2	8.9	8.3	(December 2014)
91 day T-bill yield (real, percent; end-period) 3/	-2.1	-0.3	-2.0	0.5	3.3	(December 2014)
External indicators						
Exports (percent change, 12-month basis in US\$) 4/ 5/	37.3	23.7	-1.0	3.9	6.2	(Projection)
Export volume (percent change, 12-month basis) 5/	26.6	8.9	1.5	3.9	6.0	(Projection)
Imports (percent change, 12-month basis in US\$) 4/ 5/	26.7	31.1	0.5	-7.2	5.7	(Projection)
Import volume (percent change, 12-month basis) 5/	14.6	8.0	1.9	-4.5	8.7	(Projection)
Terms of trade (percent change, 12 month basis) 5/	-3.4	-5.9	-0.5	2.2	2.0	(Projection)
Current account balance (percent of GDP)	-2.7	-4.2	-4.7	-1.7	-1.8	(Projection)
Capital and financial account balance (percent of GDP)	3.6	3.6	4.8	2.6	3.6	(Projection)
<i>Of which:</i> Net portfolio investment (debt and equity)	1.8	0.9	1.4	0.3	1.2	(Projection)
Other investment (loans, trade credits, etc.)	1.3	1.5	2.3	1.2	1.1	(Projection)
Net foreign direct investment	0.5	1.2	1.1	1.1	1.3	(Projection)
Foreign currency reserves (billions of US\$)	304.8	294.4	292.0	304.2	340.8	(Projection)
Official reserves (in months of imports of goods and services)	6.3	6.1	6.4	6.3	6.6	(Projection)
Ratio of foreign currency reserves to broad money (percent)	24.5	22.8	21.6	22.1	19.3	(September 2014)
Total short-term external debt to reserves (percent) 6/	39.2	47.2	56.3	59.6	60.9	(Projection)
Total external debt (percent of GDP)	18.6	19.2	22.0	23.5	24.2	(Projection)
<i>Of which:</i> public sector debt	3.9	3.6	3.7	3.7	3.4	(Projection)
Total external debt to exports of goods and services (percent)	83.5	79.8	90.5	93.7	99.5	(Projection)
External interest payments to exports of goods and services (percent)	1.4	1.4	1.7	1.7	1.7	(Projection)
External amortization payments to exports of goods and services (percent)	12.9	13.0	14.7	19.9	19.4	(Projection)
Exchange rate (per US\$, end-period)	45.0	50.3	54.4	61.0	61.8	(January 2015)
REER (annual percent change; period average)	11.6	-8.5	-14.1	-2.4	4.6	(November 2014)
Financial market indicators						
Stock market index (end-period)	19445	17404	18836	22386	27499	(December 2014)
Foreign currency debt rating						
Moody's Investor Services	Baa3	Baa3	Baa3	Baa3	Baa3	(December 2014)
Standard and Poor's	BBB-	BBB-	BBB-	BBB-	BBB-	(December 2014)
Fitch Ratings	BBB-	BBB-	BBB-	BBB-	BBB-	(December 2014)

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/ Latest date available or staff estimate, as noted.

3/ Equals nominal yield minus actual CPI-Combined inflation.

4/ Data from 2009/10 are on a customs basis, whereas data for previous years are on a BOP basis.

5/ 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.

6/ 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 9. India: Financial Soundness Indicators, 2010/11–2013/14

	2010/11	2011/12	2012/13	2013/14
Measures of financial strength and performance 1/				
Risk-weighted capital adequacy ratio (CAR)	14.2	14.2	13.9	13.0
Public sector banks	13.1	13.2	12.4	...
Old Private Sector Banks	14.6	14.1	13.7	...
New Private Sector Banks	16.9	16.7	17.5	...
Foreign banks	17.0	16.8	17.9	...
Number of institutions not meeting 9 percent CAR	0	0	0	0
Net nonperforming loans (percent of outstanding net loans) 2/	1.1	1.4	1.5	2.2
Public sector banks	1.2	1.7	1.8	2.7
Old Private Sector Banks	0.5	0.6	0.6	0.7
New Private Sector Banks	0.6	0.5	0.3	...
Foreign banks	0.6	0.6	1.0	1.1
Gross nonperforming loans (percent of outstanding loans)	2.4	3.1	3.4	4.1
Public sector banks	2.3	3.3	3.8	4.7
Old Private Sector Banks	2.3	1.8	1.9	1.9
New Private Sector Banks	2.6	2.2	1.9	...
Foreign banks	2.5	2.6	3.0	3.9
Restructured Loans (percent of outstanding advances)	3.5	4.7	5.7	5.9
Public sector banks	4.3	5.9	7.1	7.2
Old Private Sector Banks	3.0	3.5	3.8	...
New Private Sector Banks	0.7	1.1	1.2	2.3
Foreign banks	0.2	0.1	0.1	0.1
Net profit (+)/loss (-) of commercial banks 3/	1.1	1.1	1.0	0.8
Public sector banks	1.0	0.9	0.8	...
Old Private Sector Banks	1.1	1.2	1.3	...
New Private Sector Banks	1.5	1.6	1.7	...
Foreign banks	1.8	1.8	1.9	...
Balance sheet structure of all scheduled banks				
Loan/deposit ratio	76.5	78.6	79.1	79.0
Investment in government securities/deposit ratio	26.0	27.0	29.0	...
Lending to sensitive sectors (in percent of loans and advances)				
Real estate	16.6	15.7	17.3	...
Capital market	1.8	1.7	3.4	...
Commodities	0.0	0.0	0	...
Sources: Annual Report and Report on Trend and Progress of Banking in India, Reserve Bank of India; Bankscope.				
1/ Some loan classification and provisioning standards do not meet international standards.				
2/ Gross nonperforming loans less provisions.				
3/ In percent of total assets.				

Annex I. Risk Assessment Matrix

Nature/Source of Threat	Likelihood	Impact	Policies to Minimize Impact
Domestic Risks			
Slower-than-expected progress in addressing supply side bottlenecks	M	M: Slower-than-expected progress in addressing supply side bottlenecks could weigh on growth and stoke inflation, thereby it could undermine macroeconomic and financial stability.	Continue to address long-standing supply bottlenecks, especially in the energy, mining and power sectors, as well as labor market reforms. Strengthen business climate and address factors hampering agricultural productivity.
Strong pick-up in inflation	M	M-H: A strong pick-up in inflation could discourage financial saving, erode external competitiveness and generate external imbalances. It also hurts the poor, especially in urban areas, the most. High inflation expectations could increase the economic costs of bringing inflation down in a sustainable way, further damaging growth.	Raising interest rates until inflation is clearly on a downward trend. Improved agricultural productivity and investing in infrastructure to improve the supply response can reduce food price pressures.
Balance sheet risks	M	H: Continued corporate stress could add to bank NPAs, raising capital concerns and reducing lending in the medium term.	Strengthened oversight of financial and corporate risks. Raising provisioning requirements. Policies to incentivize genuine corporate restructuring and improvements to insolvency framework.
External Risks			
A surge in financial market volatility	H	M: While external vulnerabilities have declined considerably, the impact from a surge in global financial market volatility could be disruptive, particularly against the backdrop of large capital inflows more recently and weak corporate balance sheets.	Enhance the environment for attracting stable non-debt creating capital flows, particularly FDI. Rupee flexibility and monetary policy tightening. Offer FX swaps to banks to attract NRI deposits as well as providing dollar liquidity to oil marketing companies to limit depreciation.
Protracted period of slower growth in advanced economies	H	M: Deterioration in the advanced countries' economic outlook would cloud the sustainability of the recovery in India, both for exports and investment.	Structural reform will raise returns to investment and strengthen domestic sources of growth.
Heightened geopolitical risks in the Middle East	M	M-H: Significant effects on the current account deficit, inflation and the fiscal deficit.	Further shift toward market pricing to minimize fiscal impact and improved targeting of transfers to shelter the most vulnerable.
Financial imbalances from protracted period of low interest rates continue to build	M	M: Rapid capital inflows, increased leverage by corporates especially those with unhedged FX exposures, and strong currency appreciation pressures would set the stage for disruptive movements in macroeconomic and financial variables in the event of sudden shifts in markets' expectations.	Further improve the current account deficit financing mix. Structural reforms, close monitoring of unhedged FX positions, and building of external buffers are also key.
<p><i>"L"=Low; "M"=Medium; "H"=High.</i></p> <p><i>This matrix shows events that could materially alter the baseline path (the scenario most likely to materialize in the view of IMF staff). The relative likelihood of risks listed is the staff's subjective assessment of the risks surrounding the baseline. The Risk Assessment Matrix reflects staff views on the source of risks and overall level of concern as of the time of discussions with authorities.</i></p>			

Annex II. Public and External Debt Sustainability Analysis¹

India's public debt remains sustainable given manageable interest rate costs and expected recovery in the economy's growth rate.² Under the baseline, the public debt-to-GDP ratio is forecast to decline gradually to about 58½ percent of GDP in the medium term from the current level of 65½ percent, with gross financing needs also declining slightly to about 11 percent of GDP in 2019/20. While the baseline scenario already uses conservative real GDP growth assumptions, further negative growth shocks represent one of the major risks to the debt outlook. In addition, realization of contingent liabilities coming from future bank capital injections and liabilities of the electricity distribution companies may also push the debt trajectory up to about 70 percent, before the debt-to-GDP ratio declines gradually in the medium term. On the other hand, the captive domestic investor base is likely to mitigate the impact of any real interest rate shocks.

1. India's public debt sustainability analysis is based on the following assumptions:

- **Macroeconomic assumptions.** Growth is forecast at 5.6 percent (at factor cost) in 2014/15,³ and should gradually return to potential in the medium term (at around 6¾ percent). CPI inflation is projected to decline from 9½ percent in 2013/14 to around 5½ percent in 2019/20. This baseline scenario assumes continued implementation of structural reforms that do not require legislative approval, and a relatively benign global economic recovery scenario as outlined in the WEO.
- **Fiscal Assumptions.** The 2013/14 central government budget deficit came in at 4.5 percent of GDP (below the authorities' deficit target of 4.8 percent of GDP), which corresponds to 4.8 percent under the Fund's definition. Over the medium term, this is expected to decline slowly toward 3¾ percent of GDP, while state government deficits should decline to 2½ percent of GDP.
 - Tax performance, especially for income taxes, is expected to improve slightly as ongoing administrative measures continue to be implemented and base broadening is expected to continue. Goods and Services Tax is not assumed in this baseline as it requires legislative changes, including a constitutional amendment.
 - At the same time, savings are likely to be found from reduced fuel subsidies, including as a result of deregulation of diesel prices, and the planned gradual introduction of cash transfers should help rationalize spending over the medium term. However, the Food Security Act will keep the subsidy bill high.

¹ Prepared by Ran Bi, Mehdi Raissi, and Sonali Jain-Chandra.

² The analysis of public debt sustainability is based on the framework developed for market access countries. See [Staff Guidance Note for Public Debt Sustainability Analysis in Market Access Countries](#), IMF, May 2013.

³ The real GDP growth rates presented in the public and external DSA tables are based on market prices, as required by WEO. However, to be consistent with the authorities' measure of real GDP, the text here and other macro tables present real GDP growth at factor cost.

- Public banks' capital positions are expected to be enhanced to meet Basel III targets and some of the debts of electricity distribution companies are to be assumed by the government.

2. Under the baseline projection, India's debt ratio and gross financing needs will remain on a declining path. India's primary deficit is projected to trend downward and remain below its debt-stabilizing threshold (estimated at 2.8 percent of GDP based on the 2019/20 projections) in the projection years. Therefore, gross financing needs are expected to remain at around 12 percent of GDP in 2014/15 before gradually declining to around 11 percent in 2019/20. Automatic debt dynamics arising from the interest rate-growth differential will on average reduce the debt ratio by some 2½ percentage point per year from 2014/15 to 2019/20. As a result, the public debt-to-GDP ratio is expected to fall from 65½ percent in 2013/14 to 58½ percent in 2019/20. The medium-term public debt-to-GDP ratio is about 5 percentage points lower than envisaged in the last Staff Report, reflecting a downward data revision of the historical public debt path as well as a more buoyant growth outlook in the near term.

3. India faces relatively low risks to debt sustainability under the baseline, but it could be vulnerable to slower real GDP growth and a contingent liability shock. The heat map suggests that the debt burden benchmark and the gross financing needs threshold are exceeded under a contingent liability shock. A financial sector contingent liability shock (which could arise from losses at public banks)⁴ pushes the debt-to-GDP ratio to about 70 percent in 2015/16. While not flagged as a main risk by the heat map, a one-standard deviation shock to real GDP growth increases the debt-to-GDP ratio to about 66 percent in 2016/17, lower than the threshold of 70 percent above which the heat map flags the risk. Both shocks, however, do not change the downward debt trajectory in the medium term. The lack of fiscal adjustment is another principal risk to debt sustainability in India's context. An unchanged primary balance would slow debt reduction by about ¼ of one percentage point per year on average from 2014/15 to 2019/20, but it does not change the downward trend. Finally, the combined macro-fiscal shock also has a level effect but does not change the direction of the debt trajectory. As a result, the asymmetric fan chart suggests that upside risks to debt ratio dominate in the medium term. The debt profile, on the other hand, is at risk to market perception shocks and external financing requirements. In particular, market perception is flagged as a high risk as India's recent sovereign EMBI spreads have breached the threshold of 600 bps. However, these two risks are mitigated by the fact that most of the public debt is financed through a captive domestic investor base, the very small external debt is mostly from official creditors, and more than adequate international reserves are available in the rare case that external financing needs arise. Risks that could improve India's public debt sustainability include better tax buoyancy, a GST and a revised Direct Tax Code that improve efficiency and lead to near-term revenue gains. A strong revival of the economy could also return India to the debt dynamics prevailing before the global financial crisis.

⁴ Due to the lack of data on the actual public bank recapitalization needs, the default shock of 10 percent of total banking sector assets is used. This contingent liability shock is in addition to the public bank recapitalization assumed under the baseline to meet Basel III targets.

4. There is no evidence of a systematic projection bias in the baseline assumptions and the projected fiscal adjustment is in line with other countries' experiences. India's forecast track record is comparable to that of all other surveillance countries. The median forecast errors for real GDP growth, primary balance and inflation during 2005–13 are all close to median among all surveillance countries. India's projected fiscal adjustment (an improvement of around one percentage point in cyclically-adjusted primary balance/GDP over the medium term) is modest and should be achievable. This magnitude of adjustment is also in line with other countries' experiences, with a three-year adjustment in cyclically-adjusted primary balance at 37 percentile among all surveillance countries with market access. Unlike in the last Staff Report, the boom-bust analysis is not triggered because India had a negative output gap in 2013/14.

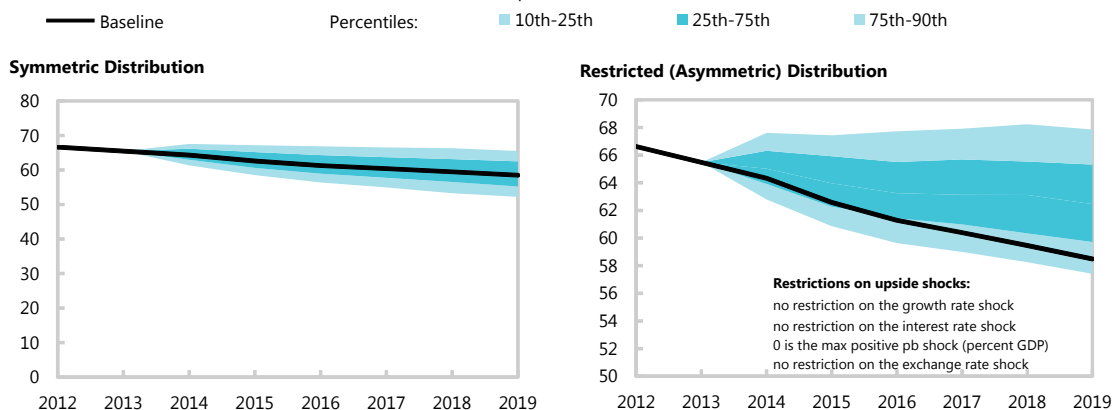
Annex II. Figure 1. India Public DSA—Risk Assessment

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

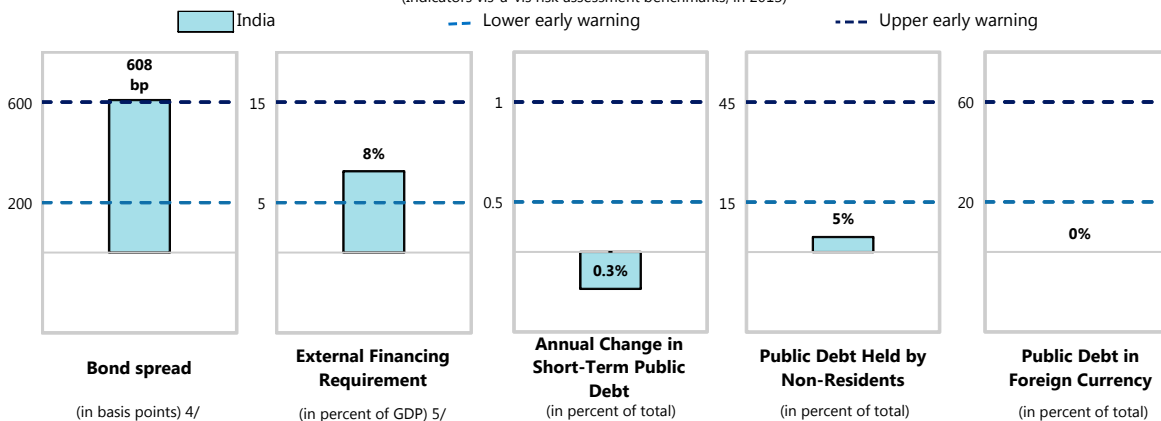
Evolution of Predictive Densities of Gross Nominal Public Debt

(in percent of GDP)



Debt Profile Vulnerabilities

(Indicators vis-à-vis risk assessment benchmarks, in 2013)



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:

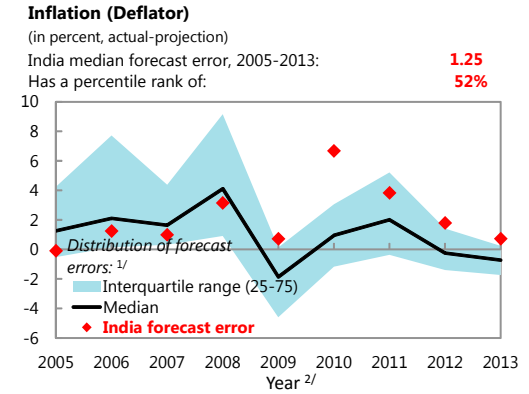
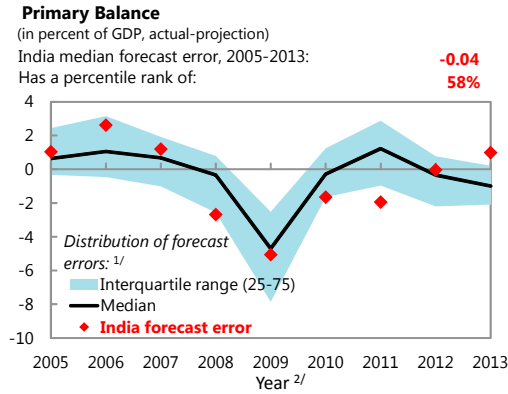
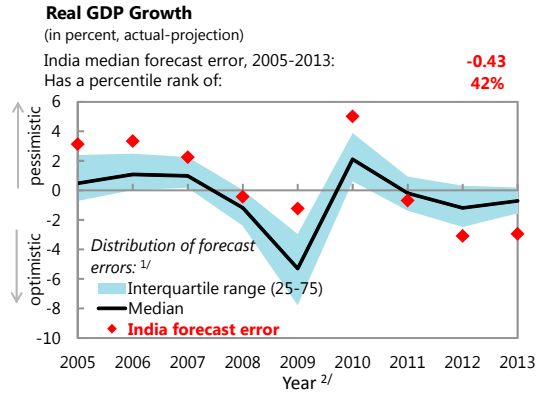
200 and 600 basis points for bond spreads; 5 and 15 percent of GDP for external financing requirement; 0.5 and 1 percent for change in the share of short-term debt; 15 and 45 percent for the public debt held by non-residents; and 20 and 60 percent for the share of foreign-currency denominated debt.

4/ Long-term bond spread over U.S. bonds, an average over the last 3 months, 17-Sep-14 through 16-Dec-14.

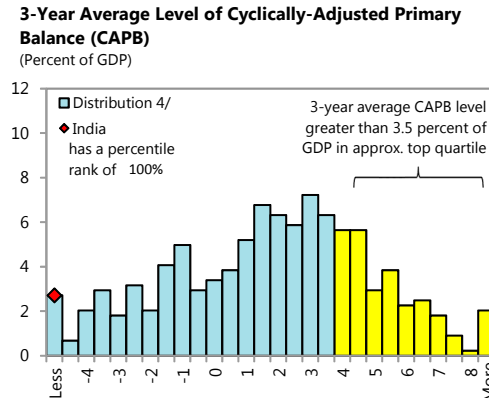
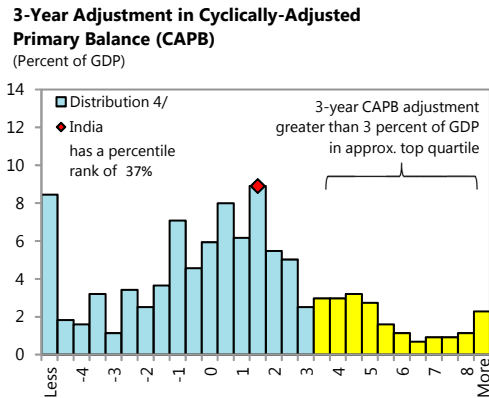
5/ External financing requirement is defined as the sum of current account deficit, amortization of medium and long-term total external debt, and short-term total external debt at the end of previous period.

Annex II. Figure 2. India Public DSA—Realism of Baseline Assumptions

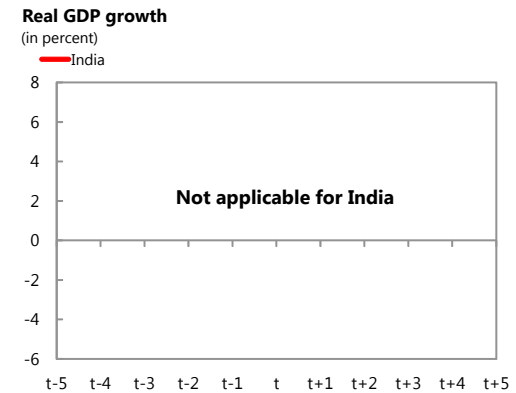
Forecast Track Record, versus surveillance countries



Assessing the Realism of Projected Fiscal Adjustment



Boom-Bust Analysis^{3/}



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 observations from 1990 to 2011 for advanced and emerging economies with debt greater than 60 percent of GDP. Percent of sample on vertical axis.

Annex II. Figure 3. India Public DSA—Baseline Scenario

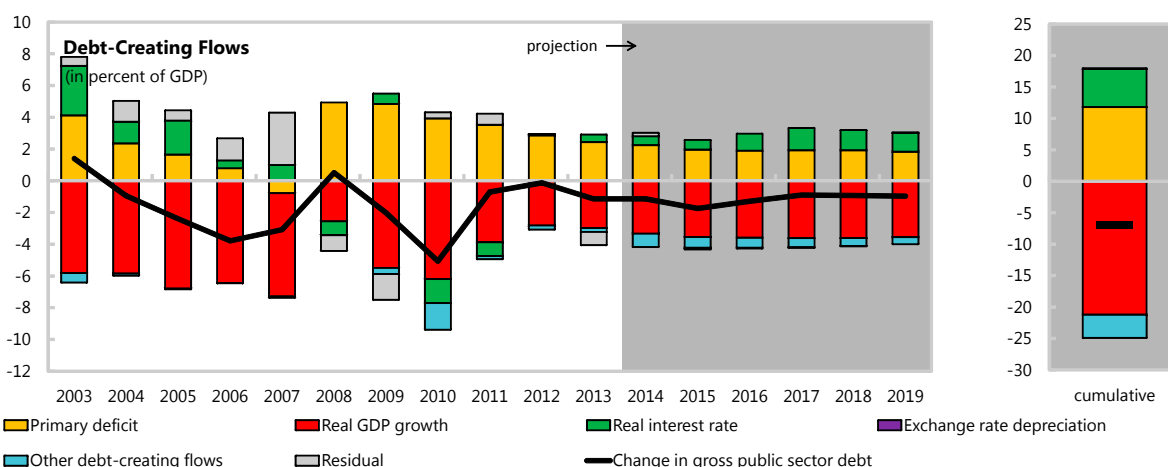
(in percent of GDP unless otherwise indicated)

Debt, Economic and Market Indicators ^{1/}

	Actual			Projections						As of December 16, 2014			
	2003-2011 ^{2/}	2012	2013	2014	2015	2016	2017	2018	2019	Sovereign Spreads			
Nominal gross public debt	75.6	66.6	65.5	64.3	62.6	61.3	60.4	59.5	58.5	EMBIG (bp) ^{3/}			588
Public gross financing needs	12.0	12.4	11.9	12.1	11.7	11.3	11.2	11.0	10.7	5Y CDS (bp)			170
Real GDP growth (in percent)	8.2	4.7	5.0	5.8	6.3	6.5	6.6	6.7	6.7	Ratings	Foreign	Local	
Inflation (GDP deflator, in percent)	6.5	7.2	6.9	6.9	7.0	6.1	5.4	5.5	5.6	Moody's	Baa2	Baa3	
Nominal GDP growth (in percent)	15.1	12.2	12.3	12.7	13.9	13.1	12.5	12.6	12.6	S&Ps	BBB	BBB	
Effective interest rate (in percent) ^{4/}	7.8	7.6	8.1	8.3	8.5	8.4	8.3	8.3	8.2	Fitch	BBB-	BBB-	

Contribution to Changes in Public Debt

	Actual			Projections						cumulative	debt-stabilizing primary balance ^{9/}
	2003-2011	2012	2013	2014	2015	2016	2017	2018	2019		
Change in gross public sector debt	-1.8	-0.1	-1.1	-1.1	-1.7	-1.3	-0.9	-0.9	-1.0	-7.0	
Identified debt-creating flows	-2.4	-0.2	-0.3	-1.4	-1.6	-1.2	-0.9	-0.9	-1.0	-7.0	
Primary deficit	2.8	2.9	2.4	2.2	2.0	1.9	1.9	1.9	1.8	11.8	-2.8
Primary (noninterest) revenue and grants	19.4	19.5	19.8	19.6	19.7	19.7	19.8	19.9	20.0	118.7	
Primary (noninterest) expenditure	22.2	22.3	22.2	21.9	21.6	21.6	21.7	21.8	21.8	130.5	
Automatic debt dynamics ^{5/}	-4.9	-2.8	-2.5	-2.8	-2.9	-2.5	-2.2	-2.3	-2.4	-15.1	
Interest rate/growth differential ^{6/}	-4.9	-2.8	-2.5	-2.8	-2.9	-2.5	-2.2	-2.3	-2.4	-15.1	
Of which: real interest rate	0.6	0.1	0.5	0.6	0.6	1.1	1.4	1.3	1.2	6.1	
Of which: real GDP growth	-5.5	-2.8	-3.0	-3.3	-3.5	-3.6	-3.6	-3.6	-3.6	-21.2	
Exchange rate depreciation ^{7/}	0.0	0.0	0.0	...	...	...	...	...	...	...
Other identified debt-creating flows	-0.4	-0.3	-0.2	-0.8	-0.7	-0.6	-0.6	-0.5	-0.4	-3.7	
Consolidated General Govt - Domestic											
Financing: Privatization Receipts (Rs)	-0.4	-0.3	-0.2	-0.8	-0.7	-0.6	-0.6	-0.5	-0.4	-3.7	
Contingent liabilities	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/}	0.6	0.0	-0.8	0.2	-0.1	0.0	0.0	0.0	0.0	0.0	



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.

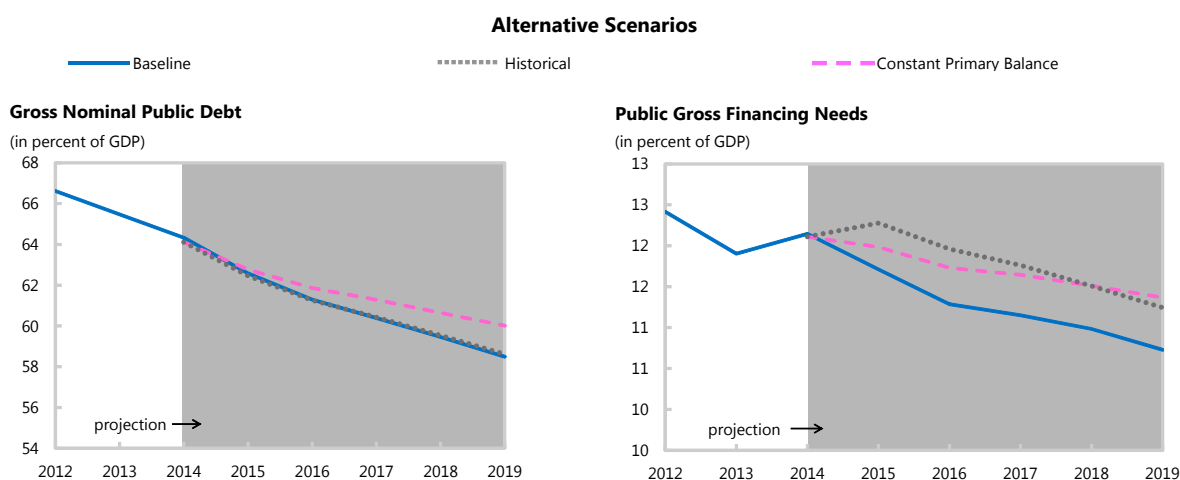
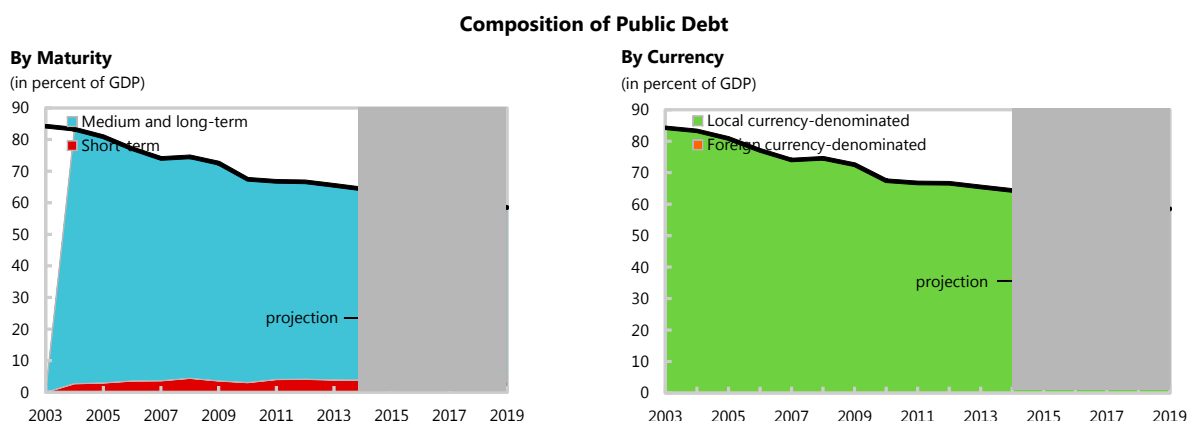
4/ Defined as interest payments divided by debt stock (excluding guarantees) at the end of previous year.

5/ Derived as $[(r - \pi(1+g) - g + ae(1+r))/(1+g+\pi+g\pi)]$ 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 $r - \pi(1+g)$ 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.

Annex II. Figure 4. India: Public DSA—Composition of Public Debt and Alternative Scenarios



Underlying Assumptions (in percent)

Baseline Scenario	2014	2015	2016	2017	2018	2019
Real GDP growth	5.8	6.3	6.5	6.6	6.7	6.7
Inflation	6.9	7.0	6.1	5.4	5.5	5.6
Primary Balance	-2.2	-2.0	-1.9	-1.9	-1.9	-1.8
Effective interest rate	8.3	8.5	8.4	8.3	8.3	8.2

Constant Primary Balance Scenario	2014	2015	2016	2017	2018	2019
Real GDP growth	5.8	6.3	6.5	6.6	6.7	6.7
Inflation	6.9	7.0	6.1	5.4	5.5	5.6
Primary Balance	-2.2	-2.2	-2.2	-2.2	-2.2	-2.2
Effective interest rate	8.3	8.5	8.4	8.3	8.2	8.1

Historical Scenario	2014	2015	2016	2017	2018	2019
Real GDP growth	5.8	7.5	7.5	7.5	7.5	7.5
Inflation	6.9	7.0	6.1	5.4	5.5	5.6
Primary Balance	-2.2	-2.7	-2.7	-2.7	-2.7	-2.7
Effective interest rate	8.3	8.5	8.2	7.9	7.7	7.5

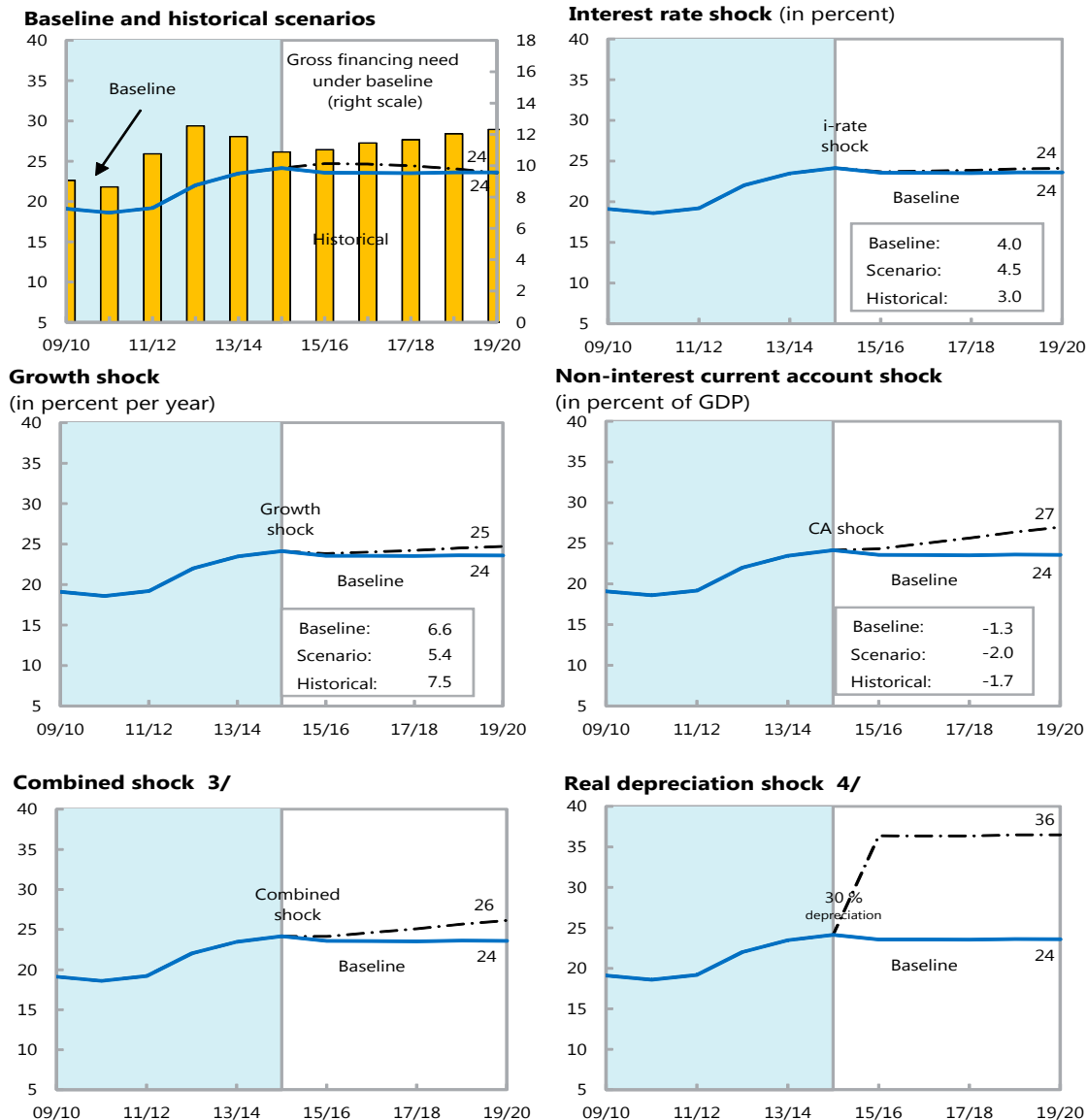
Source: IMF staff.

Annex II. Figure 5. India Public DSA—Stress Tests



Source: IMF staff.

Annex II. 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 2014/15.

Annex II. Table 1. India: External Debt Sustainability Framework, 2009–2019

(In percent of GDP, unless otherwise indicated)

	Actual					Projections						Debt-stabilizing non-interest current account 6/ -3.6
	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	
Baseline: External debt	19.1	18.6	19.2	22.0	23.5	24.2	23.6	23.6	23.5	23.6	23.6	
Change in external debt	0.8	-0.5	0.6	2.8	1.5	0.7	-0.6	0.0	0.0	0.1	0.0	
Identified external debt-creating flows (4+8+9)	-2.9	-3.5	0.3	2.2	-0.1	-2.0	-2.2	-1.9	-1.8	-1.7	-1.5	
Current account deficit, excluding interest payments	2.4	2.4	3.8	4.3	1.3	1.4	1.2	1.2	1.3	1.3	1.5	
Deficit in balance of goods and services	-46.8	-49.7	-54.8	-55.7	-54.1	-52.5	-49.9	-49.3	-48.6	-48.0	-47.2	
Exports	20.4	22.4	24.0	24.3	25.0	24.3	23.1	22.8	22.4	22.1	21.6	
Imports	-26.4	-27.2	-30.7	-31.4	-29.0	-28.3	-26.8	-26.5	-26.2	-25.9	-25.5	
Net non-debt creating capital inflows (negative)	-3.7	-2.4	-2.1	-2.6	-1.4	-2.6	-2.6	-2.6	-2.6	-2.6	-2.6	
Automatic debt dynamics 1/	-1.5	-3.4	-1.5	0.4	0.1	-0.8	-0.8	-0.6	-0.5	-0.4	-0.4	
Contribution from nominal interest rate	0.4	0.3	0.3	0.4	0.4	0.4	0.5	0.8	0.9	1.0	1.0	
Contribution from real GDP growth	-1.4	-1.6	-1.1	-0.9	-1.1	-1.2	-1.3	-1.4	-1.4	-1.5	-1.5	
Contribution from price and exchange rate changes 2/	-0.6	-2.2	-0.7	0.9	0.7	...	...	...	...	...	...
Residual, incl. change in gross foreign assets (2-3) 3/	3.6	3.0	0.3	0.6	1.5	2.7	1.6	1.9	1.8	1.7	1.5	
External debt-to-exports ratio (in percent)	93.7	82.9	79.8	90.5	93.7	99.5	101.9	103.4	105.1	107.0	109.0	
Gross external financing need (in billions of US dollars) 4/	123.8	147.8	202.1	233.0	222.6	223.1	253.7	287.0	318.9	358.2	401.3	
in percent of GDP	9.1	8.6	10.7	12.5	11.9	10.9	11.0	11.5	11.7	12.0	12.3	
						10-Year	10-Year					
Scenario with key variables at their historical averages 5/						24.2	24.7	24.7	24.4	24.1	23.6	-4.1
Key Macroeconomic Assumptions Underlying Baseline						Historical Average	Standard Deviation					
Real GDP growth (in percent)	8.5	10.3	6.6	4.7	5.0	7.5	2.3	5.8	6.3	6.5	6.6	6.7
GDP deflator in US dollars (change in percent)	2.8	13.5	3.2	-5.6	-3.9	4.2	7.9	3.3	5.7	2.2	2.4	2.0
Nominal external interest rate (in percent)	2.7	2.0	2.0	2.1	1.9	3.0	1.0	2.0	2.5	3.7	4.2	4.8
Growth of exports (US dollar terms, in percent)	-5.6	37.7	17.9	0.0	3.9	18.5	15.1	5.8	7.1	7.2	7.2	7.3
Growth of imports (US dollar terms, in percent)	0.0	29.0	24.2	0.9	-6.6	20.1	17.7	6.5	6.3	7.8	7.9	7.7
Current account balance, excluding interest payments	-2.4	-2.4	-3.8	-4.3	-1.3	-1.7	1.5	-1.4	-1.2	-1.2	-1.3	-1.3
Net non-debt creating capital inflows	3.7	2.4	2.1	2.6	1.4	2.2	0.9	2.6	2.6	2.6	2.6	2.6

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.



INDIA

STAFF REPORT FOR THE 2015 ARTICLE IV CONSULTATION—INFORMATIONAL ANNEX

January 26, 2015

Prepared By

Asia and Pacific Department

CONTENTS

FUND RELATIONS	2
RELATIONS WITH THE WORLD BANK GROUP	5
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FUND RELATIONS

(As of December 31, 2014)

Membership Status:

Joined December 27, 1945; Article VIII.

General Resources Account

	SDR Million	% Quota
Quota	5,821.50	100.00
Fund Holdings of Currency (Exchange Rate)	4,573.23	78.56
Reserve Tranche Position	1,248.36	21.44
Lending to the Fund		
New Arrangements to Borrow	1,045.01	

SDR Department:

	SDR Million	% Allocation
Net cumulative allocation	3,978.26	100.00
Holdings	2,888.77	72.61

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				
	2015	2016	2017	2018	2019
Principal					
Charges/interest	0.57	0.57	0.57	0.57	0.57
Total	0.57	0.57	0.57	0.57	0.57

Exchange Rate Arrangement:

As per the Annual Report on Exchange Arrangements and Exchange Restrictions (AREAER), 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 2013. The staff report (IMF Country Report No. 14/57) was discussed by the Executive Board on January 27, 2014.

FSAP Participation and ROSCs:

FSSA/FSAP report was issued in January 2001; a fiscal transparency ROSC was issued in February 2001 (<http://www.imf.org/external/np/rosc/ind/fiscal.htm>); the data model of the ROSC (Country Report No. 04/96) was issued in April 2004. The missions for the FSAP Update took place in 2011, and concluding meetings were held in Delhi and Mumbai in January 2012—the FSSA Update report was published in January 2013 (Country Report No. 13/8). Detailed assessment reports on FSAP-related papers were issued in August 2013 and published as Country Reports No. 13/265–268.

Technical Assistance:

Dept	Purpose	Date of Delivery
FAD	State level fiscal database and debt register	11/04
FAD	Pilot study on public private partnerships	12/04
STA	Balance of payments statistics	9/05
LEG	AML/CFT	5/08
LEG	AML/CFT	10/08
STA	Workshop on national accounts	03/10
LEG	Insolvency regime workshop	7/13
ICD	Financial programming	11/13
STA	Government finance statistics	1/14
MCM	Macroeconomic modeling for inflation targeting	2/14
STA	Sectoral accounts and balance sheets	3/14
MCM	Technical cooperation and IMF/RBI on stress test	4/14

INDIA

APD	Financial programming for Ministry of Finance	7/14
MCM	Macroprudential issues	10–12/14
MCM	Developing a forecasting and policy analysis system (FPAS)	11/14

Outreach and Other Activities:

Dept	Purpose	Date of Delivery
APD	Article IV outreach: Conference call, blog, IMF Survey article, presentation at ICRIER	2/14
APD	Presentation on growth and investment uncertainty, NCAER	2/14
APD	Op-ed on Article IV conclusions, Times of India	2/14
APD	Presentation on India Article IV conclusions, Delhi University economics department	3/14
APD	“Fighting Indian Inflation,” op-ed, Mint	3/14
APD	“India’s investment slowdown: High cost of economic policy uncertainty,” blog, IMF	3/14
APD	Presentation on India Economic Outlook, National Stock Exchange	4/14
APD	Assocham seminar on India’s Economic Agenda: 2014–19	6/14
APD	Lecture at IIM-Bangalore: APD REO and implications for India	6/14
APD	“Inflation targeting in India: Lessons from Africa,” blogpost	8/14
APD	ICRIER G-20 Conference	8/14
APD	“Supervising myriad small institutions can be a challenge,” interview, Mint	8/14
APD	Presentation on global outlook and India’s prospects, Nomura	9/14
APD	ICRIER Conference on Agenda for Reforms	9/14
APD	“India needs to take more steps to contain inflation, fiscal deficit: IMF,” article, Mint	9/14
APD	“Asia has absorbed shocks and moved on,” op-ed, Hindustan Times	10/14
APD	Financial Times-Yes Bank International Banking Summit	10/14
APD	Indian Statistical Institute: Delhi Macro Workshop	10/14
APD	South Asia Economic Summit	11/14
APD	United States-India Chamber of Commerce Conference	11/14
APD	NCAER Review of the Economy	11/14
APD	Citibank India Investor Summit	11/14
APD	IMF-IIM Bangalore Conference on Housing Markets, Financial Stability and Growth	12/14
APD	NIPFP-Ministry of Finance Conference on Fiscal Policy	12/14

Resident Representative:

A resident representative’s office was opened in November 1991. Mr. Thomas Richardson has been the Senior Resident Representative since August 2012.

RELATIONS WITH THE WORLD BANK GROUP

In Bank FY14 (July 1, 2013–June 30, 2014), IBRD/IDA lending in India totaled US\$5.1 billion (of which US\$1.97 billion IBRD and US\$3.13 billion IDA). IFC committed US\$1.2 billion in FY14. The World Bank Group’s (WBG) Country Partnership Strategy (CPS) for India for 2013–2017¹ focuses on helping India accelerate poverty reduction and boost shared prosperity, and is closely aligned the Government’s 12th Five-Year Plan, and its goal of “faster, sustainable, and more inclusive growth.” To make a meaningful contribution to India’s many development challenges, the volume of WBG support—from IBRD, IDA, and IFC—should reach \$5 billion annually over the five-year period of the CPS.

Under the Strategy, the WBG aims to contribute to India’s development by deepening and strengthening engagement in three priority areas: integration, rural-urban transformation and inclusion. “Integration” seeks to increase market integration by focusing on addressing infrastructure gaps and investment climate as key measures needed to help low-income states converge more quickly with their faster-growing neighbors. With 600 million people expected to live in India’s cities by 2031, “rural-urban transformation” will require intensified engagement to improve the management and livability of medium-sized cities. “Inclusion” will entail a stronger focus on human development with improvements in healthcare systems and nutrition, on the quality of education at all levels, as well as on better access to finance and social protection for the underprivileged. A common theme across these three areas of engagement will be an emphasis on improved governance, environmental sustainability, and gender equality.

Two key strategic shifts are central to the WBG program and India’s efforts to reduce poverty and boost shared prosperity—increased support to 14 low-income and special category states² and to urbanization. The Bank is working with the Government to rebalance its lending portfolio, so that 30 percent of all IBRD/IDA lending will be directed to these states, which together account for 400 million—one-third of India’s poor people living on less than \$1.25 per day. Many of these states also have human development indicators—high infant mortality, high child malnutrition, low female literacy—on par with the poorest countries in the world. IFC has also intensified its program in low-income states. Engagement in more advanced states and at the central level will focus on activities that are transformative and innovative. Urbanization presents tremendous opportunities, both for agriculture and poverty reduction, and competitiveness. WBG support focuses on government efforts at the national, state and city levels to help improve the livability of medium-sized cities.

A robust knowledge portfolio will complement and underpin financing and includes: (i) focus on in-depth analytical work on key cross-sectoral questions; (ii) inform design and implementation of future interventions by drawing on impact evaluations; (iii) respond quickly and flexibly with

¹ See <http://openindia.worldbankgroup.org> for a visualization on the WBG country strategy.

² Low-income and special category states include: Bihar, Chhattisgarh, Jharkhand, Madhya Pradesh, Odisha, Rajasthan, Uttar Pradesh, and eight northeast states (Assam, Himachal Pradesh, Manipur, Meghalaya, Mizoram, Sikkim, and Uttarakhand). IFC also includes West Bengal, but excludes Himachal Pradesh and Uttarakhand.

demand-driven technical assistance and just-in-time knowledge support to help reform and implementation; (iv) broker South-South and across-state knowledge exchanges; (v) develop flexible programmatic approaches to develop analytic and advisory activities; and (vi) scale-up training capacity.

The 2014 national elections brought in a new Government led by Prime Minister Narendra Modi, and with it opportunities to further strengthen WBG long-standing partnership with India. Stressing the importance of WBG as the “Knowledge Bank”, Prime Minister Modi has requested more intense engagement in supporting six strategic priorities: operationalizing the Government’s initiative to develop 100 “smart cities”; empowering and providing 500+ cities with comprehensive municipal services and networks; revitalizing the power sector and supporting Government’s 24-7 Power for All initiative; supporting rural sanitation, with a focus on behavior change-led investments; additional support for efforts to clean and conserve the Ganga Basin; and skills development to ensure India’s global competitiveness and inclusive growth.

India: World Bank Financial Operations

	(In millions of U.S. dollars) ^{1/}
	2013/14 ^{2/}
Commitments^{3/}	3,302
IBRD	891
IDA	2,411
Disbursements	2,055
IBRD	933
IDA	1,112
Repayments	1,821
IBRD	845
IDA	976
Debt outstanding and disbursed	38,714
IBRD	11,903
IDA	26,811

Source: World Bank.

1/ On an Indian fiscal year basis beginning April 1.

2/ April 1, 2013 through March 31, 2014.

3/ Based on loan approval date.

RELATIONS WITH THE ASIAN DEVELOPMENT BANK

The Asian Development Bank (AsDB) operations in India began in 1986. Cumulative public sector loan commitments totaled \$29.7 billion as of 30 September 2014 for 180 loans. With an additional \$2.4 billion in private sector loans (the latter without government guarantee), total loan commitments on a cumulative basis amount to \$32.1 billion. These funds have been provided from AsDB's ordinary capital resources (OCR). Also, AsDB has approved equity investments amounting to \$0.4 billion. AsDB's lending and equity activities are summarized below.

India: Asian Development Bank Financial Operations (sovereign and non-sovereign)

(In millions of U.S. dollars, as of 30 September 2014)

Calendar Year	OCR Loan Commitments	Private Equity	Disbursements
1986–90	2,361.3	15.9	354.3
1991–95	3,551.0	59.5	2,222.8
1996	600.0	--	605.6
1997	563.0	15.5	645.0
1998	250.0	--	620.4
1999	625.0	--	605.1
2000	1,150.0	--	487.0
2001	1,500.0	--	269.8
2002	1,183.6	15.0	576.5
2003	1,512.0	0.7	658.2
2004	1,200.0	29.7	401.6
2005	417.3	15.0	698.3
2006	1,485.0	67.6	711.9
2007	1,311.4	--	1,493.2
2008	2,482.6	18.6	1,655.6
2009	1,811.0	40.0	1,551.7
2010	2,119.6	0.0	1,858.1
2011	2,872.9	20.0	1,544.6
2012	2,133.9	--	1,411.8
2013	2,359.9	32.0	1,173.1
2014	615*	82.0*	915.7*
Total	32,104.5	411.3	20,460.4

Source: Asian Development Bank.

*As of 30 September 2014.

AsDB's India Country Partnership Strategy (2013–2017) (CPS) is based on three strategic pillars: (i) inclusive growth; (ii) environmental sustainability; and (iii) regional cooperation and integration. The CPS is anchored to AsDB's Strategy 2020 and has been designed to support the Government of India's 12th Five Year Plan (2012–2017) vision of faster, more inclusive, and sustainable growth. The CPS emphasizes robust infrastructure development, job creation and access to jobs, regional connectivity, and environmental sustainability. The backbone of the India program will be energy, transport, and urban services. On a selective basis, ADB will also invest in special purpose vehicles for infrastructure financing, water resources management, skills development, and state-level fiscal reforms.

STATISTICAL ISSUES

1. Macroeconomic statistics are adequate for surveillance, but 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.
2. 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 STA.
3. **National accounts and employment statistics:** The Central Statistical Organization (CSO) releases a new series of national accounts, with base year 2004–2005 with a dissemination lag for quarterly releases of two months. Large revisions to historical series and major discrepancies between supply and expenditure national accounts complicate analysis: these differences have become larger in recent quarters. Supply-side data remain of better quality than expenditure-side data. Estimates of value added in constant prices for public administration and defense may be biased upwards, as they are based on the government's wage bill (with arrears counted in the year that they are paid) deflated by the Wholesale Price Index (WPI). There are long standing deficiencies in employment data: they are only available on an annual basis and with a substantial lag, and they only cover the formal sector, which accounts for a small segment of the labor market. A new series of national accounts with 2011/12 as base year is planned to be released in early 2015.
4. **Price statistics:** A revised all-India CPI with new weights was unveiled 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 patterns and the CPI series will be revised beginning 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. The WPI has a 2004/05 base year, for which data are also subject to frequent and large revision, usually upward. New RBI price series on residential real estate 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.

5. **External sector statistics:** While the concepts and definitions used to compile balance of payments statistics are broadly in line with the sixth edition of the *Balance of Payments Manual* (BPM6). Furthermore, trade data have quality, valuation, timing, and coverage problems, and data on trade prices, volumes, and composition are not regularly available on a timely basis. Only trade credit extended for more than 180 days is included in the balance of payments (and the IIP and external debt data); trade credit is often less than 180 days in most countries. Bilateral data on services exports to the United States and other developed countries are manifold higher than counterpart services imports published by these same countries. External debt statistics are available on a quarterly basis with a one quarter lag. Estimates of short-term external debt are presented in the debt statistics 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 six months of the reference period in respect of annual data.³ Coverage of direct investment positions data is hampered by the absence of appropriate legal or institutional authority. India began disseminating the Data Template on International Reserves and Foreign Currency Liquidity as prescribed under the SDDS in December 2001. The more up-to-date information on certain variables, such as total foreign reserves, 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.

6. **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, RBI's survey, 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.

7. Concepts and definitions used by the RBI to compile monetary statistics are in broad conformity with the guidelines provided in the *Monetary and Financial Statistics Manual* (MFSM). Nevertheless, the following concepts and principles deviate from the MFSM. First, the resident sector data do not provide sufficient information on the sectoral distribution of domestic credit. Specifically, under their present sectorization scheme, the authorities subdivide the resident nonbank sector data by (i) central government; (ii) state government; and (iii) the commercial sector (including other financial corporations, public and other nonfinancial corporations, and other resident sectors). Second, commercial banks add accrued interest to credit and deposit positions on a quarterly basis only (instead of the prescribed monthly basis).

8. The RBI reports monetary data for IFS on a regular basis. Since October 2006, the RBI has initiated the electronic reporting of monetary data, which is a major improvement from the previous

³ The IIP as published by the RBI values equity liabilities at acquisition cost, while the Fund uses market prices, resulting in substantial differences.

paper-based reporting which was prone to errors and delays. India has also submitted to STA test data (starting from December 2001 data) on the Standardized Report Forms (SRFs) that have been developed to implement the methodology outlined in the MFSM. STA is working with the authorities in resolving the outstanding data issues on the development of the SRFs.

9. **Government finance statistics:** The Ministry of Finance (MoF) is responsible for compiling and disseminating the GFS. India reports 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. With the agreement of the authorities, STA uses these data to compile a monthly cash flow statement for publication in the *International Financial Statistics*, following the *GFSM 2001* presentation, with some missing breakdowns, particularly for expenditure. 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* (GFSY), the latest reported data corresponding to 2010. Two years after the reference year, the Ministry of Finance reports general government data to STA in the *GFSM 1986* format, that staff reworks to the *GFSM 2001* presentation for inclusion in the GFSY (latest reported data correspond to 2008). 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 but meets the SDDS specifications for central government debt and operations.

India: Table of Common Indicators Required for Surveillance

As of January 12, 2015

	Date of latest observation	Date received	Frequency of Data 1/	Frequency of Reporting 1/	Frequency of Publication 1/
Exchange Rates	01/05/15	01/05/15	D	D	D
International reserve assets and reserve liabilities of the monetary authorities 2/	12/26/14	01/02/15	W	W	W
Reserve/base money	12/26/14	01/02/15	W	W	W
Broad money	12/12/14	01/02/15	BW	W	W
Central bank balance sheet	Dec. 2014	01/04/15	M	M	M
Consolidated balance sheet of the banking system	Oct. 2014	11/26/14	M	M	M
Interest rates 3/	01/05/15	01/05/15	D	D	D
Consumer price index	Nov. 2014	12/12/14	M	M	M
Revenue, expenditure, balance and composition of financing - General Government 4/ 5/	2012/13	01/22/14	A	A	A
Revenue, expenditure, balance and composition of financing - Central Government 4/ 5/	Nov. 2014	12/31/14	M	M	M
Stocks of central government and central government-guaranteed debt 6/	Nov. 2014	12/31/14	M	M	M
External current account balance	Sept. 2014	12/08/14	Q	Q	Q
Exports and imports of goods and services	Sept. 2014	12/08/14	Q	Q	Q
GDP/GNP	Sept. 2013	12/01/14	Q	Q	Q
Gross external debt	Sept. 2014	01/02/15	Q	Q	Q
International Investment Position	Sept. 2014	12/31/14	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 the IMF Staff Representative
February 13, 2015

This statement contains information that has become available since the staff report was circulated to the Executive Board. This information does not alter the thrust of the staff appraisal.

1. **Historical GDP figures for 2011/12–2013/14 have been revised.** India's Ministry of Statistics released (on January 30) a new series for national accounts—revising the base year from 2004/05 to 2011/12, and incorporating numerous conceptual and methodological changes consistent with the adoption of the 2008 System of National Accounts. India's nominal GDP (at market prices) was marked down by only about 2 and 1 percent in 2011/12 and 2012/13, respectively, while nominal GDP for 2013/14 was essentially unaffected. These changes would alter only marginally key ratios (including the debt-to-GDP ratio). Consequently, upward revisions to real GDP growth in 2012/13 and 2013/14 were also made, raising growth from 4.7 to 5.1 percent and from 5 to 6.9 percent, respectively.
2. **The official forecast of GDP growth for 2014/15 has also been revised.** Using the new GDP at market prices series, the Ministry of Statistics released (on February 9) revised preliminary estimates of real GDP growth for 2014/15, coming in with an advanced estimate of 7.4 percent. New quarterly numbers for real GDP growth at market prices (for fiscal year 2014/15) were also released, indicating that growth in the first three quarters of the fiscal year came in at 6.5, 8.2 and 7.5 percent, respectively. Staff and the economic authorities (Reserve Bank of India and Ministry of Finance) will be guided by these new high-frequency numbers, and other series and information on the revised methodology to be released later in February, in revising 2014/15 and medium-term GDP growth forecasts.
3. **The Reserve Bank of India (RBI) kept its policy repo rate unchanged at 7.75 percent on February 3, in line with market expectations.** The RBI stated in its latest bi-monthly monetary policy statement that the rationale for its decision of no change to the policy rate was the absence of substantial new developments on the disinflationary process or on the fiscal outlook, since the 25 basis points cut in the policy repo rate of January 15.
4. **The RBI announced a range of regulatory measures in its sixth bi-monthly monetary policy statement.** In its February 3, 2015 statement, the RBI reduced the statutory liquidity ratio (SLR) of scheduled commercial banks by 50 basis points from 22 percent to 21.5 percent of their net deposit liabilities, increased the limits for foreign exchange remittances, and increased the minimum residual maturity of foreign portfolio investment in India to three years. The SLR was, in particular, reduced to provide room to banks to increase their lending to productive sectors on competitive terms to support investment and growth.
5. **International reserves have increased due, in part, to continued robust capital inflows.** Net portfolio investment inflows (both equity and debt) have amounted to about US\$ 7

billion in 2015, of which about US\$ 2 billion has occurred thus far in February 2015. International reserves have increased by about US\$ 8 billion during 2015, after increasing by US\$ 27 billion in 2014, and currently stand at about US\$ 328 billion (an all-time high) representing about 6½ months of next year's imports of goods and services.

6. **The government undertook the largest-ever share sale by any private or public sector company in India, selling part of its shares in Coal India.** During the week ending January 30, 2015, the government sold 10 percent of its stake in Coal India Limited, the largest coal miner in the world by output, raising around US\$ 3.6 billion from the sale. This will help the authorities meet their 2014/15 fiscal deficit target of 4.1 percent of GDP.



INTERNATIONAL MONETARY FUND



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International Monetary Fund
700 19th Street, NW
Washington, D. C. 20431 USA

IMF Executive Board Concludes 2015 Article IV Consultation with India

The Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation¹ with India on February 13, 2015.

India's near-term growth outlook has improved, and the balance of risks is now more favorable, helped by increased political certainty, several positive policy actions, improved business confidence, and reduced external vulnerabilities. In response to the balance of payments pressures during the post-May 22, 2013 taper tantrum period, and against the background of still-limited policy space, the Indian authorities have maintained pro-cyclical fiscal and monetary policy stances. Consequently, India's vulnerabilities have receded more than those of most emerging markets and sentiment has been revived, with growth rebounding to 5.5 percent in the first half of fiscal year (FY) 2014/15 (ending in March), and the recovery strengthening gradually. Furthermore, CPI inflation has declined from 9.5 percent in FY 2013/14 to 5 percent in December 2014, reflecting economic slack, a tight monetary stance, lower global commodity prices, government efforts to contain food inflation, and favorable base effects. Robust capital inflows in conjunction with the sharp current account deficit correction (largely due to the contraction in gold imports) have provided for an increase in international reserves of about \$30 billion over the last year, reaching US\$320 billion (representing about 6½ months of import coverage) at end-December 2014.

Growth is projected at 5.6 percent for FY 2014/15, picking up to 6.3 percent in FY 2015/16 (at factor cost), as a result of the revival in industrial and investment activity. However, weaknesses in India's corporate and bank balance sheets will weigh on credit growth, and fiscal restraint and a tight monetary stance will act as headwinds in the near term, offsetting the positive growth impact of the improved commodity terms of trade. CPI inflation is projected to move up to about 6¼ percent by March 2015 and hover slightly above 6 percent over the course of FY 2015/16, as growth picks up, slack dissipates, and favorable base effects unwind. The current account deficit is expected to remain contained at around 1¾

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.

percent of GDP in FY 2015/16, helped by significantly lower oil import prices, shrinking gold imports, and rebounding exports.

Despite the reduction in India's external imbalances and strengthening of buffers, the spillover impact from global financial market volatility to India could be very disruptive, including from any unexpected developments in the course of U.S. monetary policy normalization, particularly against the backdrop of recent large capital inflows. External risks also emanate from a prolonged period of weak global growth, which could dampen Indian exports. Domestic risks include a supply-driven spike in inflation, further deterioration in bank asset quality and continued stress in corporate financial positions, as well as slower-than-expected progress in addressing supply-side bottlenecks, which could weigh on growth and stoke inflation. On the upside, expedited structural reforms and faster implementation of cleared investment projects could lead to stronger growth, as would sustained low global energy prices.

Executive Board Assessment²

Executive Directors welcomed the authorities' comprehensive policy initiatives, which have helped reduce India's external vulnerabilities and improve the economic outlook. Among these initiatives are recent policy measures to revive investment, reduce inflation, consolidate the fiscal position, and improve the ease of doing business. Directors noted, however, that significant external and domestic risks remain while room for countercyclical macroeconomic policy support is limited by still-high fiscal deficits and upside risks to inflation.

Directors considered that the main external risk facing India is a surge in global financial market volatility. They agreed that, should external pressures re-emerge, rupee flexibility should continue to be an important shock absorber, complemented by judicious foreign exchange intervention, tightening of monetary conditions, and additional fiscal adjustment.

Directors welcomed the progress made in reducing inflation, supported by a tight monetary stance and government efforts to contain food inflation. Nonetheless, Directors noted that, in light of high inflation expectations and upside risks to inflation, monetary policy should remain tight to consolidate past gains. Directors concurred that further efforts are needed to strengthen the monetary policy framework, including a move towards flexible inflation targeting.

Directors commended the government's commitment to strengthening the fiscal position

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>.

further, and welcomed recent reforms, including the deregulation of diesel prices. They supported the authorities' medium-term fiscal targets and encouraged the authorities to articulate and implement specific supporting measures, which could be used also to enhance the quality and sustainability of fiscal consolidation. In this regard, fiscal space for higher growth-enhancing capital spending and social expenditures could be obtained by further rationalizing fuel, fertilizer, and food subsidies; and raising tax revenues to pre-global financial crisis levels, in particular by introducing a well-designed goods and services tax and enhancing tax administration.

Directors noted that India's international reserves are assessed to be adequate and foreign exchange intervention should continue to be limited to preventing disruptive movements in the exchange rate. They emphasized the importance of further improving the external financing mix by enhancing the environment for attracting stable, non-debt creating capital flows, particularly foreign direct investment.

Directors stressed that boosting potential growth would require addressing long-standing supply bottlenecks, especially in the energy, mining, and power sectors, as well as bolstering the business climate. Directors agreed that further easing of restrictive labor laws, raising the productivity of the agriculture sector, and addressing skills mismatches would make growth more inclusive and assist with job creation.

While acknowledging that India's financial system is well-capitalized and supervised, Directors noted that deteriorating corporate financial positions and worsening bank asset quality could weigh on financial sector soundness. They welcomed the RBI's ongoing measures to enhance bank supervision and monitoring, and commended the RBI's efforts to broaden financial inclusion. Directors encouraged the authorities to further strengthen prudential regulation for banks' asset quality classification; address concentration risks; augment capital buffers; improve corporate governance at public sector banks; and strengthen the insolvency framework.

India: Selected Economic Indicators, 2010/11–2015/16 1/

I. Social Indicators

GDP (2012/13)		Poverty (percent of population)	
Nominal GDP (in billions of U.S. dollars):	1,859	Headcount ratio at \$1.25 a day (2010):	32.7
GDP per capita (U.S. dollars):	1,503	Undernourished (2011):	17.5
Population characteristics (2012/13)		Income distribution (2010, WDI)	
Total (in billions):	1.2	Richest 10 percent of households:	28.8
Urban population (percent of total):	32	Poorest 20 percent of households:	8.5
Life expectancy at birth (years):	65	Gini index (2010):	33.9

II. Economic Indicators

	2010/11	2011/12	2012/13	2013/14 Prel.	2014/15 Proj.	2015/16 Proj.
Growth (in percent)						
Real GDP (at factor cost)	8.9	6.7	4.5	4.7	5.6	6.3
Industrial production	8.2	2.9	1.1	-0.1	...	...
Prices (percent change, period average)						
Consumer prices - Combined	9.5	9.5	10.2	9.5	6.7	6.3
Saving and investment (percent of GDP)						
Gross saving 2/	33.8	31.4	30.0	29.7	29.8	30.4
Gross investment 2/	36.5	35.5	34.7	31.4	31.6	32.1
Fiscal position (percent of GDP) 3/						
Central government deficit	-6.4	-6.0	-5.1	-4.8	-4.4	-4.1
General government deficit	-8.4	-8.0	-7.4	-7.2	-7.1	-6.8
General government debt 4/	67.5	66.8	66.6	65.5	64.3	62.6
Structural balance (% of potential GDP)	-8.9	-8.4	-7.5	-7.1	-6.9	-6.7
Structural primary balance (% of potential GDP)	-4.3	-3.9	-3.0	-2.4	-2.1	-1.9
Money and credit (y/y percent change, end-period)						
Broad money	16.1	13.5	13.6	13.2	14.0	14.7
Credit to commercial sector 5/	21.3	17.8	13.5	13.7	10.1	...
Financial indicators (percent, end-period)						
91-day treasury bill yield (end-period) 6/	7.3	9.0	8.2	8.9	8.2	...
10-year government bond yield (end-period) 6/	8.0	8.6	8.0	8.9	7.7	...
Stock market (ytd percent change) 5/	10.9	-10.5	8.2	18.8	22.8	...
External trade 7/						
Merchandise exports (in billions of U.S. dollars)	256.2	309.8	306.6	318.6	338.3	357.8
(Annual percent change)	40.4	20.9	-1.0	3.9	6.2	5.8
Merchandise imports (in billions of U.S. dollars)	383.5	499.5	502.2	466.2	492.8	518.7
(Annual percent change)	27.5	30.3	0.5	-7.2	5.7	5.3
Terms of trade (G&S, annual percent change)	-3.4	-5.9	-0.5	2.2	2.0	3.2
Balance of payments (in billions of U.S. dollars)						
Current account balance	-48.1	-78.2	-88.2	-32.4	-37.5	-39.4
(In percent of GDP)	2.8	-4.2	-4.7	-1.7	-1.8	-1.7
Foreign direct investment, net	11.8	22.1	19.8	21.6	26.6	29.9
Portfolio investment, net (equity and debt)	30.3	17.2	26.9	4.8	25.2	28.3
Overall balance	13.1	12.8	3.8	15.5	36.6	50.1
External indicators						
Gross reserves (in billions of U.S. dollars, end-period)	304.8	294.4	292.0	304.2	340.8	390.9
(In months of imports) 8/	6.3	6.1	6.4	6.3	6.6	7.1
External debt (in billions of U.S. dollars, end-period)	317.9	360.8	409.5	442.3	495.2	542.9
External debt (percent of GDP, end-period)	18.6	19.2	22.0	23.5	24.2	23.6
Of which: Short-term debt 9/	7.0	7.4	8.9	9.7	10.1	10.1
Ratio of gross reserves to short-term debt (end-period) 9/	2.6	2.1	1.8	1.7	1.6	1.7
Debt service ratio 10/	4.7	5.1	5.6	5.7	5.3	5.6
Real effective exchange rate 11/						
(based on annual average level)	11.6	-8.5	-14.1	-2.4	4.6	...
Exchange rate (rupee/U.S. dollar, end-period) 6/	45.0	50.3	54.4	61.0	61.8	...
Memorandum item (in percent of GDP)						
Fiscal balance under authorities' definition	-4.8	-5.7	-4.8	-4.5	-4.1	-3.9

Sources: Data provided by the Indian authorities; 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. Subsidy related bond issuance classified as expenditure.

4/ Includes combined domestic liabilities of the center and the states, inclusive of MSS bonds, and external debt at year-end exchange rates.

5/ For 2014/15, as of December 2014.

6/ For 2014/15, as of 29 January 2015.

7/ On balance of payments basis.

8/ Imports of goods and services projected over the following 12 months.

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

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

11/ For 2014/15, as of January 2015.

**Statement by Rakesh Mohan, Executive Director for India
and Janak Raj, Senior Advisor
February 13, 2015**

1. On behalf of our authorities, we would like to thank staff for a well-written, comprehensive and evenhanded assessment of recent macroeconomic and financial sector developments in India and the evolving outlook. The report is the outcome of the productive and candid discussions that the Mission had with our authorities. Our authorities broadly share the staff's assessment.
2. The Indian economy has made a remarkable turnaround since mid-May 2013 when the 'taper tantrum' induced turmoil in global financial markets had a significant impact on the Indian economy. Three main concerns that arose were: a high and rising current account deficit; high fiscal deficit; and elevated inflation and inflation expectations. Our authorities did not lose time to take quick, decisive, and well-thought out policy measures to address the emerging vulnerabilities. As a result, the present situation marks a significant improvement over that which prevailed in May 2013. India's current account deficit has declined sharply; inflation and inflation expectations have moderated significantly; and the fiscal deficit is being contained. Our authorities continue to pursue the path of fiscal consolidation. Furthermore, various measures taken by the newly elected government at the Centre have led to a significant improvement in business confidence.
3. Even as the macroeconomic situation is improving, some challenges remain to put the economy on a sustainable high growth path. Investment activity remains weak due to some segments of the corporate sector being overleveraged along with their related impact on bank balance sheets. A full-blown recovery of the private sector is thus being restrained. Fiscal consolidation could also have some impact on the speed of economic activity. Our authorities are, therefore, trying to strike a fine balance between supporting the recovery and pursuing a prudent fiscal policy. The new government is pursuing a policy regime that promotes higher growth and lower inflation, accompanied by a sustained external sector balance.

Recent Macroeconomic Developments

GDP growth and Short-term Outlook

4. The Indian economy is now clearly on a recovery path. India's growth recovered to 7.4 per cent in the first three quarters (April-December) of 2014-15 as compared with 7.0 per cent during the same period of last year. The GDP series has recently been revised by updating the base year and incorporating several methodological improvements that better capture the evolving structure of the economy (Annex). Based on the revised series, India's GDP growth for 2013-14 has been estimated at 6.9 per cent *vis-à-vis* 5.0 per cent in the old series partly because of some downward revisions in the previous year. However, the size of the nominal GDP for 2013-14 under the revised series is broadly the same as that under the old series. The Advance Estimates for 2014-15 have placed India's GDP growth higher at 7.4 per cent as compared with 6.9 per cent last year, and higher than most current projections.

5. The outlook for the Indian economy beyond the current year has also improved significantly. Several positive developments such as moderation in inflation, the policy rate cut by the Reserve Bank of India (RBI), real income gains from decline in oil prices and overall improvement in the business and consumer confidence should further improve the outlook.

Fiscal Policy

6. India has continued on the path of fiscal consolidation. The GFD of the Central Government, which was 5.7 per cent of GDP in 2011-12, declined to 4.6 per cent in 2013-14 and is budgeted to decline further to 4.1 per cent in 2014-15 (these estimates are not materially affected by the GDP revisions). In order to contain the fiscal deficit on a sustained basis, our authorities have initiated several measures. First, the government announced deregulation of diesel prices in October 2014. Second, taking advantage of the falling oil prices, the excise duty on petroleum products has been raised in stages, and the formula for fixing the price of natural gas has been revised. Third, the subsidy regime is being overhauled and made more targeted while providing protection to the vulnerable sections of society; for instance, the cooking gas subsidy has been replaced by direct transfers on a national basis. Fourth, an Expenditure Management Commission has also been set up to look into various aspects of expenditure reforms to be undertaken by the government. The Commission has since submitted its *interim* report. However, fiscal consolidation so far has largely been achieved by reduction in expenditure. The realization of revenues has not fully matched the targets set, though various measures such as increase in excise duty on petroleum products and expected disinvestment proceeds are supporting fiscal consolidation.

7. Our authorities give paramount importance to fiscal prudence not only to improve immediate macroeconomic fundamentals but also because of the consideration of inter-generational equity.

Inflation and Monetary and Exchange Rate Policies

8. Inflation, which was a major concern for India during 2010-13, has moderated significantly. CPI inflation, which is now used as the main measure of headline inflation by the Reserve Bank of India (RBI), declined to 5 per cent in December 2014 from 11.2 per cent in November 2013. The sharp decline in global commodity prices, especially crude oil, tight monetary and fiscal policies, and supply side measures, including lower increases in minimum support prices for major foodgrains, have helped in containing inflation. The Reserve Bank has indicated that inflation is likely to be around 6 per cent by January 2016. Reflecting softening of inflation, both near-term and longer-term inflation expectations of households have also moderated to single digits for the first time since September 2009.

9. Reflecting the easing of inflationary pressures, the Reserve Bank of India reduced the policy rate by 25 basis points in January 2015. However, the RBI left the policy rate unchanged in February 2015. It indicated that further monetary policy measures will depend on developments on both the disinflationary process and on the fiscal front.

10. India's current account deficit (CAD) declined sharply from 4.8 per cent of GDP in 2012-13 to 1.7 per cent in 2013-14 and is expected to decline further to 1.3 per cent in 2014-15. Improvement in the current account has been underpinned by a sharp decline in gold imports and in oil prices. Reflecting the improved domestic macroeconomic situation as also the continued accommodative global monetary conditions, India has received large portfolio flows in the recent period - much higher than the current account deficit. This has enabled the Reserve Bank of India to build up its foreign exchange reserves, which are now at US\$ 328 billion (as of January 30, 2015), up by US\$ 52 billion from the level at end-August 2013. Recognizing the improved external balance position, the RBI has liberalized outflows for residents. For instance, the limit on remittances by Indian entities for making overseas direct investment (ODI) under the automatic route, which was reduced in August 2013 from 400 to 100 per cent of their net worth, was reversed in July 2014. In early February 2015, the limit of foreign exchange remittance for individuals was enhanced from US\$ 125,000 per person per year to US \$ 250,000 as a further exercise in macro-prudential and capital flow management. This limit is available to individuals without end-use restrictions, except for prohibited transaction such as lotteries.

11. The objective of India's exchange rate policy is to maintain orderly conditions in the market. The rupee's exchange rate is determined by market forces of demand and supply. The Reserve Bank of India intervenes mainly to contain excessive volatility in the market. India's foreign exchange intervention strategy is not guided by the need to enhance growth or reduce inflation in India, as indicated by staff.

Financial Sector

12. Banks in India remain well capitalized with the CRAR at 12.8 per cent. The capital adequacy ratio of public sector banks is also comfortable at around 12 per cent and is well above the regulatory requirement. The government has infused capital of Rs. 586 billion in public sector banks in the last four years (2011-14) and plans to further infuse an amount of Rs. 112 billion in 2014-15 in order to ensure continued compliance with Basel norms and to provide ample space for growth commensurate with the overall credit needs of the growing economy. At the same time, the government is also planning to dilute its stake in some public sectors banks to 52 per cent.

13. The growth slowdown of recent years has had an impact on banks' asset quality. High indebtedness of some corporates has impacted banks' balance sheets. However, there is some evidence that several of the corporates are on the path of deleveraging and their debt equity ratios seem to be stabilizing. There has also been renewed focus on speedy regulatory clearances for projects and their implementations. Once the stalled projects reach the stage of commercial operations, it will help improve the profitability of the corporate sector, which, in turn, will lead to an improvement in asset quality of banks. The stress tests by the Reserve Bank in the baseline scenario of improving the overall macroeconomic situation, as is expected, suggest that the gross non-performing assets ratio of commercial banks may decline to 4.0 per cent by March 2016 from 4.5 per cent as at end-September 2014.

14. Although NPLs continue to be at a manageable level, the RBI has also introduced a framework for revitalizing distressed assets. The framework outlines a corrective action plan that

will incentivize an early identification of problem accounts which are considered viable and their timely restructuring and taking prompt steps for recovery or sale of unviable accounts.

15. The recent slowdown in credit growth has been on account of a combination of factors with any risk aversion by banks being only one of several factors. As such with comfortable capital adequacy ratios, banks should be able to increase the credit flows and support the recovery. With buoyant secondary markets, banks should also be in a position to raise capital from the market.

16. The regulatory regime for NBFCs has been tightened over the years to bring it in broad alignment with that for commercial banks.

17. Financial inclusion has been a new thrust area for the new government. To promote financial inclusion, a new scheme (*Pradhan Mantri Jan Dhan Yojana*) was launched in August 2014 to open bank accounts for poor families. It is a unique scheme which embeds features such as debit card, credit facility and accident and life insurance cover. In a short span of about 6 months, a record number of 126 million bank accounts have been opened as against the target of 100 million. The opening of a large number of accounts should also facilitate direct benefit transfers to the beneficiaries and improve public expenditure management.

18. To promote competition, two new private banks were issued licenses in 2014. A framework has also been put in place for licensing differentiated banks (payment banks and small finance banks) for serving niche interests. The Reserve Bank of India has received 72 applications for small finance banks and 41 applications for payment banks. The final selection will be made on the recommendations of the two committees constituted by the RBI for the purpose.

Structural Reforms

19. To raise the long-term growth potential of the economy, our authorities have introduced several structural reforms. FDI limits have been relaxed in several sectors such as railway infrastructure, construction, defence and insurance sectors. Diesel prices have been deregulated, which should facilitate new investments in this sector as well as promote efficiency. Gas prices have been increased and linked transparently and automatically to international prices so as to provide incentives for greater gas supply and thereby relieving the power sector bottlenecks. The coal sector has been rationalized through disinvestment of Coal India Ltd (a public sector enterprise) and reallocation of all the cancelled coal blocks through auction process. Progress has also been made in the process to initiate legislative action relating to introduction of the goods and services tax (GST). Some flexibility is also being introduced in labor laws. Several supply side bottlenecks have also been addressed. Efforts are afoot to skill the youth with an emphasis on employability and entrepreneurial skills. A pan India program 'Digital India' is being planned to provide broad band connectivity up to the village level, improved access to services through IT enabled platforms and greater transparency in government processes. The government is also stepping up efforts to implement a program of disinvestments.

Medium-term Prospects

20. Recent policy initiatives in land acquisition, efforts underway to unlock mining activity, liberalization of foreign direct investment limits and predictability of the tax regime should help to improve the investment climate. India has announced a national strategy for ‘Make-in-India’ to boost manufacturing, complete work on industrial corridors, and build 100 smart cities. There is a proposal to set up 10 coastal economic regions. Several structural constraints and supply bottlenecks are also being addressed. Project appraisal and approval processes have been liberalized. All these announcements have led to an improvement in business confidence, which is reflected in new investment intentions. Several stalled projects cleared are expected to be off the ground soon. Indian stock markets have outperformed many of its peers. This augurs well for raising capital from the market to support investment. The moderation in inflation should also encourage financial savings. It is the endeavor of our authorities to achieve a sustained growth of 8 per cent or above along with macro-economic stabilization in an environment of lower and stable inflation, fiscal consolidation, a manageable external situation, and continued financial deepening and development.

Conclusion

21. The Indian economy is in much better shape now than it was a year ago. External sector vulnerability has been addressed and it has become much more resilient. Inflation and inflation expectations have moderated significantly. The fiscal deficit has been contained and the process of fiscal consolidation continues. The Indian economy is now clearly on a recovery path and is the only major emerging economy whose growth rate has been revised upwards recently by the Fund for 2014. The recovery should gather further momentum once the impact of various measures initiated recently is felt fully. As such India is now also better prepared to deal with global financial market volatility that could arise in the context of US monetary policy normalization. As India’s underlying vulnerabilities have receded, there is some room for countercyclical macroeconomic policies to respond to domestic and external shocks.

22. The challenge now is to maintain such overall macroeconomic conditions on a sustained basis so that the Indian economy is able to achieve a high growth of 8 per cent and above over an extended future timeframe spanning a couple of decades.

Annex¹

The Central Statistics Organization (CSO) of India, which compiles data on national accounts, introduced in January 2015 changes in the compilation of the National Accounts, consistent with the adoption of the 2008 System of National Accounts, as detailed below:

i) Headline growth rate will now be measured by GDP at market prices in keeping with international practice. Although data on GDP at market prices were compiled and disseminated earlier, it was GDP at factor cost, which was used as a measure of headline growth.

¹ The details are available in the Press Note of January 30, 2015 and could be accessed at http://mospi.nic.in/Mospi_New/upload/nad_press_release_30jan15.pdf

ii) The coverage of the economy under the National Accounts has been improved with more comprehensive coverage of the corporate sector and different segments in the financial sector and improved coverage of activities of local bodies and autonomous institutions.

iii) The base year has been shifted from 2004-05 to 2011-12.

The CSO released data for three years 2011-12 to 2013-14 based on the new 2011-12 series (Tables 1 and 2). Back data for the earlier years in the new series are expected to be released later.

Table 1: Changes in Growth Rates

S.No.	Industry	Growth at current prices				Growth at constant prices			
		2012-13		2013-14		2012-13		2013-14	
		2004-05 Series	2011-12 Series	2004-05 Series	2011-12 Series	2004-05 Series	2011-12 Series	2004-05 Series	2011-12 Series
1.	Agriculture, forestry and fishing	9.7	10.8	15.9	12.7	1.4	1.2	4.7	3.7
2.	Mining and quarrying	-0.1	8.4	0.1	4.8	-2.2	-0.2	-1.4	5.4
3.	Manufacturing	6.9	11.6	2.2	9.3	1.1	6.2	-0.7	5.3
4.	Electricity, gas, water supply & other utility services	15.8	10.0	29.2	14.2	2.3	4.0	5.9	4.8
5.	Construction	10.2	3.6	7.7	8.3	1.1	-4.3	1.6	2.5
6.	Trade, repair, hotels and restaurants	10.9	18.5	7.0	20.2	4.5	10.3	1.0	13.3
7.	Transport, storage, communication & services related to broadcasting	15.3	15.9	10.2	12.1	6.0	8.4	6.1	7.3
8.	Financial, real estate & business services	17.1	17.4	19.9	14.8	10.9	8.8	12.9	7.9
9.	Community, social & personal	16.2	17.4	13.5	14.8	5.3	8.8	5.6	7.9
	TOTAL GVA	11.9	12.9	11.5	13.2	4.5	4.9	4.7	6.6

Table 2: Shares in Gross Value Added (GVA) at Current Prices

S.No.	Industry	2011-12		2012-13		2013-14	
		2004-05 Series	2011-12 Series	2004-05 Series	2011-12 Series	2004-05 Series	2011-12 Series
		1.	Agriculture, forestry and fishing	17.9	18.4	17.5	18.0
2.	Mining and quarrying	2.7	3.2	2.4	3.1	2.1	2.8
3.	Manufacturing	14.7	18.1	14.1	17.9	12.9	17.3
4.	Electricity, gas, water supply & other utility services	1.6	2.4	1.7	2.3	1.9	2.3
5.	Construction	8.2	9.4	8.1	8.7	7.8	8.3

6.	Trade, repair, hotels and restaurants	17.4	10.8	17.2	11.3	16.5	12.0
7.	Transport, storage, communication & services related to broadcasting	7.3	6.5	7.5	6.6	7.5	6.6
8.	Financial, real estate & business services	16.5	18.8	17.2	19.5	18.5	19.8
9.	Community, social & personal services	13.8	12.5	14.3	12.5	14.5	12.9
	TOTAL GVA	100.0	100.0	100.0	100.0	100.0	100.0