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**IMFC Statement by Nirmala Sitharaman
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India

On behalf of

Bangladesh, Bhutan, India, and Sri Lanka

Statement by Ms. NIRMALA SITHARAMAN, Minister of Finance and Corporate Affairs, India, and Member, International Monetary and Financial Committee (IMFC) representing the Constituency consisting of Bangladesh, Bhutan, India, and Sri Lanka, to the 46th Meeting of the IMFC at the Annual Meetings 2022

2022 has been a year like no other – at least in recent memory. The year has posed multiple challenges to policy makers. India experienced the 3rd wave of the pandemic starting end December 2021, which continued into Q1 of 2022. No sooner had the world, and India, started to recover, we were confronted with the conflict in Europe, which broke out on February 24, 2022, with the resultant intensification of global supply chain disruptions, and commodity price increases. India, being a net importer of crude and edible oils has had to face spike in prices and disruptions – another sign that in this integrated world there is no place to hide.

Even before the conflict hit the world economy, talk of monetary policy normalisation in the advanced economies (AEs) was beginning to have its ripple effects on the rest of the world. Flight to safety started from the emerging market economies (EMEs) last year itself, impacting their currencies and posing a challenge to their CAD financing. This year, moves to monetary policy normalisation in the AEs, turned into a perfect storm for the EMEs with the central bank communication from AEs, destabilising the financial markets the world over.

While most of the economies are facing twin deficit problem – widening of Growth Fiscal Deficit (GFD) along with Current Account Deficit (CAD), there has been some recent tempering of commodity prices given the apprehension of a recession world-wide. Thus, EMEs are confronted with multiple challenges of slowing global growth, elevated food and energy prices, and spillovers from policy normalisation.

INDIA

In a world of uncertainties, India is one of the very few stand-out performers. National Statistical Organisation Office (NSO) of India has now placed the GDP growth for Q1 of the current financial year 2022-23 at 13.5% on a y-o-y basis – the highest among the large economies.

This was achieved despite the fact that India started the monetary normalisation process quite early: surplus liquidity is being absorbed with Standing Deposit Facility, instituted in April 2022, and interest rate hikes from May this year.

The Central Government is on a consolidation path and has budgeted to prune the GFD-GDP ratio to 6.4% from 6.7% in 2021-22 and 9.2% in 2020-21. Further, government expenditure is now tilted towards capital rather than revenue, strengthening the foundations for medium-term growth.

Touching 13.5% GDP growth in Q1 enabled India to cross the pre-pandemic level by 3.8%. India has completely withdrawn from lockdowns since April 2022. Total vaccination has crossed the mark of 2 billion. Double doses are now given to close to 70% of population and precautionary doses is in full swing, including for children of 12 years and above. Alongside, daily new infection numbers have come down to around 3000.

So, we see consumer spending picking up at 26% in Q1. This is made possible by bolstering of consumer confidence and revival of contact intensive activities. But still, there's scope for improvement as the key 'trade, hotel, restaurant' GVA is yet to cross the pre-pandemic level.

On the investment side, gross fixed capital formation (GFCF) growth shot up to 20% in Q1, driven largely by governments and PSUs in the transport sector as also by housing, construction, steel, pharma and IT in the private sector. This growth is also reflected in proximate indicators: cement, steel, IIP capital goods, Non-Gold Non-Oil imports and capacity utilisation.

Both exports and imports are growing at double digits, but import growth is more robust than that of exports, reflecting the revival of domestic economy and the divergent slowdown in the global economy.

Elevated imported inflation pressures remain an upside risk for the future trajectory of inflation, amplified by the continuing appreciation of the US dollar. Indeed, inflation

has ruled at or above the upper tolerance limit of 6% since January 2022. In this context, calibrated withdrawal of monetary accommodation has continued to restrain broadening of price pressures, anchoring of inflation expectations and containing the second-round effects. India is better placed than many other advanced or emerging market economies.

In this tumultuous global environment, India's external financing position remains comfortable despite the widening of CAD to 2.8% and trade deficit to 8.1% in Q1: 2022-23. Higher trade deficit is expected to be offset by growing exports of services and increasing remittances. Overall, CAD is projected to be within 3.0% of GDP. With portfolio flows stabilising and FDI remaining strong, this order of deficit is financeable.

India's foreign exchange reserve at US\$ 537.5 billion as on September 23, 2022, compare favourably with most peer economies. Two-third of the decline in reserves is due to valuation changes arising from an appreciating US dollar and higher US bond yields. Indeed, there has been an accretion of US\$ 4.6 billion to the forex reserves in Q1:2022-23 on BoP basis. Other external indicators like net international investment position and short-term debt also indicate lower vulnerability. In fact, India's external debt to GDP ratio is the lowest among major EMEs.

Turnaround of the corporate sector as also of the banking sector provides a buffer for absorbing risks in the economy. In the pre-pandemic phase, these sectors were suffering from the twin balance sheet problem. Restitution of their balance sheets has been a priority. Soft interest rates regime during the COVID-19 years helped corporates to restructure their debt and reduce interest costs. Their debt-equity ratios have since fallen to 0.5. Reduction of corporate tax rate in the pre-COVID-19 phase also helped the corporates to absorb the pandemic shock.

Similarly banking sector has posted 6-year lows on NPAs and slippage ratios and also CRAR (capital to risk-weighted assets ratio) and PCR (provision coverage ratio) have moved up. We also see strong credit growth at 15% in September 2022. Total resource flow to the corporate sector so far is five times that of last year's mobilisation, mainly by way of bank credit, CPs and FDI.

Looking ahead, the foregoing developments should support aggregate demand and activity. The headwinds from extended geopolitical tensions, tightening global financial conditions and possible decline in the external component of aggregate demand, however, pose downside risks to growth. All things considered, real GDP growth is expected at around 7.0% for 2022-23 and 6.5% in 2023-24. While inflation may settle at around 6.7% this year, we need to be vigilant.

In terms of size, Indian economy has become the 5th largest economy of the world in 2021. Favorable growth differentials have made India an attractive destination and this is reflected in the stabilising portfolio flows, as these turned positive in Q2 of 2022-23.

SRI LANKA

The economy of Sri Lanka faced unprecedented challenges during the year, as a result of accumulated vulnerabilities and policy missteps that were exacerbated by the effects of the COVID-19 pandemic and global commodity price shocks. The shortage of foreign exchange and the expanding fiscal deficit resulted in a sharp reduction of Gross Official Reserves and a significant expansion of monetary financing by the Central Bank. The resultant exchange rate depreciation, high inflation and shortages of essential imports triggered widespread social unrest that stalled most domestic economic activities in the second quarter of the year. These unprecedented developments led to a change of the Government as well as changes of several key positions as well.

With unequivocal evidence that Sri Lanka's fiscal path and the debt situation is unsustainable, the Government announced a debt standstill in relation to selected foreign debt in April 2022 and commenced discussions with the International Monetary Fund (IMF) to secure a Fund-supported macroeconomic adjustment program. Interim financing from India as well as domestic policy measures to curtail the external current account deficit and the fiscal deficit dampened the social unrest to some extent. The Government reached a Staff Level Agreement with the IMF in September 2022 for a 48-month Extended Fund Facility (EFF) of approximately US

dollars 2.9 billion. In the meantime, as progress on debt treatment is required to ensure Sri Lanka's debt sustainability, discussions are underway with key official bilateral partners and private creditors with a view to securing the necessary assurances and enabling the IMF Executive Board approval of the EFF program.

Sri Lanka's monetary policy is currently focused on ensuring an early return of inflation towards the 4-6 percent target range and regaining monetary stability. Inflation, as measured by the year-on-year change of the Colombo Consumer Price Index, is currently at 69.8 percent. Inflation is mainly driven by high food prices, energy price adjustments, and the effect of depreciation. Monetary policy has been tightened significantly thus far during the year, and market interest rates have increased to all-time highs reflecting tight monetary conditions. As a result, the year-on-year growth of credit to the private sector as well as the growth of broad money is expected to continue their decelerating trends in the period ahead. Meanwhile, the need for further monetary financing is expected to reduce gradually, with appropriate fiscal corrections. Accordingly, inflation is projected to decelerate to single digit levels by end 2023, unless disrupted by further external shocks.

Decisive revenue- and expenditure-side measures have been taken to address the large fiscal deficit. The Value Added Tax (VAT) rate has been raised and exemptions have been removed. A Social Security Contribution Levy has been introduced, and personal income tax rates have been increased while reducing tax-free thresholds. Withholding taxes have been imposed. Corporate income tax rates have been increased and exemptions removed. Meanwhile, several measures have been taken to curtail discretionary expenditure. Accordingly, a lower fiscal deficit is expected in 2022, and the fiscal consolidation efforts are expected to continue into the medium term, supported by the ongoing efforts to restructure Sri Lanka's existing debt burden.

The challenges continue in the external sector, although policy measures have been successful in curtailing the trade deficit. Import expenditure declined in August 2022, on a year-on-year basis, for the sixth consecutive month. Earnings from exports remained robust in the eight months ending August 2022. Workers' remittances, which remained subdued, showed signs of pickup in recent months. Sri Lanka's tourism industry, which was hampered by the Easter Sunday attacks in 2019, the pandemic related global and local travel restrictions and lockdowns, as well as

domestic disturbances, is expected to recover from the fourth quarter of 2022. The Colombo Stock Exchange (CSE) recorded a marginal net inflow. Gross Official reserves remained around US dollars 1.7 billion over the past few months, and this included the swap facility from the People's Bank of China, which is subject to conditions on usability. The Sri Lankan Rupee has depreciated by around 45 percent against the US dollar thus far during the year, but remained stable over the past few months.

In the first half of 2022, the economy is estimated to have contracted by 4.8 percent, and the economy's largest contraction is expected to be recorded during the year, impacted by tighter monetary and fiscal conditions, along with the continuation of supply-side constraints and uncertainty surrounding the business environment amidst shortages of foreign exchange in the domestic foreign exchange market. However, a recovery in economic activity is expected in 2023 with the envisaged improvements in the supply-side, along with the timely implementation of the required reforms.

It is expected that Sri Lanka would gradually rebound to a higher growth path with greater stability in the medium term supported by all its stakeholders and the IMF EFF program. The key elements of the program include, raising fiscal revenue to support fiscal consolidation; introducing cost-recovery based pricing for fuel and electricity to minimize fiscal risks arising from state-owned enterprises; mitigating the impact of the current crisis on the poor and vulnerable by raising social spending, and improving the coverage and targeting of social safety net programs; restoring price stability through data-driven monetary policy action, fiscal consolidation, phasing out monetary financing, and stronger central bank autonomy that allow pursuing a flexible inflation targeting regime; rebuilding foreign reserves through restoring a market-determined and flexible exchange rate; safeguarding financial stability by ensuring a healthy and adequately capitalized banking system, and by upgrading financial sector safety nets and regulatory standards; and reducing corruption vulnerabilities, thereby restoring internal and external confidence in the economy.

Bangladesh

The escalating Russia-Ukraine war, aggressive policy rate hikes by the US Fed

and other advanced economies, along with the devastating impact of the COVID-19 pandemic and global supply chain disruptions are having global repercussions on the financial markets, trade flows, prices, and exchange rates and creating significant global uncertainties. The overrun effects of all these on the rest of the world, including Bangladesh, are to face multidimensional challenges. Of which the mounting inflationary and exchange rate pressures due to high import prices and subsequent balance of payments adversities are prominent. The Government and Bangladesh Bank are extending the required policy measures to control demand while promoting supply- and production-enhancing initiatives to address the ongoing inflationary and exchange rate pressures.

The economy bounced back from the fallout of COVID-19, predominantly by robust and condign fiscal and monetary policy measures, better management of the pandemic situation, and upbeat business confidence. The various stimulus packages implemented by both the government and central bank have also played an instrumental role in steering the economy on the right track. Riding on the judicious fiscal and monetary policy measures, the real GDP of Bangladesh registered a growth of 7.25 percent in FY22 as compared to 6.94 percent in the previous fiscal year.

Bangladesh Bank (BB) pursued a cautious with a tilt toward tightening and accommodating monetary policy stance for FY23 in order to control inflation and exchange rate pressures while assisting the economic recovery process, ensuring the required flow of funds to the economy's productive and employment-generating activities for the long-term economic growth. Following the global trend, headline CPI inflation (p-t-p) climbed to 7.56 percent in June 2022 from 6.22 percent in March 2022, with a faster rise in food inflation, driven mainly by the knock-on effect of a higher fuel (diesel) price in the domestic market, the pass-through of global commodity prices and a notable depreciation of BDT. Similarly, twelve-month average CPI inflation crept up to 6.15 percent in June 2022, remaining above the budgetary target of 5.3 percent for FY22. The rise in inflation, particularly food inflation, was much pronounced in rural areas, with a disproportionately higher impact on lower-income groups.

The overall fiscal activities maintained its faster pace in Q4FY22 as economy

staged a strong recovery from the pandemic. Given a low growth in revenue collections, higher government expenditure following a strong economic recovery widened the budget deficit during the Q4FY22 compared to previous quarter. Total revenue collection and government expenditure increased by 16.4 and 15.6 percent respectively in Q4FY22 compared to the previous quarter. Fiscal deficit (including grants) was 4.1 percent of GDP in FY22, which remained below 5 percent of GDP. In FY22, almost 45 percent of budget deficits were financed by foreign sources which were 36.1 percent in FY21.

The external sector confronted significant challenges in FY22 as a result of rising import payments (82.5 billion, 36 percent growth) that outpaced gains in export earnings (52.1 billion, 34 percent growth) due to elevated global commodity and energy prices. The current account deficit widened to USD 18.7 billion in FY22, exceeding the surplus in the capital and financial account due to the expanding trade deficit and relatively modest remittance inflows, which declined by 15.1 percent (y-o-y). The resulting large deficit (5.4 billion) in the overall balance of payment (BoP) exerted depreciation pressure on the foreign exchange market. BB intervened in the foreign exchange market in FY22 with net sales of around USD 7.4 billion in an effort to rein in excessive exchange rate volatility. As a result, the foreign exchange reserve declined from USD 46.4 billion at the end of FY21 to USD 41.8 billion at the end of FY22, which is equivalent to 5.1 months of prospective import payments. At the end of September 2022, the foreign exchange reserve stood at 36.8 billion.

Among the indicators related to the performance of the banking sector, a rise in non-performing loans and provisioning shortfall on the one hand and advancement in profitability and maintaining adequate liquidity on the other hand reflected a mixed performance of the industry at the end of FY22. The capital market witnessed some volatility with a downward trend in the last quarter of FY22, reflected in a downturn in price indices, market capitalization, and turnover. The weak performance can be attributed to a decline in the share price index in emerging market economies, commodity prices instability in both global and domestic markets, sharp depreciation of BDT against USD, and financial tightening in advanced economies.

Looking ahead, headwinds to current growth momentum could emerge from

unfavorable developments in global economies. Compounding adverse effects of elevated global commodity and energy prices, recent upward adjustment of petroleum and fertilizer prices in the domestic market, and a significant depreciation of BDT against USD could intensify the cost-push shocks to the economy. Moreover, several measures to limit unnecessary and luxury imports, rationing of power supply, and austerity policy of the government might provide some respites in terms of containing domestic demand. The government and Bangladesh Bank continued their supportive measures, including stimulus packages and refinance schemes for the productive sectors of the economy improving the supply side to maintain price stability while keeping the growth momentum incessant.

Although the economy was in the path to recovery from the devastating impact of COVID-19, the downside risks are mounting from the stressed world economy. The prolonged Russia-Ukraine war, policy rate hikes in the US and other advanced economies, the tight COVID-19 stance and real estate sector slowdown in China, the energy market crisis, inflationary pressures and geopolitical risks are all denting growth prospects. Further, the timely completion of SDGs and expected progress toward LDC graduation require huge resources. Bangladesh looks forward to the continuous support of the development partners and their subsidiaries in mobilizing such external financial support in order to bridge the funding gaps and achieve sustainable and environment friendly economic growth.

BHUTAN

MACROECONOMIC REVIEW

Growth rebounded moderately in 2021 as economic activities picked up supported by expansionary fiscal policy, monetary support and progressive relaxation of containment measures. The economy grew at 4 percent in 2021, an increase of 14.1 percentage points compared to a decline of -10.0 percent in 2020. All the sectors exhibited a robust growth due to strong domestic demand and in tandem with the global economic recovery. Industrial output grew by 1.9 percent

after an all-time low of -12.9 percent in 2020. The sub-sectors contributing to the industrial growth were mining & quarrying, and construction sector. Manufacturing production (cement, food, chemical and metal industries) also improved buoyed by government's countercyclical programs and monetary relief measures.

With the gradual easing of mobility restrictions and resumption of economic activities, service sector recorded a positive growth of 6.3 percent in 2021.

Despite tourism industry being on a standstill, the revival in retail trade and other domestic businesses, steered the growth of the service sector, contributing around 44.0 percent to the GDP in 2021. Agriculture growth decelerated to 2.1 percent in 2021 compared to 4.6 percent in 2020 attributable to reduced production in livestock and forestry sector.

Economic growth of 4.9 percent anticipated in 2022 despite the two prolonged lockdowns from mid-January to March to contain the spread of the virus.

With the nation achieving mass vaccination (almost 90 percent of its adult total population has received a booster dose by early March 2022) backed by robust policy measures and gradual opening up of tourism by September 2022, the economy is projected to sustain a growth of 4.9 percent. The growth trajectory is based on the assumption that there will be no emergence of new variants or mobility restrictions while government spending continues to boost aggregate demand and investments are implemented on time.

Inflation peaked at 8.2 percent by the end of FY 2021-22 mainly driven by increase in nonfood prices.

For the last two years, inflation was mainly driven by increased food prices, which was on a higher end compared to non-food prices. However, starting from July 2021, increase in non-food prices added to the inflationary pressure. Sudden hike in the fuel prices (petrol and diesel) due to limited supply and geopolitical tensions in the region caused drastic increase in the overall commodity prices. As of June 2022, inflation increased to 6.5 percent compared to June 2021 due to increase in both food prices by 5.1 percent and non-food prices by 7.8 percent.

Inflationary pressure will persist in the medium-term with the surge in both food and nonfood prices. Overall inflation for FY 2021-22 was recorded at 5.9 percent, a decrease of 2.3 percentage points compared to FY 2020-21. It was mainly attributable to slowdown in food inflation (primarily vegetables and meat) as price were regulated by the concerned authority, and also due to rationalization of customs duties for the imports from COTI. Under the baseline scenario, annual inflation is estimated at 7.0 percent in current FY 2022-23 and 6.7 percent in FY2023-24. However, as 80 percent of Bhutan's import is associated with India, any inflationary pressure in India is expected to transmit to domestic inflation though with a time lag. Thus, estimates of inflation remains highly uncertain.

For the current FY 2022-23, fiscal deficit is estimated at 9.0 percent of GDP as government spending continues to accelerate economic recovery. The total expenditure is estimated to increase by 8.0 percent with capital budget of Nu. 38.5 billion, which is one of the highest constituting 51.5 percent of the total outlay. Domestic revenue is revised from an estimated of Nu. 36.4 billion to Nu. 41.3 billion, with the inclusion of royalty from tourism industry and broad-based improvement in the collection from both direct and indirect taxes. In terms of grant mobilization, residual amount of 12th FYP amounting to Nu. 14.8 billion is estimated to be received in the current FY.

Total public debt is estimated to increase although the overall risk is deemed manageable as the risk of debt distress is considered moderate. As major portion of external debt is in hydropower projects, which are commercially viable and deemed self-liquidating, increase in debt ratio may not be a cause of concern. For FY 2021-22, total public debt stock stood at Nu. 257.6 billion, accounting for 132.9 percent of GDP, of which external debt stock comprised of Nu. 229.6 billion. While the domestic debt stock stood at Nu. 28.1 billion, an increase of 64.4 percent due to issuance of government bonds of Nu.8.5 billion.

The current account balance (CAB) is expected to deteriorate from negative 12.1 percent of GDP in FY 2020-21 to negative 28.0 percent in the FY 2021-22, as a result of widening trade deficit. With the normalization in situation and resumption of economic activities, trade flows picked up surpassing the pre-pandemic threshold. However, the increase in imports were much higher compared

to the exports leading to a huge trade deficit of 19.3 percent in the FY 2021-22 from 6.9 percent in the FY 2020-21. As a result, CAB is expected to remain elevated in the medium-term with imports increasing exponentially and exports remaining subdued.

The recovery in trade performance has been immediate and widespread across all the sectors of the economy after a significant drop in 2020. The overall import in 2022 (January- June) increased by 52.0 percent as compared to the same period in the previous year whereas exports increased by 24.3 percent only. If similar trade pattern continues in the upcoming months, the baseline scenario projects that by the end of 2022, overall import value will stand at Nu. 111.3 billion and export at Nu. 60.4 billion. As the magnitude of increase in imports is much higher compared to the export, trade deficit is expected to widen further.

The balance of payment situation is expected to worsen as current account balance deteriorates in the medium term. The net financial inflows which is used to finance the current account deficits over the period has been decreasing due to lower inflow of official grants, thereby impacting the gross international reserves. The gross international reserves stood at US\$ 839.6 million stood as on June 2022 and is estimated to remain around US\$ 845.2 million, sufficient to finance 12 months of essential imports.

Despite slowdown in the economy and high inflation, the monetary and credit situation remained favorable, supported by accommodative monetary and expansionary fiscal policies. Money supply (M2), measured by broad money, is estimated to grow at 7.5 percent in the FY 2021-22, owing to an increase in total deposits (7.2 %) held by the commercial banks, accounting for 93.1 percent of money supply components. On the asset side, growth in M2 is driven by improved performance in both net foreign assets (NFA) and net domestic assets (NDA). The money supply in FY 2022-23 is projected to grow by 10.1 percent.

Domestic credit growth is estimated to have slowed down to 4.8 percent in the FY 2021-22 compared to 6.5 percent in FY 2020-21. The slower growth was most accentuated in the manufacturing, construction, and service & tourism sector, reflecting an adverse impact of the pandemic including delays in government

spending on capital projects. Going forward, domestic credit is projected to grow at 10.8 percent in FY 2022-23 and 12.3 in FY 2023-24 in tandem with economic growth and supportive monetary measures.

In terms of soundness of the financial sector, the overall asset quality of the financial institutions weakened with the marginal increase in NPL by 2.1 percent in the FY 2021-22. In terms of sectoral NPL, the highest was recorded in the service & tourism sector at 29.3 percent, followed by trade & commerce sector at 19.5 percent and manufacturing sector at 19.2 percent, as these sectors were severely affected by the pandemic.

Supported by various policy measures, overall banking liquidity remains adequate to facilitate credit growth in FY 2022-23. The excess liquidity in banking sector for FY 2021-22 was estimated at Nu. 19.9 billion (equivalent to 10.3 percent of money supply) compared to Nu. 32.2 billion in the FY 2020-21. The reduction was mainly on account of economic activities picking up and gradual fall in term deposits. However, the liquidity position in FY 2022-23 is expected to remain just adequate to meet the government's domestic borrowing. While continuity of expansionary monetary stance in the medium term is expected to poses risks in meeting the fiscal obligations with crowding out private credit.

RISKS AND CHALLENGES

With the recent on-going geopolitical conflict and high degree of uncertainty with the pandemic situation, risks to economic growth and recovery could emanate from both external and domestic environments. Besides the broad macroeconomic challenges such as economic diversification, vulnerabilities from climate change and unemployment, some of the possible risks and challenges to economic recovery based on the current update are listed below:

Widening current account deficit will put further strain on the overall reserve of the economy. As the economy returned to normalcy with the relaxation of containment measures, economic activities including public infrastructure as well as hydropower projects resumed resulting in significant imports. The growth in imports

were much stronger than the exports, leading to deterioration of the trade balance and the Current account balance.

As the financial inflows are not adequate to meet the current account deficit, the negative balance of payments will lead to depletion of overall reserve assets posing risk to the constitutional mandate of meeting 12 months of essential imports. The macroeconomic imbalance emanating from the external sector is likely to spillover to other sectors of the economy eventually impacting growth prospects.

The rising geopolitical tension will aggravate the already existing inflationary pressure. Against the already turbulent backdrop of global inflationary pressures following the COVID-19 pandemic, the war between Russia and Ukraine has exacerbated supply chain disruptions leading to a spike in commodity prices and broadening price pressures. The geopolitical conflict is likely to have a prolonged impact especially on food and energy prices leading to demand-supply imbalances.

With the war-induced commodity price increase, the impact will be felt mostly through higher cost-push inflation weighing on all the economic sectors including households, businesses and government. As an import dependent economy, higher energy and food prices will increase the import prices resulting in an increase in prices of domestic production. Therefore, surge in prices combined with low growth and high unemployment may lead to stagflation crippling the economy.
