International Monetary and Financial Committee

Thirty-Second Meeting
October 9–10, 2015

IMFC Statement by Arun Jaitley
Minister of Finance, India

On behalf of Bangladesh, Bhutan, India, Sri Lanka

Statement by Mr. Arun Jaitley,
Minister for Finance, Corporate Affairs and Information & Broadcasting
and
Governor of the IMF
at the IMFC Plenary 2015
on behalf of
Bangladesh, Bhutan, India and Sri Lanka

Mr. Chairman,

1. The performance of the global economy is a matter of serious concern. The International Monetary Fund (IMF) has recently revised downwards its July 2015 estimate of global growth, for both the years 2015 and 2016. Global growth in 2015 is now projected to be 0.3 percent weaker than 2014. Growth in Advanced Economies (AE) though is expected to pick up slightly. What is particularly striking is that growth for Emerging Market and Developing Economies (EMDEs) is projected to decline for the fifth consecutive year, with the decline being as much as 0.8 percent this year relative to last year. The outlook for Low Income Countries (LICs) is also not optimistic. A recovery that was uneven to begin with has become even more uneven. All this has led some to question whether the trajectory and distribution of global growth at all constitute a recovery.

2. Financial stability risks have heightened since we met last. The recent episodes of volatility in global financial markets exemplify these risks. World trade volume has recorded its biggest contraction since the financial crisis. An already weak potential global growth outlook has worsened.

3. During our April 2015 meeting, we had committed ourselves to 'take further measures to lift actual and potential growth' and support the 'goal of a more robust, balanced and job-rich global economy'. However, global economic developments have been belying our hopes. This demands a closer look at the possible ways we can coordinate and collaborate with each other in our economic policies.

4. Clearly, recent global economic developments have implications for IMF's operations. Not only should the Fund exercise closer surveillance to be in a position to give timely warning of crises, it should also be prepared to provide greater lending support. There is now greater possibility of new demands emerging for the use of the Fund's resources. The principles on which the Fund was established require that most of its lending resources should be in the form of quotas. However, at present, the Fund relies heavily on borrowed resources. In fact, its current reliance on borrowed resources is historically the highest. While members have so far been willing to lend resources to the Fund, this cannot and should not be taken as given. One cannot rule out the possibility of a future crisis developing because of the Fund's inability to continue with borrowing arrangements while its quota resources are not increased. This is a situation that the Fund should tackle as a strong, adequately resourced and quota based institution rather than worrying about finding resources for its lending operations. A failure to do so would have serious implications for its legitimacy and credibility. The urgency, therefore, for implementation of the 2010 Reforms has never been greater.

A. The Global Economy and Financial Markets

5. Among Advanced Economies (AEs), the Euro Area is projected to grow 0.5 percent faster than last year and growth in the United States is likely to be again substantially higher. Lower oil prices and continuing accommodative monetary policies are two important factors that have supported growth in AEs. However, inflation remains subdued and addressing structural issues such as slow productivity growth and ageing are critical

to improving the growth performance in the medium to long term. Persistent below target inflation in some AEs remains a downside risk.

6. The economic transition underway in the Chinese economy and its resultant slowdown, the sharp slowdown in Brazil and Russia and weaker growth in Sub-Saharan Africa would all add up to a substantial decline in growth this year for EMDEs. Capital flows to EMDEs have slowed down. Apart from spillovers from the transition in China and lower commodity prices, the risks to the outlook for EMDEs also includes financial instability, particularly that arising from monetary policy normalization in the United States. Growth in LICs is also likely to be adversely impacted because of the weakened global growth combined with lower commodity prices. For both EMDEs and LICs, monetary policy normalization in the United States is likely to lead to tightened external financing conditions.

7. A central message from the latest IMF assessment is that the near term outlook for EMDEs and LICs has worsened sharply in the past six months. Another central message is that medium term prospects for both AEs and EMDEs remain subdued for structural reasons.

Policy Challenges

8. The external environment EMDEs and LICs face poses serious risks not only to growth but also to macroeconomic stability. These include a further decline in commodity prices, volatility in asset and exchange rate markets and a reversal of capital flows. The immediate challenge is to maintain macroeconomic stability even while supporting growth in the near term. The situation is further complicated by the limited policy space available. Countries that do have policy space need to use it with caution.

9. There is an urgent need for EMDEs and LICs to strengthen policy frameworks and maintain adequate buffers. Macroeconomic supervision, in particular, should be tightened. The global safety net should be in a position to provide adequate liquidity in the times of need. As the most important part of the safety net, the Fund should function as a credible institution with members' quotas constituting most of its resources.

10. In my April 2015 statement, I had expressed concern about the prolonged use of UMPs by AEs. An orderly exit from UMPs seems to have become even more complicated. The possible prolonged downturn in commodity prices and its economic impact, including global deflationary pressures could delay exit from UMPs by AEs. I would again urge Central banks in the major AEs to be mindful of the spillovers to other countries while deciding on an exit. This should be in addition to clear communication about the exit.

11. Difficult structural reforms are needed to lift potential growth. In AEs, addressing sluggish productivity growth may require a combination of measures. EMDEs and LICs should, in general, give more attention to social and infrastructure sectors and to improving the business climate. Strengthening the fiscal and monetary frameworks should also be one of the priorities, and the IMF can assist significantly in these tasks. Large commodity exporters should put in place long term fiscal framework with regard to saving for future generations and safeguarding spending plans against shocks.

B. The IMF's Role –Architecture for Global Co-operation

12. This Committee has repeatedly expressed disappointment at the delay in implementing the 2010 Reforms. We have never before seen such a prolonged delay in implementing quota changes pursuant to the Board of Governors resolution on a General Review of Quotas. As stated earlier, such a heavy reliance by the IMF on borrowed resources is also unprecedented. We need to recognize that the delay in the 2010 reforms becoming effective has medium term implications for the Fund's governance. By now we should have been very close to

completing the 15th Review; however, the discussions have not even commenced. It is time for us to seriously consider what should be done to correct the steadily increasing misalignment between the Fund's governance and the prevailing economic realities.

13. The global economy needs the IMF for maintaining financial stability in today's challenging times, and the IMF needs the continued active participation and leadership of the United States for its credibility, effectiveness and legitimacy. The US leadership will need to help the rest of IMF's membership to proceed in such a way that the Fund remains a quota based institution that is broadly representative of the changing global economy, and it has adequate resources at its command for its continued effectiveness.

C. Developments in the Constituency

14. I now turn to developments in my constituency.

Bangladesh

15. The economy of Bangladesh continues to do well. Real GDP growth has been provisionally estimated at 6.5 percent in financial year (FY) 15 (ending in June 2015). The government expects growth in FY16 to go up to 7.0 per cent, which is higher than the IMF's forecast of 6.5 per cent. This is a continuation of the robust growth performance over the last three years in which the economy grew at an average of about 6¼ percent, buoyed mainly by higher public investment and exports.

16. Headline inflation eased in FY15, averaging just below 6½ percent, and is expected to remain stable in FY16. Food inflation has come down following a good rice harvest and a decline in global commodity prices, while nonfood inflation largely moved sideways since late 2014. The monetary policy stance continues to be prudent and the authorities remain vigilant against upside risks to inflation, particularly from the public sector wage increase that would come into force in the later part of the current fiscal year. On the external front, the current account balance has turned negative because of subdued exports and a recovery in imports. The garment sector is seeing a continued improvement in labor and safety standards. Foreign exchange reserves are expected to remain at a comfortable level of more than 5½ months of imports in FY16.

17. The preliminary estimate for the fiscal deficit in FY15 was 3½ percent, but it could rise in light of expected reconciliation of some of the expenditure items. Revenues came in below our target, but current spending was restrained. Public investment has increased; subsidies as a share of GDP have come down, helped in part by a lower fuel subsidy; and social spending has been protected. The public debt/GDP ratio has remained stable. A public sector pay hike, the first in six years, will be implemented in phases starting from the current fiscal year. This will result in an additional expenditure of about 1 percent of GDP by FY17. However, this impact will be offset by increasing the tax-to-GDP ratio through the introduction of a new VAT from the next fiscal year. In the banking sector, enhanced supervision of banks continues and the authorities are working on improving performance at the state-owned banks.

18. The Government of Bangladesh aims for the economy to grow at a faster pace over the medium term and to make growth more inclusive. This will require an improvement in the low tax/GDP ratio to open up space for higher public spending in growth-critical areas. Introduction of a new VAT is currently the main tool to boost tax collections. The creditable, single-rate VAT is designed to protect poor households and small businesses, and is expected to reduce taxpayers' compliance costs by making tax administration more transparent. The authorities are committed to launching the new VAT by July 2016.

Bhutan

19. For the year 2013/2014, estimates of economic growth for Bhutan have been revised downwards to 4.7 percent, reflecting a lower than expected pace of recovery. This is due to external imbalances, a severe Indian rupee shortage during the preceding two years, and the impact of monetary policy and other prudential measures to rein in aggregate demand. In 2014/15 growth is expected to pick up, with the real GDP growth projected to increase to 6.8 percent, buoyed by the secondary sector. In particular, activities in the construction, mining and quarrying, and manufacturing sub-sectors are expected to drive the economic growth higher.

20. Consumer price inflation (year-on-year) has moderated to 5.2 per cent in the second quarter of 2015 from 8.6 per cent in the second quarter of 2014, on the back of significant reduction in food inflation. Fiscal deficit in 2013/2014 was contained at about 4.4 percent of GDP due to initiation of several expenditure rationalization measures by the Government as well as some decline in investment.

21. The current account deficit in 2013-14 is estimated to be around 25.3 per cent of GDP, reflecting large imports associated with the construction of hydropower plants. However, robust aid inflows have led to a comfortable overall balance of payments position, enabling the continued accumulation of international reserves, which stood at USD 958.5 million, equivalent to 12.9 months of merchandise imports, in June 2015. Financial soundness indicators remain stable, with capital adequacy and liquidity well above the required prudential norms, although the relatively high level of non-performing assets (11 per cent as of June 2015) remains a policy concern.

22. With the introduction of new fiscal measures by the Government, in particular new and higher taxes on the import of vehicles and fuel, the Royal Monetary Authority of Bhutan (RMA) phased out the temporary credit restrictions that were imposed on the housing and transport portfolios in September 2014. Consequently, growth of credit to the private sector has increased from 9.3 percent in September 2014 to 14 percent in June 2015. Credit growth is expected to pick up to meet pent-up demand and new demand; the RMA will continue to monitor credit growth and review and revise its macro prudential regulations where necessary to counter any prospective overheating.

India

23. India's stable macroeconomic environment and strong growth outlook stand out relative to other emerging markets. Growth in 2014-15 was 7.3 percent, substantially higher than 6.9 percent in 2013-14. This strong growth performance continued in the first quarter of 2015-16 with 7.0 percent growth, compared to 6.7 percent in the corresponding period of 2014-15.

24. Headline Consumer Price Index (CPI) inflation reached its lowest level in August, 2015 since November 2014. In addition, inflation expectations have also eased. The January 2016 target of 6 percent inflation is likely to be achieved and the Reserve Bank of India will now focus on bringing inflation to around 5 percent by the end of 2016-17. Liquidity conditions eased considerably during August to mid-September. On September 29, the Reserve Bank of India reduced the policy rate by 50 basis points from 7.25 percent to 6.75 percent. India's foreign exchange reserves rose to US$ 355 billion (as of August 21, 2015), up by US$ 12 billion from the level on April 3, 2015.

25. The GFD of the central government is budgeted to decline from 4.0 percent in 2014-15 to 3.9 percent in 2015-16. The current account deficit (CAD) declined sharply from 4.8 percent of GDP in 2012-13 to 1.7 percent in 2013-14 and then, as expected, further to 1.3 percent in 2014-15. It is expected to decline even further to 1.1 percent in 2015-16.

26. The Indian government remains committed to structural reforms to boost potential growth and put India on a high growth trajectory. These include an accelerated public investment program in infrastructure, reforms to improve the business climate and major tax reforms. Leveraging information technology to increase productivity and make growth inclusive is a key priority.

Sri Lanka

27. The Sri Lankan economy grew by 5.6 per cent during the first half of 2015, significantly faster than 1.3 per cent during the corresponding period of the previous year. This growth was supported by all the three major sectors of the economy. The services sector, the largest contribution to the overall output of the country, grew by 7.1 per cent, supported by the expansion in education, insurance, telecommunications and financial services activities. The agriculture sector also performed strongly recording 3.3 per cent growth mainly on account of a bumper paddy harvest. However, growth in the industry sector at 1.3 percent was moderate, largely driven by contraction in construction and manufacturing activities. GDP is projected to grow by 5.5 to 6.0 per cent in 2015.

28. Inflation, which has persistently remained at single digit levels, declined further, supported by appropriate monetary policy actions, low commodity prices in global markets and improved domestic supply conditions. Year on year headline inflation declined to negative territory in July 2015 and remained negative thereafter, while annual average inflation in August was 1.0 per cent. In view of the continued low inflation environment, as well as favorable inflation expectations, the Central Bank continued its accommodative monetary policy stance during 2015 to encourage smooth flow of credit to the private sector, thereby supporting economic activity. Fiscal management in the first half has been difficult mainly due to the lower than expected increase in government revenue and increased recurrent expenditure. Therefore achieving the fiscal deficit target of 4.4 per cent during 2015 will be challenging. During the second half of this year, implementing the new revenue measures that were proposed in the interim budget for 2015, while rationalizing recurrent expenditure, would be essential to meet the targeted budget deficit.

29. Sri Lanka's external sector performance moderated in the first half of 2015 because of developments in both in the domestic and global economies. The trade deficit widened due to increased imports because of significantly high domestic demand and a marginal drop in exports. A widening trade deficit and moderation in workers' remittances led to expansion in current account deficit. This, together with the slowdown in inflows to the financial account, had an impact on the balance of payments which recorded a deficit of US dollars 792 million during the first half of 2015. Meanwhile, gross official reserves were estimated at US dollars 7.1 billion in early September 2015, which is equivalent to over 4.4 months of imports. Considering these developments, the Central Bank decided to allow greater flexibility in determination of the exchange rate by minimizing its intervention through supply of foreign exchange to the market. The financial sector stability and soundness was maintained, supported by adequate capital and liquidity levels and contained non-performing loan ratios.