International Monetary and Financial Committee

Thirty-Sixth Meeting
October 14, 2017

IMFC Statement by Arun Jaitley
Minister of Finance and Corporate Affairs, India

On behalf of
Bangladesh, Bhutan, India, and Sri Lanka

Statement by Mr. Arun Jaitley, Minister of Finance and Corporate Affairs, India,

(Representing the Constituency consisting of Bangladesh, Bhutan, India and Sri Lanka)

to the International Monetary and Financial Committee
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Mr. Chairman,

1. A broad based global economic recovery has taken shape since we met in April 2017. Led by improved outlook in the US, Euro area and Japan, and stabilizing conditions in large emerging markets and developing economies (EMDEs), including steady growth in India, global recovery is likely to gain traction in the coming months. However, the optimism about sustained long term recovery still eludes - clouded as it is by several factors including financial vulnerabilities owing to weak bank balance sheets and the large burden of public and private debts. The external imbalances in advanced economies (AEs) need to be addressed through corrective adjustments to avoid disruptive spillovers. We also need to renew our resolve to work against growing protectionist tendencies that could derail ongoing global recovery.

2. As called upon by G-20 leaders at the Hamburg Summit, we need to foster mutually beneficial trade and investment frameworks based on the principle of non-discrimination, and continue to fight protectionism to maintain a level playing field. We should collectively leverage the cyclical recovery to implement credible reforms for strengthening inclusive and sustainable global growth.

3. Growth in EMDEs is strengthening this year although prospects in some commodity exporting countries still remain challenging. We support policies that foster strengthening of structural policy frameworks in unison with growth friendly fiscal policies to build resilience of the global economy. At the same time, proactive financial sector policies to mitigate vulnerabilities will be necessary to safeguard the international financial system.

The Role of IMF- Architecture of Global Cooperation

4. A strong quota based and adequately resourced IMF is necessary to strengthen the international financial architecture and the Global Financial Safety Net (GFSN). The IMF should continue to strengthen its capacity for multilateral surveillance to identify evolving vulnerabilities and undertake close oversight of the global economy. The IMF should primarily remain a quota based institution and reduce its dependence on borrowed resources. An adequately resourced IMF at the center of the GFSN is necessary to instill market confidence and strengthen the stability of the international monetary system.

5. We welcome the shared commitment on completing the 15th General Review of Quotas (GRQ), including realignment of the quota formula, no later than the 2019 Annual Meetings. Increased inter-connectedness and complexity of financial markets ordain that the size of the Fund is increased sizably to mitigate the impact of crises effectively. The update with 2015 data using the current formula confirms its increasing out-of-lineness with respect to the relative weights of members in the global economy. This calls for significant realignment of members' quota shares especially in favor of EMDEs whose under-representation has increased by 0.5 percentage points compared with the previous calculations.

6. We welcome the progress made by the Fund in revamping its toolkit to facilitate meaningful and timely lending and policy support to the membership's needs. We also appreciate the efforts taken to increase cooperation with other layers of the GFSN that would significantly reduce risks to the international monetary system.

7. We call upon the IMF to encourage rebalancing of the global economy while drawing attention to the adverse implications of spillovers. We welcome IMF's unambiguous and strong voice in support of fair rules based multilateral trading system.

DEVELOPMENTS IN THE CONSTITUENCY

A. BANGLADESH

8. Bangladesh has demonstrated resilience amidst global headwinds and domestic challenges. The real GDP growth in FY17 (ending in June 2017) was estimated at 7.24 percent, up from 7.11 percent in FY16. Growth in FY18 is projected to remain robust. Headline inflation eased further in FY17, with annual average CPI inflation reaching 5.44 percent in June 2017 – below the central bank FY17 ceiling of 5.8 percent. In FY18 so far, point to point inflation has risen to 5.57 percent (annual average CPI inflation is 5.45 percent) in July 2017, fractionally above the FY18 ceiling of 5.5 percent.

9. Monetary policy stance will continue to remain prudent, and the authorities remain vigilant against upside risks to inflation and in readiness for policy rate adjustment. Excess liquidity in the banking system has been declining in recent months, as credit growth has picked up. There is some uptick in food price inflation due to flash-flood related crop losses. Domestic inflation risk is expected to be mitigated by low global inflation, particularly in India.

10. On the external front, the current account balance recorded a small deficit of US$ 1.48 billion during FY17 against a surplus of US$ 4.26 billion in FY16, because of strong import growth (9.0 percent) coupled with a deceleration in exports (1.7 percent) and a slowdown in remittance inflows (-14.5 percent). The recent decline in remittances not only reflects weaker economic activity in the Middle East, but also the difficulty of migrant workers to access formal remittance channels. Besides reducing remittance costs through formal channels, measures being considered to facilitate their use include sale of government bonds and providing housing loans to migrant workers on attractive terms. The FY18 current account deficit is projected at US$ 2.72 billion and a lower but still positive overall balance. Import coverage by reserves – currently at US$ 33.41 billion[2] – is expected to stay at just over 7 months in FY18 – the same level as in FY17. Bangladesh government is proactively engaging in bilateral and multilateral trade negotiations towards widening market access and diversifying the export basket.

11. Fiscal deficit (excluding grants) in FY18 is expected to remain broadly unchanged at around 5.0 percent. Budget financing is to be mainly done through National Savings Certificates (NSCs) and the remaining from bank and non-NSC sources. Gross investment as percent of GDP has risen in FY17 to 30.3 percent from 29.7 percent in FY16. While the subsidy expenditure for food is slated to increase by 27.79 percent[3] in FY18, mainly to supply rice at a lower price to the poor, no fuel subsidy will be extended and other subsidies will be contained. The deferral of VAT is not likely to pose any major

concern if the strong revenue growth momentum of FY17 continues and expenditures are kept in check.

12. In the banking sector, financial stability continues to receive a high priority with intensive monitoring of banks for remaining within the statutory limits on their capital market exposures. The central bank is engaged in strengthening of supervision and corporate governance in banks that can lead to lower credit and concentration risks and, subsequently, lower NPLs.

13. The government's reform initiatives to improve the business climate and ease infrastructure bottlenecks, including by developing special economic zones, should help crowd in both private domestic and foreign direct investments that can create more jobs, raise productivity, and potential growth. Prudent macroeconomic management, investments and innovations to improve productivity and pursuit of greater integration internally and externally through trade, fiscal and financial reforms remain strategic priorities.

B. BHUTAN

14. The year 2015-16 saw an acceleration in growth to 6.7 per cent from 6.1 per cent in 2014-15 and 4.0 per cent in 2013-14. As in the previous year, the acceleration of growth was mainly driven by a pick-up in services, mining and hydropower-related construction. The medium-term outlook is also promising, with the commissioning of new hydropower projects expected to provide further impetus to output and exports, as well as to fiscal revenues.

15. With an increase in prices of both the food and non-food components of the CPI basket, inflation increased from 3.3 per cent in 2015-16 to 5.5 per cent in 2016-17. The fiscal balance for 2016-17 is expected to remain in a deficit at 4.1 per cent. Since 2017-18 marks the final year of the 11th Five Year Plan (FYP), the Budget has been formulated only to complete the on-going activities resulting in an improvement in the fiscal deficit at 2.5 per cent of GDP. However, by the end of the 12th FYP (2022-23), the fiscal deficit is projected to be in a surplus at 7 per cent of GDP. The improvement is mainly attributed to the commissioning of Mangdechhu, Punatsangchhu I & II hydropower projects in the medium term.

16. The 2015-16 current account deficit increased by about one per cent of GDP to 29.0 per cent of GDP. The large deficit in 2015-16 and previous years is a result of imports for the construction of hydropower projects. It is expected to decline after 2018-19 with the commissioning of 4 new power plants and the resultant export of power. In the longer run, the current account balance is likely to return a surplus.

17. Credit growth recorded at 15.4 per cent in June 2017 with a slight increase from the 14.7 per cent in June 2016. The growth in credit was mainly contributed by the access to credit transmitted through financial inclusion initiatives.

C. INDIA

18. India is one of the fastest growing major economies in the world. The real GDP grew by 8.0 per cent in 2015-16 compared with 7.5 per cent in 2014-15. As per provisional estimate, GDP growth is placed lower at 7.1 per cent for 2016-17 with some deceleration

in investment demand. Provisional Q1 GDP growth for the current financial year declined to 5.7 per cent largely due to de-stocking in the wake of transition to the Goods and Services Tax (GST) regime. Growth is expected to witness strong rebound in the subsequent quarters aided by turnaround in production and stocking led by full traction of the GST system. India's macroeconomic stability has improved significantly with improved fiscal resilience and current account balance, structural reforms, pickup in growth and receding inflation. Buoyant tax revenues, increasing foreign direct investment (FDI) and the implementation of reforms in crucial areas including resolution of stressed assets, infrastructure, power, taxation have improved medium term economic outlook. Growth is projected to be near 7.0% in 2018.

19. The headline CPI (consumer price index) inflation has abated significantly since August 2016. The retail inflation has remained range-bound and well below the medium-term target of 4.0 per cent since November 2016. In recent months, it was 1.46 per cent in June, 2.36 per cent in July and 3.36 per cent in August. Following moderation of inflation risks, the monetary policy rate was reduced from 6.25 per cent to 6.0 per cent on August 2, 2017.

Financial Sector

20. The currency reform initiative of 2016 was launched with the five-fold objectives of flushing out black money; eliminating fake Indian currency notes, striking at the root of financing of terrorism and extremism, converting non-formal economy into a formal economy to expand tax base and employment, and providing a significant boost to digitalization of payments to make India a less cash economy. The package of incentives to encourage digital economy has enhanced investor preference towards structured investment vehicles. The demonetization initiative has improved tax compliance significantly. Income tax filings for the FY 2016-17 have increased by 16 per cent. An 'Operation Clean Money' has been launched to take action against deposits holding unexplained incomes and to foster citizen engagement towards tax compliance.

21. Stringent laws against accumulation of unaccounted wealth namely, the Benami Transaction (Prohibition) Amendment Act, 2016 and the Real Estate (Regulation and Development) Act, 2016 have been enacted. These laws provide for stringent penalties for indulging in unlawful dealings and accumulation of unaccounted money from real estate transactions. Such measures, *inter alia*, would insulate the financial system from misuse, increase transparency in financial dealings, and enhance investor confidence.

22. At the system level, our banks are adequately capitalized in respect of minimum regulatory capital requirements. By recent trends, the fall in restructured advances has led to the reduction of stressed advances ratio. Proactive measures have been taken to resolve stressed assets to strengthen the banks' balance sheets. Strategic debt restructuring (SDR), Joint Lenders' Forum (JLF) and Scheme for Sustainable Structuring of Stressed Assets (S4A) among others have fostered the resolution of stressed loans. In addition, the recent amendments to debt recovery laws and the operationalization of the Insolvency and Bankruptcy Code (IBC) 2016 including the setting up of Insolvency and Bankruptcy Board of India (IBBI) are expected to accelerate the resolution and liquidation of impaired assets /companies and adjudication and recovery processes for impaired assets.

23. The promulgation of the Banking Regulation (Amendment) Ordinance 2017 in May 2017 empowered the Reserve Bank of India (RBI) to direct banking companies to initiate insolvency proceedings in respect of corporate borrowers in default, under the provisions of the IBC 2016. It also enables the RBI to constitute committees to advise banking companies on resolution of stressed assets. Going forward, our government will facilitate consolidation of weaker public sector banks to increase the efficiency and governance in them to enable broader economic revival. Efforts to strengthen credit assessment and pricing as well as making risk-based, dynamic and counter-cyclical provisioning would be strengthened by the proposed constitution of a comprehensive public credit registry.

24. The '*Indradhanush*' initiative which envisaged budgetary allocation Rs. 700 billion for recapitalization of public sector banks over the period 2015-19 is being reviewed post asset quality review (AQR). A revised package of recapitalization is being formulated to ensure that public sector banks remain solvent, sufficiently capitalized and are able to finance credit demands of the productive sectors of the economy.

Fiscal Reforms

25. The government is committed to the policy of fiscal rectitude. The central government finances underwent considerable degree of consolidation over 2013-14 to 2016-17, aided by buoyant tax revenues and subsidy reductions. The gross fiscal deficit (GFD) was brought down to 3.5 per cent in 2016-17 without compromising on public investment needs and spending on social sector programs. The quality of fiscal adjustment is reflected in the reduction of revenue deficit to 2.1 per cent in the revised budgetary estimate vis-à-vis 2.5 per cent in 2015-16. The revenue deficit would be further brought down to 1.9 percent in 2017-18 which will be below the 2 per cent mandated by the Fiscal Responsibility and Budget Management (FRBM) Act.

26. The GFD for the year 2017-18 is pegged at 3.2 per cent as against 3.0 per cent recommended by the FRBMA committee. The resources for infrastructure as well as for rural, agricultural and allied sectors have been significantly increased in the budget for FY 2017-18. While the government is fully committed to maintain prudent fiscal balance, there may be need to allow somewhat higher fiscal deficit. . Our government will endeavor to improve upon fiscal numbers next year by enhancing the quality of expenditure and tax mobilization.

27. The GST introduced with effect from July 1 this year has transformed the basic structure of indirect taxes on goods and services. Unlike origin based taxation, the GST is destination based, and has subsumed a plethora of central and state level indirect taxes helping to streamline payments and credits, while enhancing the efficiency of inter-state movement of goods. On the other hand, the direct tax system has been bolstered by enhanced investments in IT system integration, expansion of tax network and e-filing and payment of taxes and setting up data warehouse and analytics with business intelligence solutions. Simplified tax laws and procedures such as automation of tax payment and assessments without public interface are enhancing the efficiency of revenue administration.

28. While public investments in electricity, roads, financial access and housing for the poor have been significantly enhanced, reforms have been undertaken to improve the efficiency of public expenditures. Reforms incorporating measures to simplify appraisal

and approval processes including structural changes in budget making such as rationalization of central sector and centrally sponsored schemes, the advancement of the budget by almost a month, doing away with the Plan-Non-plan distinction, the integration of railway budget with the main budget, and restructuring of medium term expenditure framework to give projected expenditures for the next two financial years will improve the efficacy of the budgetary program.

External Sector

29. In recent years, India's external sector has benefited from lower current account deficit (CAD), robust FDI inflows, build-up of reserves and improvement in other vulnerability indicators. The far-reaching liberalization of the FDI policy has given major thrust to investments and employment generation. Except a small negative list, all other sectors can have been brought under automatic approvals route for foreign investments. Moreover, with the successful implementation of e-filing and online processing of FDI applications, the approval system, hitherto vested with the foreign investment promotion board (FIPB), has been abolished. India is now one of the most open economy in the world for FDI. The UNCTAD's survey of multinational enterprises ranked India as the third most favorite host country for FDI for 2017-19 after the US and China. Net FDI inflows during April-August 2017-18 increased to US$ 19.78 billion from US$ 14.63 billion during the comparable period in the previous year. The increasing strength of economic fundamentals has made India the most sought after destination for investments.

30. India's foreign exchange reserves were US$ 399.6 billion as of September 29, 2017. The CAD to GDP ratio continue to remain at a sustainable level of 0.7 per cent in 2016-17, as in the previous year (2015-16) when it was placed at 1.1 per cent. The CAD ratio, temporarily, increased to 2.4 per cent in the first quarter of 2017-18 due to higher imports relative to exports.

Structural Reforms

31. To focus on the resolution of stressed assets in the banking system, the legal framework for insolvency resolution has been reinforced with the enactment of IBC 2016 and amendments made to the Securitization and Reconstruction of Financial Assets and Enforcement of Security Interest (SARFAESI) and Debt Recovery Tribunal Acts. The IBC 2016 provides for a market-determined, time-bound process for orderly resolution of insolvency, and ease of exit, wherever required. The National Company Law Tribunal (NCLT) and National Company Law Appellate Tribunal (NCLAT) - the arbitration and appellate frameworks - are already in place and have established operational processes for complete resolution of cases brought before it. New commercial courts have also been set up. Rules governing voluntary corporate liquidation have since been established by the IBBI responsible for implementation of IBC 2016. Three insolvency professional agencies and over 1200 resolutions and professionals are currently registered with the IBBI to undertake insolvency proceedings.

32. The Financial Resolution and Deposit Insurance Bill 2017 (FRDI Bill), introduced in the Indian Parliament on August 10, 2017, envisages a Resolution Corporation to protect consumers of financial service providers in financial distress. The proposed legislation will inculcate discipline among financial service providers in the event of financial crises by limiting the use of public money to bail out distressed entities. The FRDI Bill will

complement the IBC, and together, they will provide complete and a comprehensive resolution framework for the entire economy.

33. While protecting labor laws, efforts are being undertaken reduce the multiplicity of labor laws to support employment growth. Social safety nets for the common people have been substantially strengthened with the introduction of low cost insurance and pension schemes.

D. SRI LANKA

34. The Sri Lankan economy expanded at a relatively high pace of 3.9 per cent, in real terms, during the first half of 2017, compared to 3.7 per cent growth recorded during the corresponding period of the previous year. Agricultural production continued to be affected by extreme weather conditions and weak external demand during the first half of 2017. In terms of value addition, key growth drivers in the first half of the year were construction, mining and quarrying, financial and insurance activities, and wholesale and retail trade. However, the medium-term outlook remains positive with envisaged structural reforms and expected inflows of foreign investments. Sri Lanka's economy is expected to grow by around 4.5 per cent in 2017 and projected to move to a higher growth path of around 7.0 per cent by 2020.

35. Consumer price inflation remained above the envisaged mid-single digit levels during the first eight months of 2017 resulting from adverse impact of weather related supply side disruptions, revisions to the government tax structure as well as rising international commodity prices. Headline inflation as measured by the National Consumer Price Index (NCPI) accelerated to 7.9 per cent (year-on-year) in August 2017 from 4.2 per cent at end 2016. However, core inflation decelerated during the first half 2017, which was followed by a slight uptick in the months of July and August. Core inflation decelerated to 4.8 per cent (year-on-year) in August 2017 from 6.7 per cent at end 2016, reflecting the containment of demand driven inflationary pressures in the economy resulting from restrictive monetary policy measures adopted since end 2015.

36. Sri Lanka's external sector recorded a mixed performance during the first half of 2017. Despite an increase in export earnings, the deficit in the trade account widened during the first half of the year due to the notable increase in import expenditure mainly on account of higher drought related imports, particularly fuel, and rice. Reflecting the expansion in trade and primary income account deficits, the moderation in tourist earnings and the decline in workers' remittances, the current account deficit widened during this period. Net inflows to the financial account increased during the first half of 2017 mainly due to the increased levels of foreign investment in both government securities and portfolio investments, signaling a boost in investor confidence. The proceeds of the eleventh International Sovereign Bond (ISB) and the syndicated loan facility also strengthened the financial account. Reflecting these improvements in the external sector, the Balance of Payments (BOP) registered an overall surplus by end June 2017. Exports continued to grow in the third quarter of the year, and the income from tourism and workers' remittances continued to support the BOP. With the receipts of ISB, syndicated loans and the third tranche of the IMF-EFF (Extended Fund Facility) program, as well as foreign currency purchases of the Central Bank, the country's gross official reserve level improved to US$ 7.3 billion by mid-September 2017. The Sri Lankan rupee has depreciated by 2.0 per cent against the US dollar so far during the year.

37. Reflecting the government's commitment towards revenue based fiscal consolidation, the fiscal sector showed some improvement during the first half of 2017. Government revenue to GDP ratio recorded a notable improvement, increasing to 6.7 per cent during this period from 6.0 per cent in the corresponding period of 2016. This was mainly due to higher tax revenue collection, particularly from VAT. Total expenditure and net lending as percentage of estimated GDP also increased to 9.3 per cent during the first half of 2017, in comparison to 8.7 per cent recorded in the same period in 2016, due to increases in both recurrent expenditure and public investment during this period. Accordingly, the overall budget deficit declined to 2.6 per cent of the estimated GDP during the first half of 2017 from 2.7 per cent recorded in the corresponding period of 2016, as the increase in government revenue was higher than the increase in government expenditure. The ongoing 3-year arrangement under the EFF with IMF has complemented the reform efforts of the government aimed at strengthening fiscal and external balance of the economy.

38. The financial sector continued its positive growth momentum during the first half of 2017. A growth in the credit and investment portfolios of banks contributed to the expansion of asset base of the banking sector, which was largely funded through deposits. Liquidity and capital ratios were maintained at levels that were well above the statutory requirements. The licensed finance companies (LFC) and specialized leasing companies (SLC) sector grew at a modest pace during this period, affected particularly by the implementation of macro-prudential policy measures. The insurance sector and superannuation funds recorded a positive performance while the unit trust sector recorded a contraction.

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