



International Monetary and Financial Committee

Twenty-Seventh Meeting
April 20, 2013

Statement by P. Chidambaram, Minister of Finance, Ministry of Finance, India

On behalf of Bangladesh, Bhutan, India, Sri Lanka

**Statement by Finance Minister Mr. P. Chidambaram
Leader of the Indian Delegation to the
International Monetary and Financial Committee
Washington DC, April 2013
(Representing the Constituency consisting of Bangladesh, Bhutan, India and Sri Lanka)**

Mr. Chairman,

1. We are meeting at a time when there are some signs, *albeit* tentative, of stabilizing global economic activity. Although financial market conditions have improved, their impact on the real economy has been muted so far. Global growth remains weak and the global economy continues to face several risks. Moreover, some new concerns have also arisen. As such, the global economy continues to pose huge challenges for policymakers, particularly in advanced economies. When we met in October last year in Tokyo, we agreed that we would act decisively and restore the global economy to a path of strong, sustainable and balanced growth. It is, therefore, important to review the progress made in achieving our objectives so that we can move forward to face the emerging challenges.

A. The Global Economy and Financial Markets

2. Two major uncertainties, *viz.*, the risk of break-up of the Euro area and sharp decline in economic activity due to ‘fiscal cliff’ in the US have been partially addressed by the policymakers. Short-term risks in emerging market economies (EMEs) have also receded. As a result, confidence has improved and global economic activity is beginning to stabilize. There is a pick-up of activity in emerging market economies. Indicators such as rising consumption spending and a recovering housing market suggest that growth impulses are also gradually strengthening in the US. Growth in the Euro area, however, remains a cause of concern with many of its economies facing recession.

3. There has been a marked improvement in global financial market conditions in recent months as reflected in the increase in equity prices and decline in sovereign and corporate bond spreads. However, credit conditions in advanced economies, especially the Euro area, remain tight. Deleveraging by the private sector and fiscal consolidation have also continued. All these factors have continued to depress domestic demand and growth in many advanced economies. The outlook for global growth, both in the short-term and over the medium-term, also remains uncertain. In particular, high unemployment in advanced economies is expected to act as a major drag on global economic activity. Although the recent improvement in financial market conditions is a welcome development, it is largely driven by the non-conventional policies followed by central banks in advanced economies. Thus far, the impulses from unconventional policy have not been transmitted in a significant degree to real actions such as corporate investment. In the absence of this, there is a risk of prices in financial markets getting far out of alignment with macroeconomic fundamentals, which could pose a threat to financial stability and the tentative global recovery. We need to be cautious about the risks that can emanate from a prolonged monetary accommodation in

advanced economies; risk from weak regulation of shadow banking systems; and risk from excessive financial risk taking.

4. Despite some slowdown, emerging market economies remain the strongest source of global growth, reflecting resilient domestic demand conditions and healthy banking sectors. Growth in emerging market economies is now beginning to pick up. Capital flows to these economies have increased, reflecting improved financial market conditions, but they are also a consequence of the excess liquidity in global markets and the search for higher yields. Consequently, policymaking in EMEs will need to continue to be vigilant to the possibility of financial instability resulting from any reversal of capital flows. Volatility in oil prices also remains a concern for EMEs.

Policy Challenges

5. The present state of the global economy continues to pose several challenges for policymakers in advanced and emerging economies. Although the rebalancing of the Euro area continues, recent developments in Cyprus suggest that the situation in the Euro area is far from settled. Since the onset of the current crisis, unexpected developments keep occurring periodically and add to uncertainty. It would not be overstating matters to say that the key to global stability is to restore stability to Europe. While Europe has to be commended for the steps it has taken so far, they may prove to be inadequate unless the major policy measures announced recently, such as the setting up of a Banking Union, are completed. Continued fragmentation of the banking system and delay in cleaning up banks may result in continued economic weakness. There is also need to make further progress in strengthening the economic and monetary union. Restoring growth would be the key driver to addressing the debt problem in the Euro Area.

6. In the EMEs, the challenge in the short-term is to improve growth without stoking inflation. Policy space is still available in varying degrees in some EMEs, which should be used keeping in view inflation concerns. Growth in emerging market economies can help provide support to advanced economies, which are suffering from lack of adequate domestic demand. A major challenge for the emerging market economies over the medium-term is to increase potential output by implementing structural reforms. EMEs also need to be prepared to deal with volatility in capital flows and a possible rise in commodity prices.

7. Given the continued uncertainty, the Fund needs to strengthen its surveillance of the global economy. We need to recognize that in addition to the known risks at present, there are bound to be surprises that will arise in the months and years to come. The Fund should have a programme of work that focuses on the identification of risks, as they become more salient and plans of contingent action to cope with them.

B. The IMF's Role— Architecture for Global Cooperation

8. Let me now turn to some of the overarching issues relating to global cooperation that need to be addressed in the context of safeguarding global economic and financial stability in the period ahead.

Quota and Governance Reform

9. The Board of Governors resolution on the 2010 reform had stated that each member would commit to use its best efforts to complete the required steps no later than the Annual Meeting of 2012. While this deadline could not be met, we need to have more clarity on when this will be finally done. I urge all concerned to work together to bring a conclusion to this process.

10. We are hopeful of an early conclusion of the discussions for a new quota formula and that the 15th General Review of Quotas (GRQ) will be started and completed in time. In order to enhance the credibility and effectiveness of the IMF, it is important that there be a clear shift of the quota shares in favour of the emerging market and developing economies, (EMDEs), and that this shift is achieved not at the cost of other EMDEs but by the space yielded by advanced economies.

C. Developments in the Constituency

11. I now turn to developments in my constituency.

Bangladesh

12. Bangladesh economy continues to achieve robust real GDP growth despite the global economic slowdown. Preliminary estimates show that the economy expanded by 6.4 per cent in financial year 2012 supported by strong domestic demand and impressive inward remittances. Moreover, ongoing measures to reduce supply bottlenecks in power, energy, and communication sectors have appeared to encourage private investment and promote real economic growth. In particular, since 2008, an additional 3,845 MW of capacity has been added to the national grid till December 2012. Adjustments in macroeconomic and financial policies together with the assistance under the IMF's Extended Credit Facility (ECF) have helped ease external pressures. Timely fiscal consolidation and moderate monetary tightening have eased inflationary pressures in the second half of financial year 2012. Point to point inflation has decreased to about 7.9 percent in February 2013 from the double digit level in March 2012. The exchange rate remains market-based and its volatility is lower now than in 2011. High remittance inflows have compensated the impact of sluggish export growth. With strong revenue collection efforts and expenditure restraint, the overall budget deficit (excluding grants) stood at around 4 percent of GDP in financial year 2012. Fuel and electricity subsidies have been contained by adjusting administered prices. Government borrowing from the banking system in financial year 2012 remained within budgetary parameters and did not crowd out private sector credit growth. Restrained monetary policy ensured that major monetary aggregates were close to program targets in financial year 2012. The new monetary policy stance is essentially a continuation of the restrained stance. Bangladesh aims to uphold this policy stance under the ECF program to achieve sustained growth, keep inflation below 8 percent, and preserve external stability in financial year 2013.

Bhutan

13. Real GDP growth in Bhutan continued to remain strong in 2011-12, although it moderated to 8.5 percent from 11.7 percent during the previous year, supported by the tertiary and secondary sectors, particularly construction, hotel and restaurants, and transport. The unemployment rate dropped from 3.3 percent to 3.1 percent in 2011. Per capita income rose to USD 2,590 in 2011 from USD 2,277 in 2010. Consumer price inflation, which increased from 8.3 percent in 2010-11 to 13.5 percent in 2011-12, moderated to 9.5 percent during the quarter ended December 2012. The fiscal deficit increased from 2.3 percent of GDP in 2010-11 to 4.4 percent of GDP in 2011-12. Current account balance moderated slightly from 25.7 percent of GDP in 2010-11 to 20.5 percent in 2011-12. Although international reserves fell to USD 770 million by June 2012, they were sufficient to finance 9.6 months of total merchandise imports and 20.6 months of essential imports. During 2012, the authorities implemented numerous major demand-side monetary policy, currency and prudential measures to rein in aggregate demand and tackle structural imbalances in the economy. The financial system remains safe, sound and resilient. Bhutanese financial institutions on average maintain capital adequacy and liquidity well above the required prudential norms, while enjoying improvements in asset quality as reflected in their gross NPL ratios. In order to address the tight liquidity situation, the central bank reduced the CRR from 17 percent during March 2012 to five percent in June 2012. Going forward, growth prospects are robust and the Bhutanese authorities expect real GDP growth to be 7.8 percent in 2013/14.

India

14. Economic activity in India remains somewhat sluggish. Given its relatively high degree of openness, the Indian economy was impacted by the global growth slowdown. At the same time, several domestic constraints also acted as a drag on economic activity. To address these concerns, the authorities have taken several measures in the recent period. The policy focus in recent months has been, on containment of fiscal deficit, along with measures that would boost investment levels in the economy and help raise the growth rate. A Cabinet Committee on Investment (CCI) has been set up to remove blockages and fast-track the implementation of large projects, especially infrastructure projects. A plan is being implemented to gradually roll out direct cash transfers using Unique Identification Numbers (UID) beginning 2013. Eventually, cash transfers will be the preferred mode for the disbursement of subsidies and other monetary benefits to improve efficiency and avoid duplication and leakages. Efforts are underway to pen the laws and implement the Goods and Services Tax (GST) and the Direct Tax Code (DTC) as early as possible. Inflation has begun to moderate. Core inflation, in particular, has moderated significantly. Together with the measures taken for fiscal consolidation, this has provided space to the Reserve Bank of India for some monetary easing. To address growth concerns, the Reserve Bank has cut its policy rates twice during the last three months.

15. The authorities are concerned with the twin deficits and are taking measures to contain them. The gross fiscal deficit has been reduced from 5.8 per cent in 2011-12 to 5.2

per cent in 2012-13 and it has been budgeted still lower at 4.8 per cent for 2013-14. Public debt continues to follow a downward trajectory with the Central Government's gross debt declining to 45.9 per cent of GDP during 2012-13 (RE). India's current account deficit has remained elevated during the last several quarters mainly due to widening of the trade deficit reflecting weak external demand and large imports of oil and gold. Although the current account deficit has been financed by increased capital flows, the Government is committed to bring it down over time. Various measures taken by the Government combined with recent monetary policy easing by the Reserve Bank of India are expected to revive investment activity and help take the economy to a high growth trajectory.

Sri Lanka

16. The Sri Lankan economy grew at a commendable rate of 6.4 percent in 2012, following over 8 percent growth in the preceding two years. The Industry sector grew at a healthy rate with a significant contribution coming from the construction sub-sector. The growth in the Services sector moderated largely due to a slowdown in external trade, while the agriculture sector continued to be affected by adverse weather conditions. The unemployment rate declined to 4.1 per cent in 2012. The continued high growth in aggregate demand led to some imbalances in the external sector, increased pressure on the exchange rate and high credit growth. To address these imbalances, the Central Bank tightened its monetary policy and limited its intervention in the foreign exchange market. The government raised duties on selected non-essential imports and allowed upward revision of energy prices. Inflation was maintained within single digit in 2012 although there were upward pressures during the second half of the year largely due to supply side factors. The year-on-year headline inflation at 2.7 percent in February 2012 gradually increased to 9.2 percent by end 2012 reflecting upward adjustment in energy prices, the pass-through of the currency depreciation, supply disruptions due to adverse weather conditions as well as demand pressures caused by high monetary growth in the preceding years. Inflation has since moderated to 7.5 percent in March 2013. The external sector recovered significantly during the year with lower trade and current account deficits and higher inflows to the capital account leading to a surplus in the balance of payments. International reserves increased to comfortable levels. Despite some setback in revenue generation, the government remained committed to fiscal consolidation and the overall fiscal deficit further reduced to 6.4 percent of GDP in 2012 from 6.9 percent in 2011. Money supply growth decelerated in the tightened policy environment. These developments provided room for the Central Bank to relax its monetary policy stance in December 2012. The financial system remained stable and sound with high capital adequacy and moderate non-performing loans (NPLs), while profitability of industry improved.

Conclusion

17. There has been marked improvement in financial market sentiment in the recent period following some significant measures announced by policymakers in the Euro area and the US. The global macroeconomic situation is also beginning to stabilize. Although confidence has improved, it still remains fragile and the global economy continues to face several critical challenges. Despite all these uncertainties, the global economy can bounce

back if advanced economies continuously keep progressing on removing policy uncertainties and if we are able to remove some of the major bottlenecks in the real sector of the economy.

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