South Asia: The Robust Outlook Continues

Despite some slowing of activity during 2016 and 2017, growth in the region remains stronger than most other comparator regions. The deceleration in growth in 2017 to 6.5 percent reflects primarily weaker activity in India, where the economy was hit with two temporary shocks—the country's currency exchange initiative and glitches in implementation of the national Goods and Services Tax. Growth was broadly stable or accelerated in other countries, primarily driven by domestic demand. In 2018, growth is expected to accelerate, other than in Nepal, to 7.1 percent in aggregate for the region reflecting continued strong consumption and investment, supported by favorable financial conditions and improving external demand. Inflation remains broadly stable, in part tracking developments in food prices. Policies in the region need to address remaining macroeconomic and financial vulnerabilities. Durable, growth-friendly, and in many cases, revenue-based fiscal consolidation remains a priority for some of the countries. Financial vulnerabilities also require attention in several countries. Policymakers should focus on supporting sustained high and socially inclusive growth, while addressing the remaining vulnerabilities. Some common areas of priority include domestic revenue generation to support both consolidation and generate space for more public investment and targeted social spending, as well as continued structural reforms to address supply-side bottlenecks and enhance the functioning of product and factor markets.

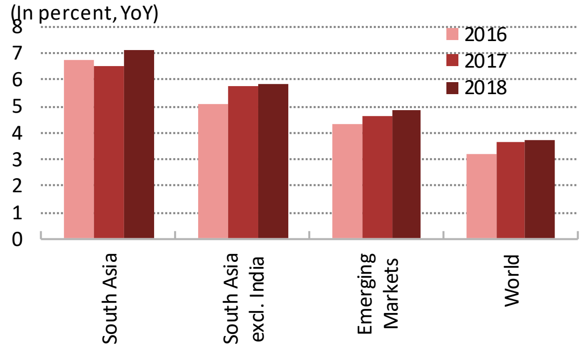
Global and Regional Economy

The global cyclical upswing that began in 2016 continues to gain momentum. In the October 2017 *World Economic Outlook* (WEO), global growth is forecast to accelerate from 3.2 percent in 2016 to 3.6 percent in 2017 and 3.7 percent in 2018—slight upward revisions compared with the April 2017 WEO forecast. The pickup in growth is generally broad based across both advanced economies and emerging market and developing economies. Global financial conditions remain favorable, with low volatility. Asset price changes generally reflect both a more optimistic market environment, with stronger risk appetite, and shifting expectations regarding the strength of the economic recovery and some policy settings in major economies, particularly in the United States.

The outlook for the Asia-Pacific region also remains robust—the strongest in the world, in fact—and recent data point to even further acceleration. Growth in the region is forecast to increase to 5.6 percent in 2017, up 0.2 percentage points from 2016. The IMF Asia-Pacific Department's October 2017 *Regional Economic Outlook* projects Asia's economic growth at 5.5 percent in 2018, driven by strong consumption and investment and supported by the global upswing.

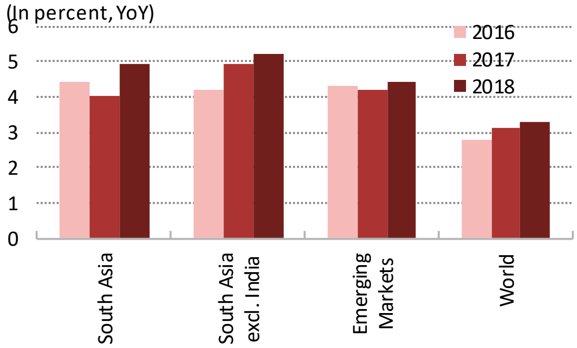
Growth in China and Japan are revised upward for 2017 compared to the April 2017 WEO World Economic Outlook, owing mainly to continued policy support and strong recent data. In China, growth accelerated to 6.9 percent in the first half of 2017, reflecting recovering global trade, continued strong infrastructure spending, and resilience in the real estate sector. In Japan, above-potential growth has now been sustained for six consecutive quarters through the second quarter of 2017, underpinned by a pickup in external demand and fiscal support. Activity in Korea also continues to recover, as domestic political tensions ceased following the elections and business investment has picked up. By contrast, growth is revised downward in India due to temporary effects from the November 2016 currency exchange initiative and implementation issues related to the July 2017 launch of the national Goods and Services tax. Over the medium term, slower growth in China is expected to be partially offset by an acceleration of growth in India, underpinned by key structural reforms.

Real GDP Growth
(In percent, YoY)



Source: IMF, *World Economic Outlook*; and IMF staff estimates.

Inflation
(In percent, YoY)



Source: IMF, *World Economic Outlook*; and IMF staff estimates.

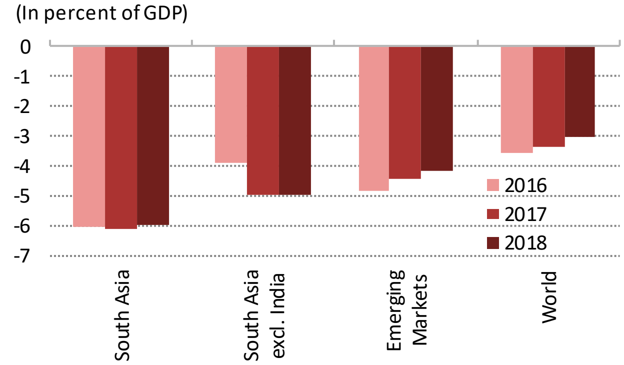
In the short term, risks are broadly balanced. On the positive side, the global cyclical upswing, including in China and Japan, could strengthen further, supported by increasing consumer and business confidence and favorable financial conditions. However, with policy uncertainty remaining high and potential geopolitical tensions, financial conditions could tighten suddenly, leading to capital outflows, which would be felt disproportionately more by emerging market and developing economies with external vulnerabilities.

In the medium term, risks remain skewed to the downside. These risks include: a more rapid and sizeable tightening of global financial conditions, a sharp adjustment in China, geopolitical tensions, a shift towards more inward-looking policies in major economies, and climate change and natural disasters. Tighter financial conditions could result from faster-than-expected normalization in advanced country monetary policies or a sharp decrease in global risk appetite particularly given current high financial asset valuations. In China, overly ambitious growth targets supported by unsustainable policies, further increases in debt, and mounting financial imbalances contribute to medium-term risks. Asia faces risks stemming from rising geopolitical tensions within the region, with the United States, and from discord between main trading partners within the region. An escalation of such tensions could hurt foreign direct investment and trade, disrupting major sources of growth and disturbing financial markets. More inward-looking policies could reduce the trade and remittances, hurt productivity and longer-term growth, and slow the pace of global economic convergence and poverty reduction.

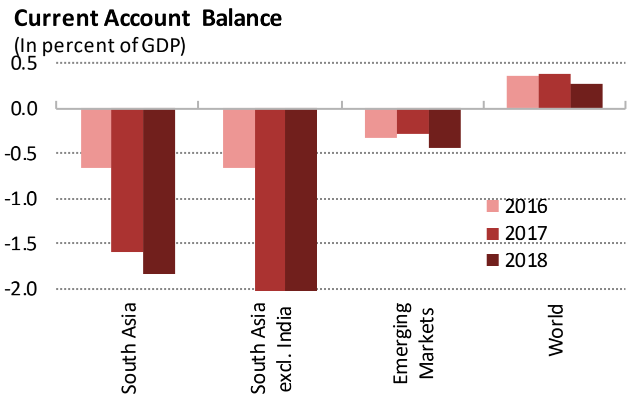
The outlook for South Asia remains strong. Aggregate growth in the region decelerated somewhat to 6.5 percent in 2017 from 6.7 percent in 2016, reflecting primarily the slowdown in India. Growth is expected to pick up, though, to 7.1 percent in 2018, with growth increasing or broadly stable in all countries with the exception of Nepal. Growth in the region, which is stronger than in most comparator regions, continues to be driven primarily by domestic demand, with support from favorable financial conditions and improving external demand. Headline inflation is expected to decline in 2017 before rising again in 2018, reflecting mainly changes in food and other commodity prices.

The region continues to face key macroeconomic vulnerabilities. While expected to improve slightly during 2017-18, fiscal deficits and public debt are higher in the region than comparator ones. Annual credit growth is increasing by more than 15 percent (y/y) in many of the countries—other than India and Afghanistan—and impaired loans are around 10 percent of total loans in all countries but Nepal and Sri Lanka. While capitalization levels of the region's banking systems appear generally adequate, underlying financial vulnerabilities are a matter of concern. After declining in recent years, the region's current account deficit is expected to rise to about 1.6 percent of GDP in 2017 and 1.8 percent of GDP in 2018. Bhutan's current account imbalances are expected to remain extremely large at about 29 percent of GDP in 2017, yet are expected to decline over the medium term as hydropower exports to India expand.

Fiscal Balance
(In percent of GDP)



Source: IMF, *World Economic Outlook*; and IMF staff estimates.



Source: IMF, *World Economic Outlook*; and IMF staff estimates.

Policies in the region should address remaining macroeconomic and financial vulnerabilities, and support sustained high and socially inclusive growth. Durable and growth-friendly fiscal consolidation remains important in several other countries, including India, Sri Lanka, Pakistan, and the Maldives. Domestic revenue generation is a priority for most countries to support consolidation where needed, and to generate space for more public investment and targeted social spending. Addressing financial sector vulnerabilities, including high levels of distressed assets, also remains high on the policy agenda, particularly in the case of India. Finally, structural reforms to overcome supply-side bottlenecks and enhance the functioning of product and factor markets would help support potential growth.

India

The slowdown in GDP growth appears to have bottomed out, with growth in Q2 FY2017/18 (July – September) staging a modest recovery to 6.3 percent with a pick-up in investment, after five quarters of continuous slowing. From 8.0 percent in FY2015/16, growth had slowed to 7.1 percent in 2016/17 and 5.7 percent during April-June 2017. The slowdown partly reflected weakened activity due to temporary cash shortages arising from the currency exchange initiative (effective November 9, 2016), and transition costs related to the new national Goods and Services Tax (GST) that came into effect on July 1. Forward looking high frequency indicators remain mixed, likely reflecting on-going adjustment to these policy actions. Accordingly, real GDP growth (at market prices) is now projected at 6.7 percent in FY2017/18 and 7.4 percent FY2018/19.

The improvement in India's terms of trade between FY2013/14 and FY2015/16 by a cumulative 13 percent contributed to improvement in India's current account and fiscal positions, a sharp decline in inflation, and a real appreciation of the rupee, though the recent increase in world oil prices may put pressure on macro stability. Because of reduced external vulnerabilities, improved growth prospects, and continued relaxation in FDI ceilings, India has experienced large FDI and portfolio capital inflows and a robust rebound in international reserves (hitting US$400 billion or about 7½ months of import cover). Macroeconomic challenges remain as growth is constrained by supply-side bottlenecks and continuing balance sheet weaknesses in India's corporate and banking sectors.

Lower global commodity prices, a range of supply-side measures, and a relatively tight monetary stance have resulted in a sharp decline of CPI inflation from an average of 9½ percent during 2011-13 to around 4½ percent during FY2016/17 and an average of 3.3 percent so far this fiscal year. CPI inflation is projected to increase to around 5 percent by end-2017/18—within the Reserve Bank of India's official target range of 4 percent with a symmetrical band of +/- 2 percent—on rising food and oil prices and a pick-up in core inflation. The current account deficit has narrowed from a high of 4.8 percent of GDP in FY2012/13 to an average of around 1.3 percent of GDP during FY2013/14–FY2016/17, and is projected at about 1.4 percent of GDP in FY2017/18. Exports rebounded in 2016 and are expected to strengthen further, but rebounding imports and terms of trade deterioration will likely dampen net exports.

The FY2017/18 Budget continues with fiscal consolidation, albeit at a slower pace than previously envisaged, with a fiscal deficit target of 3.2 percent of GDP (authorities' definition). Risks of slippage have risen during the fiscal year mainly due to weaker than expected revenues, including from the new Goods and Services tax (GST). Continued subsidy and tax reforms, including further improvements in the GST and improving tax administration, are needed to achieve fiscal consolidation plans over the medium term.

The Government of India implemented multiple structural reforms in 2016. The emphasis is now likely to shift to addressing implementation of policy rather than new policy measures. Key recent measures include: adoption of a formal medium-term inflation target (4 percent median CPI inflation with a symmetric 2 percent band) in August 2016; passage of the GST constitutional amendment in August 2016; passage of a new Bankruptcy Code in May 2016; supply-side measures to contain food inflation; and improvements in financial inclusion and domestic bond markets. The government also announced a major decision in October to recapitalize state-owned banks, committing to provide about two-thirds of the total financing of 1.3 percent of GDP. The long-awaited nationwide GST is a major reform of the Indian tax system. Focus should remain on further streamlining the rate structure and improving the supporting infrastructure to ease implementation costs particularly for SMEs. Other key reform priorities include credible reforms in the banking sector to ward off recurrent balance sheet problems particularly in the public banks, labor market reforms to facilitate greater and better quality job creation, and agricultural sector reforms to reduce production risk and improve competitiveness. These reforms and others already in train should help raise medium-term GDP growth rates in India above 8 percent.

Pakistan

Growth has continued to strengthen and inflation has remained contained. In FY2016/17, real GDP expanded by 5.3 percent, supported by recovery in agriculture, strong growth in construction and services, and a pickup in large-scale manufacturing growth. However, growth has been increasingly driven by import-intensive domestic demand—strong consumption and investment in part related to the China-Pakistan Economic Corridor. Growth is expected to accelerate further to 5.6 percent this fiscal year on the back of strong domestic demand, unless the continued erosion of external buffers (below) becomes disruptive. Headline inflation has been subdued at 4 percent (y-o-y) in November 2017, in part helped by low food prices, and is expected to remain contained–absent major changes in the exchange rate–at an average of around 4.8 percent in FY2017/18.

External and fiscal vulnerabilities have been increasing. The current account deficit widened rapidly during FY2016/17 to 4 percent of GDP reflecting strong import growth and flat remittances. Foreign exchange intervention has reduced gross international reserves to below three months of import cover. Despite higher growth and owing to significant overspending by provinces and some revenue underperformance, the overall fiscal deficit (excluding grants) widened to 5.8 percent of GDP in FY2016/17, about 2 percent of GDP looser than budgeted and reversing the declining trend achieved under the 2013-16 EFF program.

The policy mix needs to be adjusted to address Pakistan's eroding economic resilience. The State Bank of Pakistan's recent move to allow some adjustment of the exchange rate is a step in the right direction and should be accompanied by continued exchange rate flexibility in the period ahead. This should be complemented by adequately tight fiscal and monetary policies.

Reinvigorating the structural reform agenda will be essential to support private investment and growth. Business climate reforms have slowed, there is renewed accumulation of arrears in the power sector, and continued financial losses of ailing public sector enterprises pose fiscal risks. Reform priorities should include ensuring a financially-sound and growth-supporting energy sector, restructuring and attracting private sector participation in public sector enterprises, bolstering social protection, strengthening the business climate, and continuing to foster financial deepening and inclusion.

Bangladesh

The economy remains strong. Real GDP growth in FY17 was 7.3 percent. Following a supply-side increase in food prices, inflation appears to be stabilizing at around 6 percent, broadly in line with the authorities' target.

Preliminary data show that the FY17 fiscal deficit turned out to be somewhat below the original budget target of 5 percent of GDP. Public debt remains relatively low, slightly above 30 percent of GDP. Higher imports, mainly capital goods, combined with slower export growth and lower remittances, pushed the current account balance into a small deficit in FY17 and the first quarter of FY18. Foreign reserves remain broadly stable at $32 billion (around 7 months of imports). The need to sterilize FX intervention has declined while acceleration of domestic credit growth has helped reduce excess liquidity in the banking sector. Money and credit growth are broadly in line with the monetary program targets and sufficient to support robust economic activity.

Although the economic impact so far is limited, the Rohingya refugee surge would have implications for economic policies. Since late August, over 600,000 Rohingya refugees arrived into Bangladesh, creating a difficult humanitarian challenge. A large share of the immediate relief needs has been met with support from the international community. However, if the situation persists, assisting the refugees and integrating them into the local community could have a sizeable impact on the budget.

The outlook remains broadly positive. Real GDP growth is expected to remain around 7 percent over the medium term. Headline inflation is projected to remain at around the current levels as the effect of the food price shock fades. Despite the delay in the VAT launch, the fiscal deficit is expected to remain close to the 5 percent-of-GDP target, and the public debt-to-GDP ratio to remain broadly stable. On the back of major infrastructure projects and a slowdown in remittances, the current account balance is expected to remain in a slight deficit over the medium term, with international reserves remaining adequate.

However, maintaining the past growth performance will become more challenging in the future, and will require further increasing investment and upgrading the policy-making practices and institutions.

Domestic revenue collection needs to be boosted, to provide fiscal space for growth-enhancing public investment and social spending. Non-market budget borrowing continues to increase, hampering the development of a government bond market and the implementation of a sound debt management strategy. The acceleration of credit to the private sector reflects a pick-up in much-needed investments. However, as the level of non-performing loans remains high despite robust economic growth, financial sector regulation and supervision will need to be further strengthened. To provide alternative sources of long-term investment financing, improving the business environment and developing a well-functioning domestic capital market is a medium-term priority.

Sri Lanka

Weather-related supply shocks dominated growth and inflation developments in 2017. Contracting agriculture—due to the 2016 drought and 2017 floods—further pulled down GDP growth to 3.3 percent (y/y) in 2017Q3 after growing at 3.9 percent during 2017H1. Growth in 2018 is expected to be driven by manufacturing, construction, and services, as agriculture rebounds with dissipating weather-related shocks. Headline inflation (y/y) peaked in October 2017 spiking to 7.8 percent, due to weather-driven food inflation and the base effect of VAT rate hikes in November 2016. Since then, both headline inflation and core inflation declined to 7.1 percent and 4.3 percent respectively in December but food inflation remained high at 14.4 percent. Inflation is expected to stabilize to mid-single digits in 2018. Though slowing down gradually with monetary tightening since 2016, private sector credit growth remained high at 15.4 percent (y/y) in November.

On the external side, capital inflows strengthened, helping to finance the current account and fiscal deficits and reserves accumulation. Sri Lanka's external current account deficit widened to 3.5 percent of GDP in 2017H1, driven by weather-related imports of food and fuel. While exports strengthened through August due to improved EU access under GSP plus, workers' remittances and tourism receipts were weak. Portfolio inflows, however, strengthened in 2017Q2 amid a favorable global market environment, with some US$700 million flowing into government securities on net basis over April–September, helping to keep borrowing costs in check. Gross international reserves (GIR) increased from US$6 billion at end-2016 to US$7.95 billion at end-December (over 3.3 months of imports), reflecting steady foreign exchange (FX) purchases by the central bank (about US$2 billion over March-December) and a successful placement of sovereign bonds of US$1.5 billion in May.

The authorities have been implementing revenue-based fiscal consolidation since 2016 under a 3-year IMF-supported program. The fiscal deficit was reduced to 5.4 percent of GDP in 2016 (from 7 percent of GDP in 2015), supported by strong tax collections including from the VAT measures introduced in November 2016. The government has committed to achieve a primary surplus of 1 percent of GDP in 2018 and reduce the overall fiscal deficit to 3.5 percent of GDP by 2020. Under this scenario, central government debt is projected to decrease from 80 percent of GDP in 2016 to about 75 percent in 2020. Fiscal structural reforms are underway, including the new Inland Revenue Act that widens the tax net through removing exemptions (implementation starts in April 2018). Besides the income tax reform, the authorities have been strengthening tax administration and public financial management, as well as enhancing oversight and transparency of major state-owned enterprises. Financial regulation is improving, including with the phased introduction of Basel III Minimum Capital Requirement. The monetary policy framework will transition to a flexible inflation targeting regime, accompanied by greater exchange rate flexibility. A more business-friendly regulatory environment will be instrumental to promoting FDI and fostering growth.

Nepal

Real GDP growth reached 7.5 percent in 2016/17 (mid-July 2016 to mid-July 2017), after slowing to 0.4 percent in 2015/16 due to the devastating earthquakes and trade disruption at the southern border. The rebound was supported by a good monsoon, accommodative monetary policy, and rising government spending. In recent months, inflation decelerated to around 3 percent (y/y)—a multi-year low—aided by declining food prices. Economic growth is projected to moderate to 5.0 percent and inflation to pick up to about 6 percent in 2017/18 as activity begins to run up against capacity constraints.

Loose monetary conditions, along with a fourfold increase in paid-up capital required by the Nepal Rastra Bank (NRB), fueled a strong credit expansion. Private sector credit growth surged to a 7-year high of 32 percent (y/y) in February 2017. Credit growth has since moderated, to 16 percent (y/y) in December, after the NRB fully restored the ceiling on the loan-to-deposit ratio and introduced a loan-to-value ceiling on car loans. Rapid credit growth underscores the need to accelerate banking sector reforms. Building on the recent amendments to the regulatory framework, loan classification, provisioning, and banks' risk management practices should be upgraded.

The external current account balance turned to a small deficit of 0.4 percent of GDP in 2016/17, due to buoyant imports which rebounded following the trade disruption in 2015/16. Remittances have remained resilient to the weakening growth in oil-producing host countries. Gross central bank reserves have continued to grow, reaching a record US$9.4 billion (more than 9 months of imports) in December 2017.

Nepal's public debt remains low but the fiscal balance turned to a deficit, after recording surpluses in recent years. This resulted in part from a push to raise capital spending, which grew by 2.4 percent of GDP in 2016/17. The fiscal position is projected to deteriorate further in the current fiscal year with the implementation of fiscal decentralization.

The challenge now is to maintain the momentum and avoid falling back to the relatively low average historical growth of about 4 percent per annum through steady implementation of structural reforms. At the same time, with the fiscal stance becoming more expansionary, monetary policy needs to be tightened to keep inflation and balance of payments pressures in check. Fiscal policy should focus on higher and better-quality public investment and prudent implementation of fiscal decentralization through sustainable intergovernmental fiscal arrangements and the need to build public financial management capacity at the sub-national level. Hasty implementation of fiscal decentralization could strain government finances and weaken fiscal policy's stabilization function.

Bhutan

The outlook for Bhutan remains generally favorable. Growth has been robust at around 6 percent in recent years, driven by hydropower construction and services. In the medium term, commissioning of new hydropower projects will further boost output and exports, as well as fiscal revenues. Inflation has picked up from 3.7 percent at end 2016 to 5.2 percent in Q3 2017, but is projected to remain stable, benefitting partly from India's improved inflation outlook and stable Indian rupee to which Bhutan's currency is pegged.

Because of accelerated capital spending at the end of the 11th Five-Year Plan and modest domestic revenue growth, the budget deficit is expected to widen relative to 1 percent of GDP level registered in FY15/16. Funding by donors will cover part of the FY17/18 deficit, but no major new revenue policy measures are envisaged, leaving the gap to be funded domestically, including possibly by the issuance of government Treasury bonds. The fiscal outlook is also clouded by the impact of GST implementation in India, which will deprive the authorities of significant revenue from excise tax refunds (about 2 percent of GDP) from FY18/19 onward. Further, the authorities are considering new tax incentives to support business start-ups, which given the recent decline in tax revenues risks further weakening domestic revenues. Strengthening domestic revenue collection will be important in the medium-term to ensure fiscal sustainability. To that effect, the planned implementation of a modern goods and services tax will be key.

The current account deficit is projected to remain high in the near term as large hydropower projects remain in the construction phase. The deficit will continue to be financed mainly by loans and grants from India. However, over the medium-term, a sharp increase in hydropower exports are projected to improve the current account balance. Thus, international reserves, currently at about US$1.1 billion (over 10 months of imports) are projected to increase further.

Increased deposits related to hydropower construction have boosted liquidity in the banking sector. The Royal Monetary Authority (RMA) is sterilizing a large portion of the liquidity, to avoid excessive credit growth. Banks' nonperforming loans remain elevated but stable. To improve the allocation of credit to more productive activities, the RMA has recently issued guidelines for priority sector lending. The program—to be piloted throughout 2018—is intended to provide more preferential financing to cottage and small industries (both agricultural and non-agricultural).

Work is progressing on formulating the 12th Five-Year Plan (2018/19 – 2022/23). The main priorities of the 12th Five-Year Plan include maintaining macroeconomic stability, decentralizing capital spending from the central government to the provinces, and enhancing economic diversification.

Looking ahead, the main challenges facing Bhutan are effectively managing the commissioning of new large hydropower plants and their economic impact, and boosting domestic revenue collection. The effort to further develop and deepen the financial sector needs to be balanced with a focus on maintaining financial stability.

Islamic Republic of Afghanistan

Constrained by weak confidence owing to continued difficult security conditions and political uncertainty—with parliamentary elections this year and presidential elections in 2019—economic activity remains subdued. A modest recovery—mostly driven by agriculture—from the 1.3 percent real GDP growth rate recorded in 2015 is in train, with growth rising to 2.4 percent in 2016. Inflation picked up to 7.5 percent y/y earlier in 2017, but moderated to 3 percent in December as global food price inflation eased.

A small overall fiscal surplus (including grants) of 0.1 percent GDP was recorded in 2016 and is estimated for 2017. The improvement (from a 1.4 percent deficit in 2015) continues to be mainly on the operating budget—that is expenditure and revenue not related to development projects—with domestic revenues gaining more ground in 2017. In 2016, the operating deficit excluding grants narrowed by one percentage point of GDP to 8.2 percent and is estimated to have declined further to 7 percent in 2017. In mid-2017, domestic revenues were up 10 percent, reaching Af174.1 billion (20 percent above the June program target), reflecting improved tax administration and compliance. Revenues have likely overshot the end-year program target significantly.

The current account is estimated to have remained in surplus in 2017 mostly due to inflows of foreign aid. Afghanistan's international reserves cover nearly 11 months of imports.

In 2017, growth is estimated at 2.5 percent, followed by a modest rise to 3 percent in 2018. However, the deteriorated security situation and political uncertainty constitute important downside risks. The authorities continue to address fiscal and banking vulnerabilities by mobilizing revenue and strengthening financial sector supervision and enforcement. Substantial medium-term grant financing will be needed to finance development and security needs, facilitate the move toward fiscal sustainability, and enhance confidence in the Afghan economy.

Going forward, fiscal policy priorities are: domestic resource mobilization, to prepare for a normalization of foreign aid inflows, mostly through a broadening of the tax base, and raising the efficiency of spending through reforms in public financial and investment management. Structural reform priorities include promoting private sector activity by boosting anti-corruption efforts, accelerating financial sector reforms, and strengthening the business climate.

Maldives

Maldives' economic growth has been highly volatile, driven primarily by high-end tourism and construction. The economy grew by 3.9 percent (estimated) in 2016 and continues to improve in 2017 on a recovery in tourism and a continued strength in construction, but faces large and growing imbalances. Monetary policy remains accommodative and private sector credit has grown rapidly, led by the housing and construction. Headline inflation continued to decline in 2016 (period average) and is projected to remain low with some lift from the subsidy phase out.

The economy continues to be exposed to vulnerabilities from the wide current account (CA) deficit, low international reserves, and a highly fragile fiscal position. The fiscal deficit widened in 2016 driven by lower-than-expected revenue and large arrears clearance despite unchanged current spending. The CA deficit widened sharply in 2016, due to increased infrastructure-related imports, moderating tourism receipts, higher remittance outflows, and a large one-off payment. The real exchange rate is assessed to be well above the norm at end-2016, while the CA is assessed to be well below. Reserve coverage declined to 1.8 months of imports at end-2016.

Policy priorities should be to reduce fiscal and external deficits, build adequate foreign exchange reserves, develop the financial sector, and enhance longer-term growth potential through structural reforms. Fiscal policy tightening is urgently needed to restore fiscal sustainability and reduce external imbalances. Fiscal policy should focus on implementing revenue measures, containing current spending, and prioritizing investment projects. Monetary policy should be tightened to support the buildup of reserves and the stabilized exchange rate arrangement.

Growth is projected to recover in 2017 and stabilize over the medium term, benefitting from the infrastructure scale up, continued recovery in Europe, and favorable short-term and long-term tourism trends. Both the fiscal and CA deficits are projected to gradually decline over the medium term, after widening in 2016, as infrastructure spending winds down. The main challenge remains one of balancing a surge in infrastructure investment that has the potential of transforming the economy against the continuing risks stemming from high and increasing public debt.

The national accounts have been revised for 2003-15. The average rebased GDP is higher by around 11 percent annually (2003-15), compared to the 2003-based GDP estimates. The actual outturn for 2016, will be reflected as part of the January 2018 WEO dataset.

India: High-Frequency Economic Activity Indicators

% y-o-y	2012		2013		2014		2015		2016										2017											
	H1	H2	H1	H2	H1	H2	H1	H2	Q1	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec
Consumption																														
Domestic passenger vehicle sales	12.8	6.5	-9.7	-5.0	-2.9	4.9	5.0	10.4	2.5	11.0	6.3	2.7	16.8	16.7	19.9	4.5	1.8	-1.4	14.4	9.0	10.0	14.7	8.6	-11.2	15.1	13.8	11.3	-0.3	14.3	
Aviation: Passenger traffic	4.9	-9.1	0.1	9.8	4.3	14.2	19.8	20.9	24.3	20.5	20.5	20.2	26.3	23.5	23.8	23.6	22.0	23.9	25.6	15.4	14.4	14.8	17.4	20.0	12.2	15.6	16.3	19.9	16.5	
Cellular subscribers	16.2	7.6	-0.3	1.8	9.1	6.6	-2.3	1.5	10.3	8.7	8.0	7.9	8.0	7.6	7.2	7.1	7.0	7.2	19.0	19.7	18.1	21.2	22.2	22.7	22.6	21.4	20.9	22.2	21.6	
Consumer credit	12.4	14.1	13.3	13.6	14.1	14.6	16.4	17.6	18.9	19.7	19.1	18.5	18.8	18.1	19.7	17.0	15.2	13.5	12.9	12.0	16.4	14.4	13.7	14.1	15.0	15.7	16.8	16.0	17.3	
Rural wages (male)	18.2	18.5	17.2	20.2	25.4	15.3	7.0	6.1	5.9	6.3	6.3	6.3	5.8	5.7	5.3	5.7	5.9	6.1	6.2	6.2	5.8	6.1	5.7	5.4	6.2	5.9	6.1	5.7		
Domestic two-wheeler sales	10.8	1.1	-0.7	8.6	13.1	9.6	0.2	1.5	8.6	21.2	9.7	12.3	13.5	26.3	21.8	8.7	-5.9	-22.0	-7.4	0.0	0.3	7.3	11.9	4.0	13.7	14.7	9.1	-2.8	23.5	
Investment																														
Railway traffic: Net tonne km	4.1	0.5	0.3	1.9	2.2	7.1	2.2	-4.9	-8.4	-13.3	-8.2	-4.4	-7.0	-7.5	-9.6	-7.2	-1.0	-5.6	-3.5	-0.7	3.3	3.1	4.5	2.5	4.0	6.1	4.9	6.8	6.6	12.3
Government Capex (YTD)	-18.0	8.3	13.6	26.3	-20.2	-12.6	45.1	42.1	16.5	-20.5	-12.0	-16.4	-17.1	-0.7	5.3	-12.8	-10.4	-3.8	-2.7	-1.5	14.7	16.5	19.8	18.7	18.8	16.1	12.6	19.9	20.0	
External sector																														
Visitor arrivals	6.7	2.0	4.5	7.3	10.1	10.4	3.7	5.3	9.7	9.3	3.5	6.8	16.8	8.8	12.1	8.6	7.6	11.9	16.4	12.7	11.8	25.0	19.5	22.5	7.4	11.0	18.9	18.1	14.4	
Exports value	0.0	-4.1	2.3	10.1	3.8	1.1	-15.3	-18.6	-7.8	-5.8	-0.5	1.5	-6.8	0.1	4.1	8.9	2.6	6.4	5.1	22.5	27.2	17.9	7.0	2.1	3.2	9.1	25.8	-1.1	30.5	
Export (ex-oil) value	0.2	-8.5	0.1	10.8	3.4	3.1	-7.3	-10.9	-5.6	-3.0	1.8	3.7	-4.8	1.9	4.7	8.8	2.3	5.6	2.2	21.6	22.5	15.6	6.2	4.5	2.9	7.6	24.0	-2.3	29.7	
Imports (ex-oil, gold) value	7.9	-5.3	-0.7	-6.4	-3.8	12.3	3.9	-5.9	-3.8	-18.0	-4.6	-1.9	-10.5	-1.2	-1.0	5.0	11.5	5.3	4.0	4.0	19.8	43.6	22.9	17.5	12.1	21.0	19.8	4.9	22.6	
Industry																														
Industrial production	0.6	0.8	0.0	3.9	4.9	4.1	1.8	3.3	5.4	6.0	7.3	8.0	4.5	4.0	5.0	4.2	5.1	2.4	3.5	1.2	4.4	3.2	2.9	-0.3	1.0	4.5	4.1	2.2		
Manufacturing PMI*	55.9	53.7	51.0	50.6	51.7	53.6	52.1	50.2	51.9	50.5	51.5	51.2	51.8	52.4	52.6	56.1	50.4	48.6	49.8	50.7	54.0	52.5	51.9	50.3	46.8	52.3	51.6	50.5	53.1	54.5
Corporate (industry) credit	18.4	15.9	14.6	16.5	13.3	7.8	6.1	5.5	6.1	3.9	3.9	3.7	4.1	4.1	7.0	2.2	0.3	0.1	-0.4	-0.7	4.9	0.6	0.2	1.1	1.6	1.7	2.4	3.4	5.9	
Coal output	10.8	5.0	-1.8	2.6	3.8	10.0	5.6	4.4	4.6	-1.8	6.0	12.1	4.1	-9.7	-6.7	-1.9	6.1	3.6	3.5	6.6	10.6	-3.3	-3.2	-6.7	0.6	15.4	10.4	3.9	-0.2	
Steel output	9.8	5.5	5.1	7.6	9.9	6.9	-1.9	-3.6	4.5	4.5	13.4	8.8	0.0	16.7	16.1	17.4	5.4	15.9	11.3	8.7	11.0	9.0	3.8	6.0	9.4	2.2	3.7	8.4	16.6	
Cement output	9.9	6.0	6.7	3.8	6.1	7.0	-0.2	3.2	11.8	4.3	2.7	10.5	0.7	3.1	6.7	6.2	0.5	-8.7	-13.3	-15.8	-6.8	-5.2	-1.4	-3.3	1.0	0.7	0.1	-1.3	17.3	
Electricity generation	5.7	3.6	2.7	6.7	12.5	16.4	5.7	5.5	9.2	14.5	6.2	9.8	2.1	2.2	5.1	3.0	9.5	6.4	5.2	1.2	6.2	5.3	8.2	2.2	6.6	8.3	3.4	3.2	1.9	
Services																														
Services PMI*	55.3	54.3	52.7	47.5	52.9	51.3	50.9	52.5	53.0	54.3	51.4	50.4	51.1	54.4	52.2	55.0	43.1	46.3	49.4	53.1	51.8	50.8	53.1	53.8	43.5	46.4	51.9	52.9	45.4	50.9
Light commercial vehicles	18.2	-0.4	1.6	-15.2	-22.9	-7.3	-3.1	1.3	13.9	9.1	10.7	18.0	9.5	11.0	4.1	2.9	15.0	-18.4	0.4	-0.6	3.6	-7.9	0.9	1.0	20.1	5.8	10.3	10.9	26.1	
Medium & heavy commercial vehicles	-4.5	-22.8	-27.3	-34.2	-6.3	32.5	24.7	31.6	27.7	21.7	27.7	15.4	2.2	-14.9	-32.4	23.6	16.3	-20.6	-1.1	-9.8	1.7	-55.9	-58.0	-20.8	1.5	10.9	23.7	16.5	3.4	
Railway traffic: passenger	4.7	3.2	-0.9	-1.1	3.1	-5.6	-6.6	1.9	2.0	0.0	1.1	-1.2	0.2	1.8	-0.1	-1.0	7.0	-1.5	1.3	-0.7	2.3	2.1	2.7	1.4	1.8	-2.5	-1.4	4.6	-4.6	1.4
Airline: cargo traffic	-3.6	-5.1	-3.9	5.8	10.2	12.5	7.8	4.8	10.2	4.4	7.5	8.9	7.4	8.1	9.8	13.5	9.0	10.6	13.7	9.4	18.3	17.4	17.2	13.9	10.9	16.3	18.6	5.2	19.6	
Deposits	14.5	13.5	13.4	13.7	14.4	12.0	11.1	10.5	9.1	9.5	8.9	9.2	8.4	9.0	12.8	9.3	15.6	14.8	12.8	12.0	15.4	10.9	10.3	12.7	9.5	8.9	8.2	8.7	3.4	3.9
Bank Credit	17.3	16.6	15.0	15.0	13.9	10.8	9.4	9.3	10.4	10.0	9.4	9.1	8.5	8.9	11.8	8.7	6.2	4.7	4.3	3.7	8.2	4.9	4.8	8.1	5.6	6.3	6.6	6.8	9.7	10.7
Other indicators																														
Service Taxes (YTD)	38.7	30.7	32.0	21.0	14.4	5.2	10.3	27.9	28.2	13.3	30.1	28.5	26.1	24.4	22.8	24.5	27.1	25.0	23.3	21.3	20.4	14.3	10.2	20.4	14.3	-6.5	-21.5	-37.6	-46.1	
Gross tax (ex-service tax) (YTD)	14.2	9.9	11.2	9.4	7.6	8.6	15.8	21.3	6.9	64.3	40.2	30.9	26.8	21.4	15.6	16.9	20.6	17.2	16.7	16.9	17.4	36.1	28.1	14.3	17.6	25.1	26.5	29.0	28.2	
OECD Composite leading indicators*	99.2	98.7	98.4	98.5	99.2	99.8	100.1	100.2	100.1	100.1	100.1	100.0	99.9	99.9	99.8	99.7	99.6	99.5	99.5	99.4	99.4	99.4	99.5	99.5	99.6	99.7	99.8	99.9		

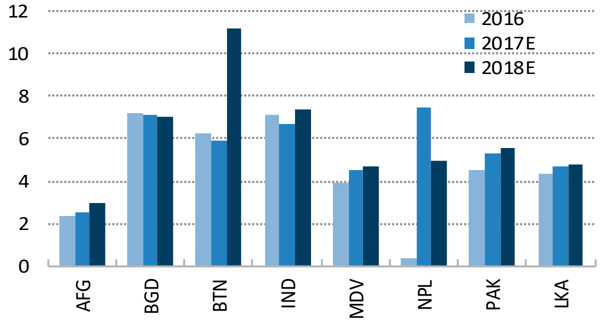
Sources: CEIC Data Company Ltd., Haver, OECD, and IMF staff estimates.

* Index values. Note: The cell is highlighted in dark green if the growth is above average. The cell is highlighted in dark red if the growth is below average. The average for each data series covers data points since 2012 H1 to latest month.

South Asia: Recent Economic Developments and Outlook

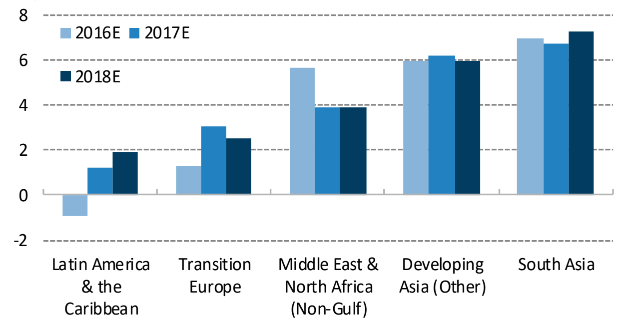
Economic growth is expected to accelerate in 2018 in most South Asian countries

Real GDP Growth
(In percent, YoY)



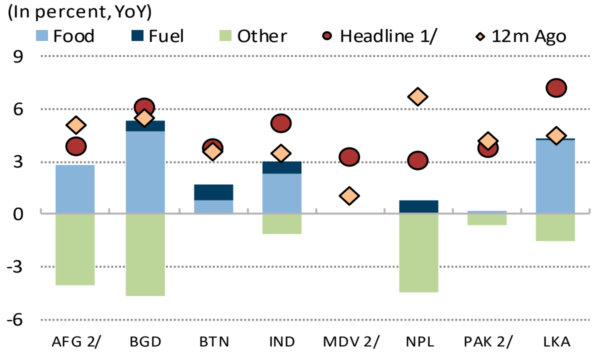
South Asia's growth exceeds growth in comparator regions

Emerging Regions: Real GDP Growth
(In percent, YoY)



Inflation remains anchored, with Nepal's inflation rate having decreased substantially

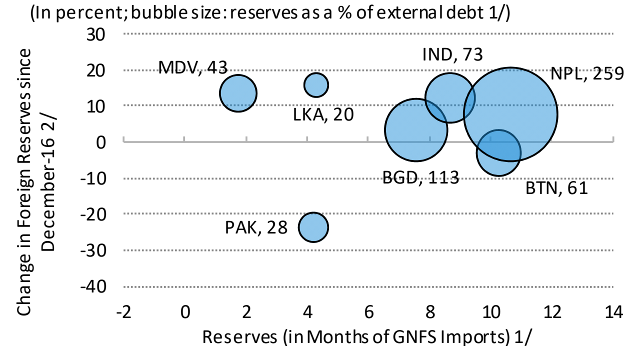
Inflation: Headline and Contributions to Change
(In percent, YoY)



1/ LKA, IND (Dec-17); PAK, NPL (Oct-17); BGD, AFG (Sep-17); MDV (Jan-17); BTN (Dec-16).
2/ Fuel series unavailable.

Foreign exchange reserves have grown, except in the Pakistan and Bhutan

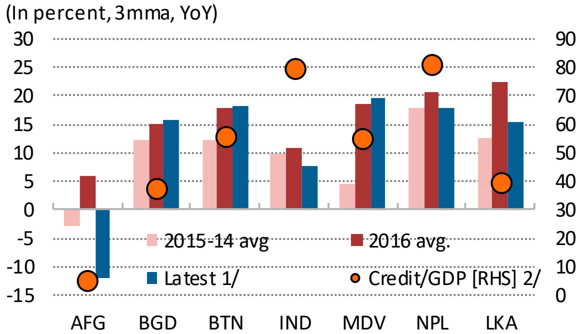
Foreign Reserves
(In percent; bubble size: reserves as a % of external debt 1/)



1/ IND, NPL, PAK, LKA, BGD (2017); MDV, BTN (2016).
2/BGD, IND (Dec-17); NPL, PAK, MDV (Nov-17); LKA (Oct-17); BTN (Jun-17).

Credit growth is accelerating in many South Asian economies, but remains modest in India

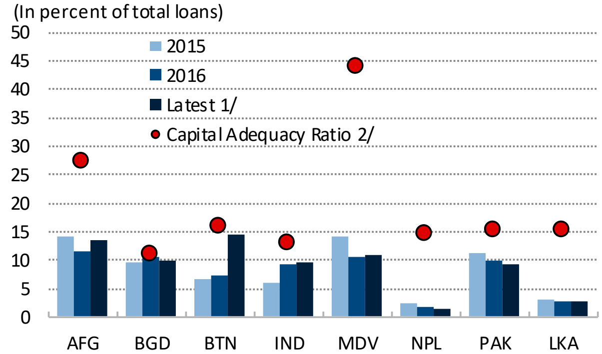
Credit to the Economy
(In percent, 3mma, YoY)



1/ LKA (Nov-17); IND (Sep-17); NPL (Oct-2017); MDV (Feb-17); BTN (Dec-16); BGD, AFG (Aug-17).
2/ IND,NPL,AFG,BGD,BTN (2017); LKA,MDV (2016); Maldives 2016 number is IMF staff estimates.

Impaired loans are large in some banking systems, but capitalization appears adequate

Nonperforming Loans Ratio
(In percent of total loans)



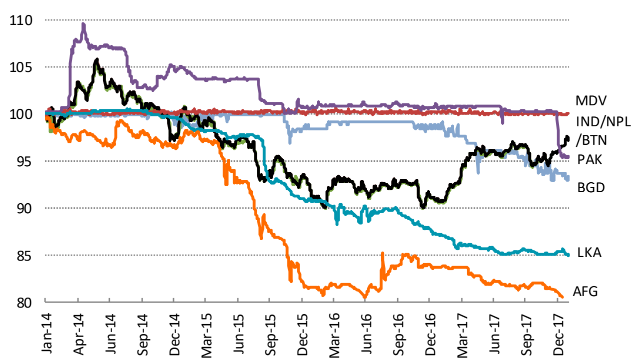
1/ BGD, NPL (2017Q4); MDV, IND, BTN, PAK, LKA (2017Q3), AFG (2017Q1).
2/ NPL (2017Q4); MDV, IND, BTN, LKA, PAK, BGD (2017Q3); AFG (2017Q1).

Sources: IMF, *International Financial Statistics*; IMF, *Financial Soundness Indicators;* IMF, *World Economic Outlook*; national monetary authorities; Haver Analytics; Bloomberg; and CEIC. Country acronyms denote: Islamic Republic of Afghanistan (AFG); Bangladesh (BGD); Bhutan (BTN); India (IND); Maldives (MDV); Nepal (NPL); Pakistan (PAK); and Sri Lanka (LKA). EM denotes emerging market economies.

South Asia: Recent Economic Developments and Outlook, cont'd

Nominal exchange rate flexibility is a policy feature in several South Asian economies

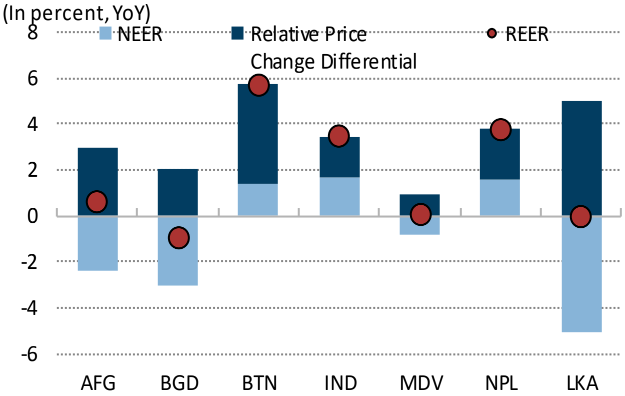
Exchange Rates
(USD/LCU, Index, Jan 1 2014 = 100, 5-day moving average) 1/ 2/



1/ LCU = Local currency unit.
2/ BTN and NPL have pegs with the Indian rupee.

Cross currency movements have been a prominent driver of real exchange rates

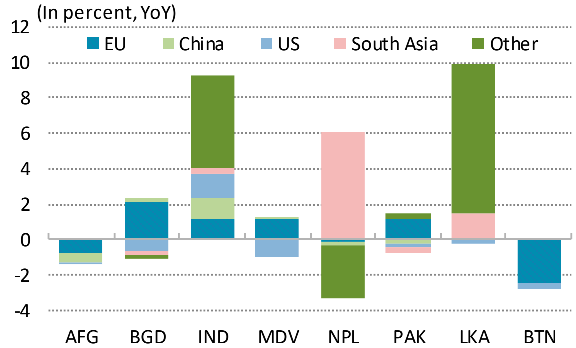
Contributions to changes in REER 1/
(In percent, YoY)



1/ As of October 2017.

Intra-South Asian trade remains small—links to advanced economies and large EMs are key

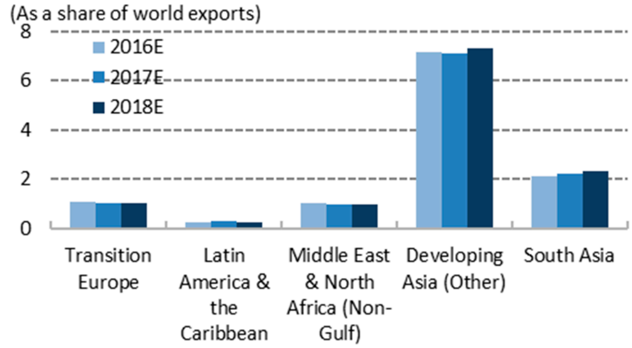
Contributions to Export Growth 1/
(In percent, YoY)



1/ As of August 2017.

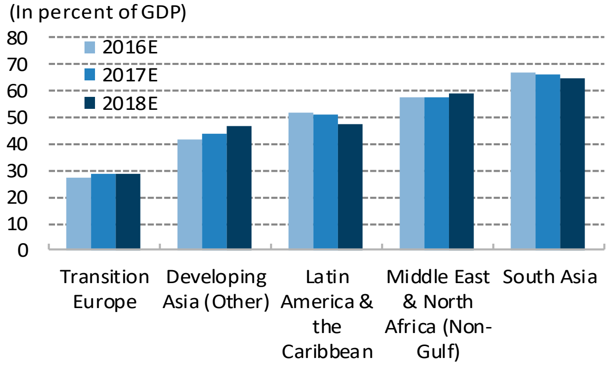
South Asia's share of world trade continues to grow, but remains relatively limited

EM's Exports of G&S
(As a share of world exports)



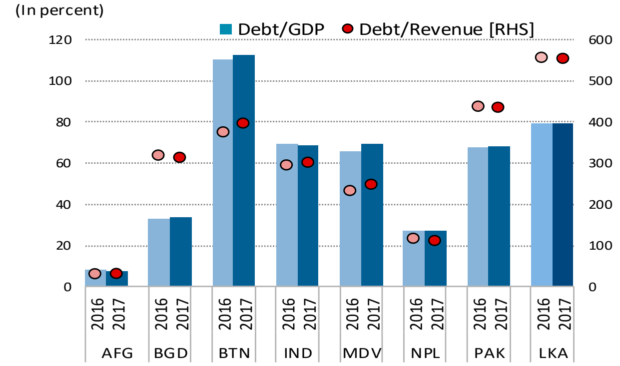
While declining, South Asia public debt remains the highest among comparator regions

EM's Government Debt by Region
(In percent of GDP)



Public debt-to-GDP ratios have increased, while debt-to-revenue ratios have fallen in some South Asian countries

South Asia: Public Debt
(In percent)



Sources: IMF, *Direction of Trade Statistics*; IMF, *World Economic Outlook*; CEIC; Haver Analytics; and Bloomberg. Country acronyms denote: Islamic Republic of Afghanistan (AFG); Bangladesh (BGD); Bhutan (BTN); India (IND); Maldives (MDV); Nepal (NPL); Pakistan (PAK); and Sri Lanka (LKA). EM denotes emerging market economies.

South Asia: Selected Economic Indicators

	Average 2001-10	2012	2013	2014	2015	2016	Projections 2017	2018
Real GDP Growth	**7.0**	**5.5**	**6.0**	**7.0**	**7.4**	**6.7**	**6.5**	**7.1**
(Annual change; percent)								
Afghanistan	…	14.0	5.7	2.7	1.3	2.4	2.5	3.0
Bangladesh	5.8	6.3	6.0	6.3	6.8	7.2	7.1	7.0
Bhutan	8.4	6.4	3.6	4.0	6.1	6.2	5.9	11.2
India	7.6	5.5	6.4	7.5	8.0	7.1	6.7	7.4
Maldives	7.1	2.3	7.1	7.6	3.3	3.9	4.6	4.7
Nepal	4.0	4.8	4.1	6.0	3.3	0.4	7.5	5.0
Pakistan	4.6	3.8	3.7	4.1	4.1	4.5	5.3	5.6
Sri Lanka	5.1	9.1	3.4	5.0	4.8	4.4	4.7	4.8
Consumer Price Inflation	**6.6**	**9.8**	**9.0**	**6.1**	**4.9**	**4.4**	**4.0**	**4.9**
(Year average; percent)								
Afghanistan	…	6.4	7.4	4.7	-0.7	4.4	6.0	6.0
Bangladesh	6.3	6.2	7.5	7.0	6.2	5.7	5.7	5.8
Bhutan	4.6	9.3	11.3	9.9	6.3	3.9	3.5	4.2
India	6.2	10.0	9.4	5.8	4.9	4.5	3.8	4.9
Maldives	4.1	10.9	4.0	2.5	1.4	0.8	2.5	2.1
Nepal	6.2	8.3	9.9	9.0	7.2	9.9	4.5	6.0
Pakistan	8.2	11.0	7.4	8.6	4.5	2.9	4.1	4.8
Sri Lanka	11.1	7.5	6.9	2.8	2.2	4.0	6.0	5.0
General Gov. Overall Fiscal Balance	**-7.6**	**-7.2**	**-6.8**	**-6.6**	**-6.6**	**-6.1**	**-6.1**	**-6.0**
(Percent of GDP)								
Afghanistan[1]	…	0.2	-0.6	-1.7	-1.4	0.1	0.4	0.2
Bangladesh[1]	-2.9	-3.0	-3.4	-3.1	-3.9	-3.4	-4.5	-5.0
Bhutan	-2.2	-2.4	-5.8	2.9	-0.2	-2.1	-4.4	-6.1
India	-8.7	-7.5	-7.0	-7.2	-7.1	-6.6	-6.4	-6.2
Maldives	-7.0	-6.9	-6.6	-7.7	-7.5	-9.7	-8.0	-7.2
Nepal	-1.6	-2.1	1.3	0.8	-0.6	0.9	-3.1	-4.0
Pakistan	-3.8	-8.6	-8.4	-4.9	-5.3	-4.4	-5.7	-5.4
Sri Lanka[1]	-6.9	-5.6	-5.2	-6.2	-7.0	-5.4	-5.2	-4.7
Current Account Balance	**-0.6**	**-4.1**	**-1.5**	**-1.1**	**-0.9**	**-0.7**	**-1.6**	**-1.8**
(Percent of GDP)								
Afghanistan	…	10.8	0.3	5.7	3.0	7.1	4.7	1.6
Bangladesh	0.5	0.7	1.2	1.2	1.6	0.6	-0.7	-1.3
Bhutan	-13.1	-21.5	-25.4	-26.4	-28.3	-29.1	-29.4	-16.6
India	-0.8	-4.8	-1.7	-1.3	-1.1	-0.7	-1.4	-1.5
Maldives	-12.6	-6.6	-4.3	-3.2	-7.3	-19.6	-17.2	-17.0
Nepal	2.5	4.8	3.3	4.5	5.0	6.3	-0.4	-0.7
Pakistan	-1.5	-2.1	-1.1	-1.3	-1.0	-1.7	-4.0	-4.9
Sri Lanka	-2.7	-5.8	-3.4	-2.5	-2.4	-2.4	-2.5	-2.3

Sources: IMF, *World Economic Outlook* ; national monetary authorities; and IMF staff estimates and projections.

[1]Central government.

Notes: Regional aggregates are weighted by national PPP GDP. South Asia countries have the following shares in South Asian PPP-weighted GDP in 2016: India (81.1 percent); Pakistan (9.2 percent); Bangladesh (5.9 percent); Sri Lanka (2.4 percent); Nepal (0.7 percent); Afghanistan (0.6 percent); Bhutan (0.1 percent); Maldives (0.1 percent). Variables reported on a fiscal year basis for India (April/March); Bhutan, Pakistan (July/June); Afghanistan (March 21/March 20 until 2011, and December 21/December 20 thereafter); Nepal (August/July); Bangladesh (Fiscal Balance only: July/June). Sri Lanka real GDP growth numbers reflect projections based on the revised (2010 base) national accounts data published by the authorities.