World Economic Situation and Prospects

2019

United Nations

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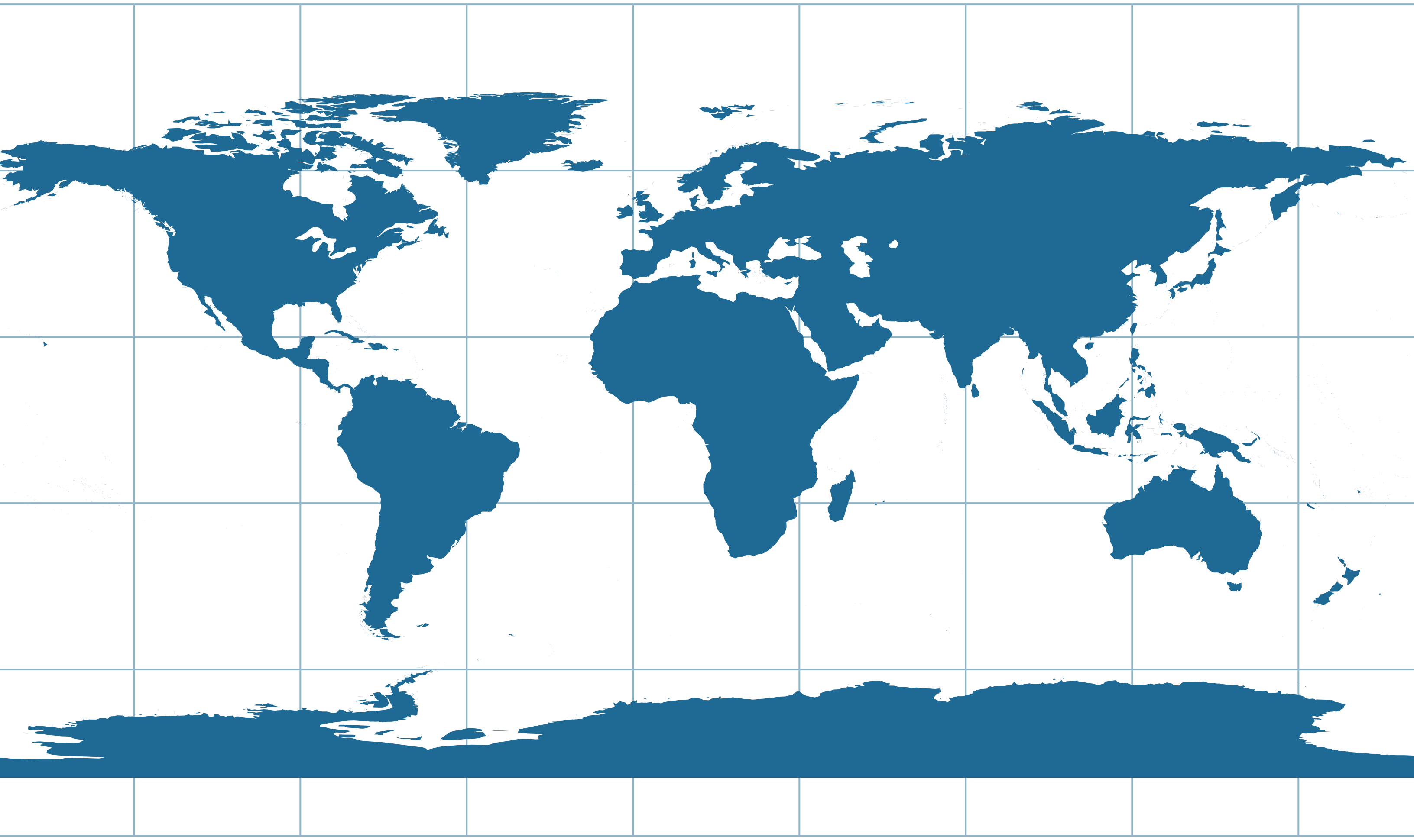
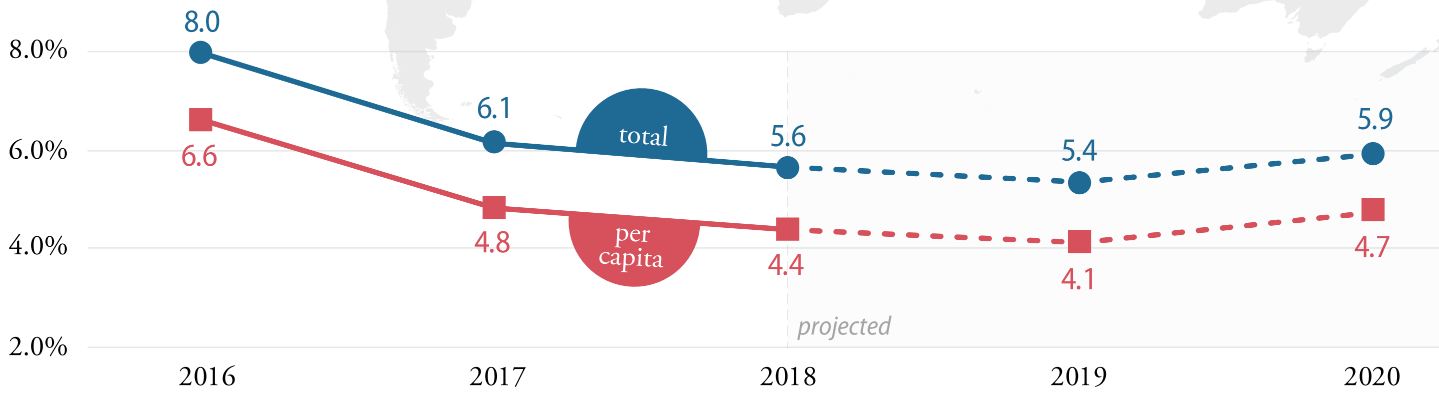


United Nations
New York, 2019

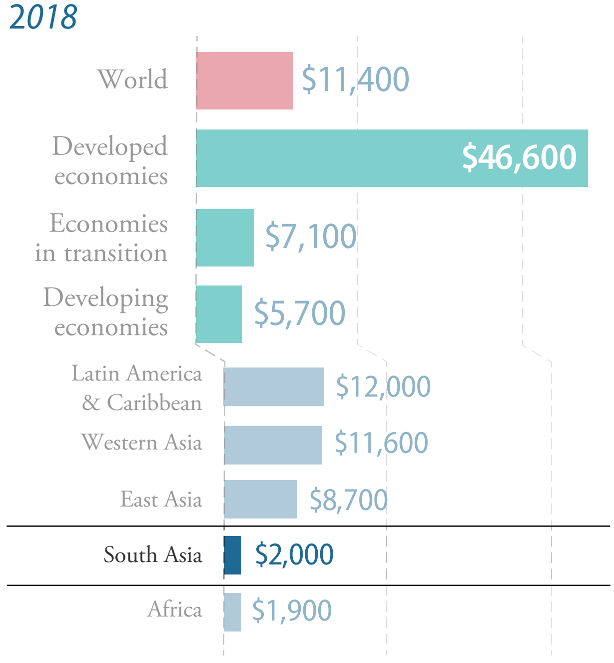
South Asia

GDP Growth



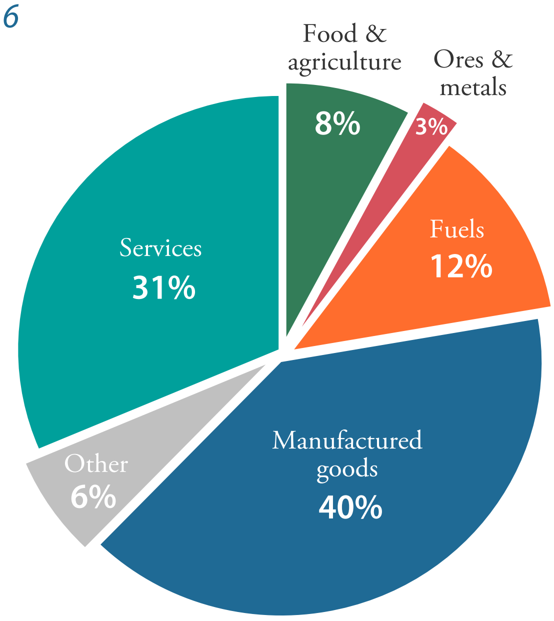
GDP per capita

2018



Exports structure

2016



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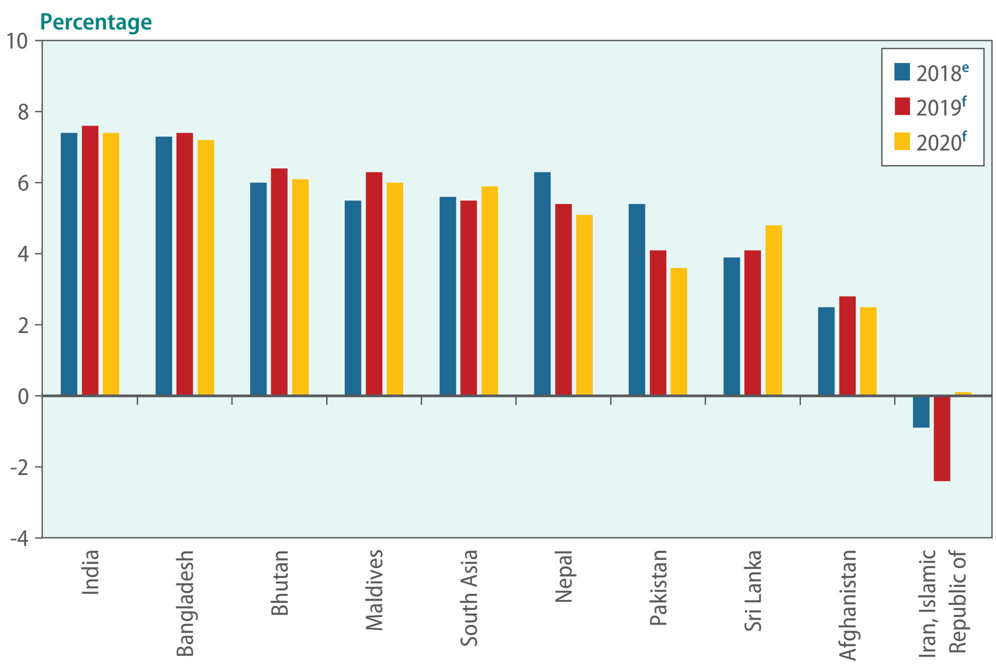
South Asia: economic outlooks diverge as short- and medium-term challenges remain

- South Asia's outlook remains moderately favourable, but economic trends are highly divergent across countries
- The downside risks have increased in several economies in the short-term
- The region needs to strengthen productive capacities and international competitiveness to unleash its growth potential in the medium-term

The economic outlook for South Asia is moderately positive...

The economic outlook for South Asia is highly divergent across countries. There are some economies, including Bangladesh, Bhutan and India, where economic conditions are largely positive, with GDP growth projected to remain robust in the near term. In contrast, the outlook in the Islamic Republic of Iran and Pakistan has visibly deteriorated. Consequently, regional GDP growth slowed down markedly in 2018. Yet, given the large size of the Indian economy, on the aggregate, the regional outlook is still moderately favourable, especially in comparison to other developing regions. Regional GDP is expected to expand by 5.4 per cent 2019 and 5.9 per cent in 2020, after an estimated expansion of 5.6 per cent in 2018 (figure III.22). Economic growth is expected to be supported by private consumption and, in some cases, investment demand, even as monetary policy stances tighten in some economies. Despite the increase observed for inflation figures throughout 2018 due to the depreciation of domestic currencies and higher oil prices, inflation is expected to accelerate only moderately or to remain stable in most economies in the near term, with the notable exception of the Islamic Republic of Iran.

Figure III.22
GDP growth in South Asia, 2018–2020



Source: UN/DESA.
Note: e=estimate, f=forecast. GDP growth numbers are based on a fiscal year basis for Afghanistan, Bangladesh, India, Iran (Islamic Republic of), Nepal and Pakistan, while on a calendar year basis for Bhutan, Maldives and Sri Lanka.

…but the domestic and external downside risks have increased across the region

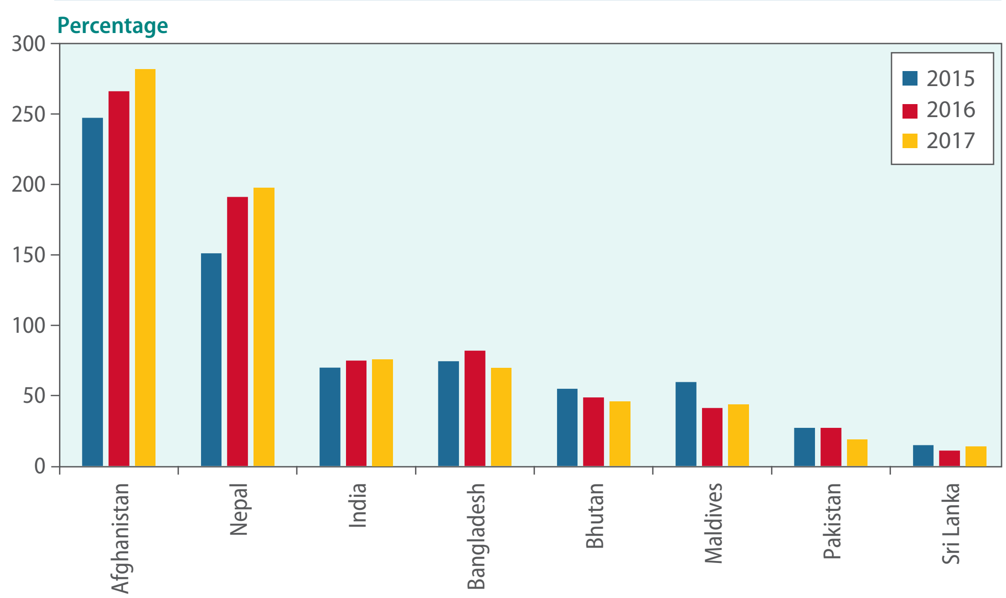
The downside risks to the projections have recently increased across the region, because of domestic and external factors. On the domestic side, political uncertainties, setbacks in the implementation of reforms and, in some countries, security problems can affect investment prospects. This is a crucial issue, as the region needs to tackle the infrastructure bottlenecks for promoting productivity growth, encouraging further poverty reductions and adjusting to climate change. Also, natural disasters, including those associated with climate change, constitute a major source of risk to economic activity. On the external side, an abrupt tightening of global financial conditions, coupled with a further escalation of the ongoing trade disputes, is also a significant downside risk to the outlook. For example, more challenging external conditions can further expose macroeconomic imbalances and financial vulnerabilities associated with rising fiscal and current account deficits and elevated levels of debt in some economies. Notably, most economies have insufficient foreign-exchange reserves to face severe external shocks (figure III.23). In addition, given that South Asia is a net oil importer, a significant rise in oil prices could raise inflationary pressures and constrain economic activity in several economies.

Economic activity in India and Bangladesh remains vigorous

The Indian economy is expected to expand by 7.6 and 7.4 per cent in 2019 and 2020, respectively, after expanding by 7.4 per cent in 2018. Economic growth continues to be underpinned by robust private consumption, a more expansionary fiscal stance and benefits from previous reforms. Yet, a more robust and sustained recovery of private investment remains a crucial challenge to uplifting medium-term growth. The Bangladesh economy is also set to continue expanding at a fast pace in the near term, above 7.0 per cent per year, amid strong fixed investment, vigorous private consumption and accommodative monetary policy. Meanwhile, Sri Lanka's economy is recovering from the slowdown in 2017, but much more slowly than anticipated, amid weak business sentiment, feeble investment demand and political turbulences. Growth is projected to remain below its potential in the near term.

However, some economies are also experiencing significant difficulties, underscoring short-term macroeconomic and financial challenges. The economic outlook in the Islamic

Figure III.23
South Asia: total reserves over external debt, 2015–2017



Sources: UN/DESA, based on data from World Bank's International Debt Statistics database.

Note: Data for Nepal correspond to 2014, 2015 and 2016, respectively.

Republic of Iran has deteriorated visibly, due to the re-imposition of trade, investment and financial sanctions by the United States, and structural domestic weaknesses. The sanctions have already exacerbated goods shortages and constrained productive capacity and oil export revenues. The depreciation of the domestic currency has also fuelled inflationary pressures: inflation reached record highs of more than 30.0 per cent by October and is projected to remain elevated in the near term. Against this backdrop, the Iranian economy is estimated to have entered into recession in 2018, which is projected to deepen throughout 2019. Importantly, weaknesses associated with severe underinvestment and lack of technology transfers for more than a decade will continue to constrain economic activity in the medium term.

Meanwhile, the economic outlook in Pakistan is challenging, and it encompasses significant downside risks. On the one hand, economic activity continues to be underpinned by robust private consumption, improvements in energy supply, and infrastructure initiatives of the China-Pakistan Economic Corridor. On the other, Pakistan's economy is facing severe balance of payment difficulties, amid large twin fiscal and current account deficits, a visible decline in international reserves and mounting pressures on the domestic currency. The level of public debt is also high—close to 70 per cent of GDP—with rising sustainability concerns. In fact, the Government is currently negotiating for official assistance from the IMF to address macroeconomic and fiscal challenges for the second time in the last five years. Against this backdrop, growth is projected to slow down markedly in 2019 and 2020 to below 4.0 per cent, after an estimated expansion of 5.4 per cent in 2018. The macroeconomic imbalances and financial fragilities pose significant risks of a further slowdown, which emphasizes the need for policy actions. This highlights some long-standing challenges for Pakistan's economy. To promote more sustainable medium-term growth, policymakers need to encourage much-needed infrastructure investment to alleviate chronic energy shortages while addressing external imbalances, particularly by promoting export growth.

Improving labour market conditions is a major challenge

Strengthening labour market indicators is a crucial aspect to forge a more inclusive development trajectory in South Asia. However, employment growth has recently slowed down in the region, and female labour force participation remains low and declining. In addition, youth unemployment is a major concern in several economies, especially given the growth of working-age populations. In India, for example, job creation rates in the formal sector have been feeble, leaving many workers underemployed or in low-salary jobs, with the situation for youth particularly worrisome. In fact, well-educated youths are struggling to find jobs in the formal sector, and most of them are absorbed into low-paying and vulnerable jobs in the informal sector.

Monetary policy stances are adjusting to more challenging external conditions…

The gradual tightening of global financial conditions is prompting the adjustment of monetary policy stances across the region. In the current context, policymakers face the challenge of maintaining growth momentum while containing inflationary pressures and facilitating domestic adjustments to lower global liquidity. Most domestic currencies across the region depreciated throughout 2018, while the current account deficits continued to rise in several countries, including Bangladesh, India and Pakistan.

Monetary policy stances have gradually and moderately tightened in several economies. In India, the central bank raised its policy interest rate by 25 basis points in both June and August, to reach 6.5 per cent, while the domestic currency depreciated to record lows in early October. Despite the depreciation, consumer price inflation moderated in the second half of 2018 and it is projected to remain within the central bank's target range. Given the currency peg of the Nepali rupee to the Indian rupee, Nepal Rastra Bank is expected to follow the same tightening path in the near term. During the first eight months of 2018, Pakistan's central bank raised its policy interest rates by 275 basis points to 8.5 per cent, and expectations are that the tightening will continue further in 2019. Despite this tightening, the significant depreciation of the domestic currency has increased consumer price inflation.

…while fiscal policies have recently become more expansionary

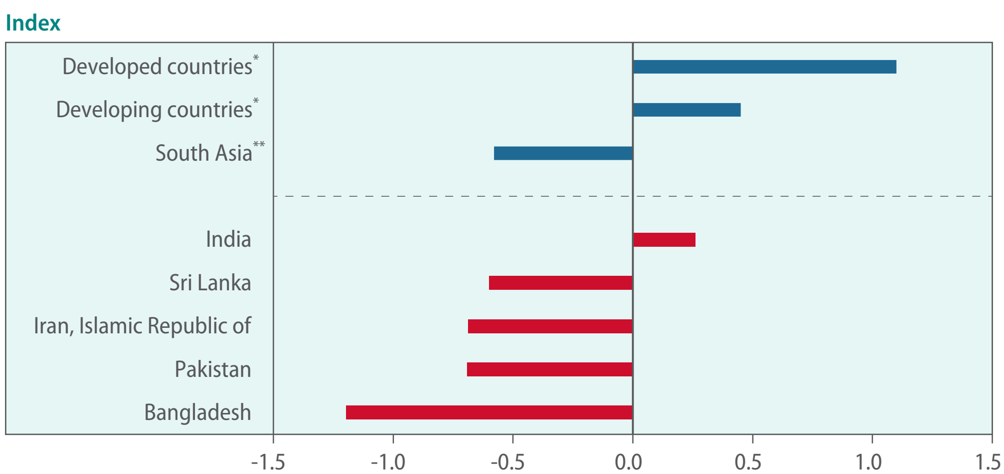
The fiscal policies across the region have gradually moved to a more expansionary stance; thus fiscal deficits are projected to remain elevated. To avert sustainability concerns, medium-term consolidation plans are required in some economies, particularly those with a fragile tax base and elevated levels of debt. For example, in India the size and composition of public budgets have been important in promoting growth, prioritizing public investments in infrastructure, subsidies and welfare payments, and the rural economy. This will prevent any reduction of the fiscal deficit in the near term. In the Islamic Republic of Iran, the fiscal deficit is expected to increase in 2019, amid significantly lower oil revenues and rising pressures to enhance social benefits. Meanwhile, the fiscal deficit in Bangladesh is at a record high, close to 5.0 per cent of GDP, as the country struggles to expand the tax base. In Pakistan, entering an IMF programme by 2019 would necessitate a sharp fiscal consolidation. In fact, rising expenditures and high debt repayment obligations have maintained a relatively high fiscal deficit, about 4.8 per cent of GDP. Overall, strengthening fiscal accounts remains a major challenge for the region, amid a low level of tax revenues, rigid public expenditures and persistent structural deficits. Improved tax revenues are a critical aspect in building fiscal buffers and in strengthening the capacity to implement countercyclical and redistributive policies.

Strengthening the productive and international competitiveness is a crucial challenge to unleash the growth potential

Beyond the short-term outlook, South Asia—which accounts for 25 per cent of the world population but only for 5 per cent of the world GDP—also needs to tackle medium-term challenges and structural constraints to unleash its enormous growth potential. A crucial challenge is the strengthening of its productive and international competitiveness, as the region is lagging in several competitiveness indicators, like attracting foreign investments, penetrating new markets, and diversifying and upgrading its export products. Also, the region shows a disappointing performance regarding technological capabilities, even in comparison to other developing regions, as measured, for example, by R&D investments, innovation activities, and other indicators, such as the Economic Complexity Index (figure III.24). Amid limited trade openness and regional integration, South Asia has an enormous

Figure III.24

Economic Complexity Index, selected countries and regions, 2016



Source: UN/DESA, based on data from MIT Observatory on Economic Complexity, available from https://atlas.media.mit.edu/en/.

Note: The Economic Complexity Index measures the multiplicity of productive knowledge in an economy by combining information on the diversity of a country's exports (based on the number of its export products) and the ubiquity of its products (based on the number of countries that export a specific product); *average; ** average of the presented 5 countries.

potential to gain market share in foreign markets and to participate more decisively in global value chains (GVCs). In fact, while there are positive examples, such as the software and business outsourcing sectors in India, the garment sector in Bangladesh and Sri Lanka, and the Sialkot light manufacturing cluster in Pakistan, the positive effects of increased global integration have remained limited in most economies in the region.

South Asia needs to tackle this issue through a comprehensive policy approach. Policies to strengthen the business environment, with emphasis on industry-specific issues, can positively impact investment prospects. Also, trade policy changes can significantly reduce the elevated trade costs across the region, facilitate the access to foreign inputs to exporters and support the participation in GVCs. Meanwhile, policies regarding foreign direct investments and multinational firms can encourage not only financial flows but also productive linkages, technology transfers and training of the workforce. Public policies can also take a more proactive stance to promote innovation activities—for example, by uplifting public R&D interventions that can catalyse private R&D investments and by enhancing complementary factors, including infrastructure, labour skills and finance.