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IMF's India Article IV Staff Report 2019

According to International Monetary Fund (IMF's) Press Call on the 2019 India Article IV Staff Report, India has been among the world's fastest-growing economies in recent years, lifting millions out of poverty. However, India is now in the midst of a significant economic slowdown. Growth in the second quarter of FY 2019/20 came in at a six-year low of 4.5% (y/y), and the composition of growth indicates that private domestic demand expanded by only 1% in the quarter. Most high-frequency indicators suggest that weak economic activity has continued into December.

<u>Several possible factors behind the slowdown:</u>

- The reduction in non-bank financial companies' (NBFC) credit expansion and the associated broad-based tightening of credit conditions appears to be an important factor.
- Weak income growth, especially rural, has been affecting private consumption.
- Private investment has been hindered by the financial sector difficulties (including in the public sector banks (PSBs)) and insufficient business confidence.
- Finally, some implementation issues with important and appropriate structural reforms, such as the nation-wide goods and services tax (GST), may also have played a role.

Addressing the current downturn and returning India to a high growth path requires urgent policy actions. The near-term policy mix needs to be mindful of supporting economic activity and restoring confidence, while recognizing significant fiscal constraints. In the medium-term, realizing India's substantial growth potential depends critically on the implementation of growth-enhancing structural reforms. On the latter, IMF believes the government needs to reinvigorate the reform agenda, with evidence globally indicating it is important to take advantage of its new mandate early in its term.

Policy recommendations:

- On monetary policy, given the sharper-than-expected slowdown and negative output gap (growth below potential), there is room to cut the policy rate further, especially if the economic slowdown continues. However, should inflationary pressures increase (stemming from the recent increase in food inflation and one-off prospective price increases in the auto and telecom sectors or resulting from fiscal pressures), the RBI will have limited room for further cuts.
- On fiscal policy, limited room is seen for stimulus and stress is laid on the need for medium-term fiscal consolidation, given the high level of general government debt and the high interest bill. In addition, as IMF noted in the Staff Report, broader measures of the government deficit, namely the public sector borrowing requirement (PSBR) and the extended central government deficit, show that fiscal policy has been more accommodative than would appear if looking only at the headline deficits. IMF will publish a Country Focus article on this topic. That said, steps could be taken to support growth including, in the short term, by focusing on the composition of expenditures and rationalizing GST and, over the medium term, by focusing on domestic revenue mobilization, decreasing (on- and off-budget) expenditures on subsidies, and enhancing fiscal transparency and thus reducing uncertainty.
- Regarding the financial sector, a comprehensive set of measures is needed to restore the health of the sector and enhance its ability to provide credit to the economy. These include steps to resolve balance sheet issues, including in the commercial banks, the corporate sector, and the NBFCs including Housing Finance Companies (HFCs). As IMF has noted in the Staff Report, steps have already been taken, especially for public sector banks (PSBs). But further steps are needed for PSB reform to shift their operations towards more

commercially-oriented decision-making, along with measures to improve accountability and risk management. On NBFCs, improved monitoring and regulation, especially of larger NBFCs, are welcome developments. However, more information on smaller NBFCs is needed to better understand the impact of reduced credit on private demand, especially micro, small, and medium-size enterprises (MSMEs) and in rural areas. While the application of the Insolvency and Bankruptcy Code to financial institutions is also a good initial step, the passage of the Financial Resolution and Deposit Insurance Bill that is currently under reconsideration will provide a more appropriate framework over the longer term.

- On structural reforms, measures to enhance efficiency of credit allocation and governance reforms in the banking sector are urgently needed to strengthen confidence and to put growth on a strong and sustainable footing over the medium-term. Labor, land, and product-market reforms aimed at enhancing competition and governance, along with measures to improve human capital (education and health), should be critical elements of India's structural-reform strategy.

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Warm Regards,

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