SOUTH ASIA

Growth in South Asia remains strong, with regional output projected to grow by 6.8 percent in 2017 and an average of 7.2 percent in 2018-19. Excluding India, growth is projected to average 5.8 percent in 2017-2019, with some cross-country variation. Robust domestic demand, an uptick in exports, and strong foreign direct investment inflows underpin this forecast. Domestic risks to the outlook include policy uncertainty related to upcoming elections and possible setbacks to reform progress. External risks include an increase in global financial volatility, a slowdown in remittances inflows, and rising geopolitical tensions.

Recent developments

Regional output expanded by an estimated 6.7 percent in 2016, despite temporary disruptions associated with the November withdrawal and replacement of large-denomination currency notes in India, the region's largest economy (Table 2.5.1). In general, South Asian economies benefited from an improvement in exports, low oil prices, infrastructure spending, and supportive macroeconomic policies last year. In India, activity was underpinned by favorable monsoon rains that supported agriculture and rural consumption, an increase in infrastructure spending, and robust government consumption (World Bank 2017k). In Pakistan, agricultural output rebounded following the end of a drought, while the successful completion of an IMF-supported program en-hanced macroeconomic conditions and foreign direct investment (FDI). Nepal's economy suffered from lingering effects of the 2015 earthquake and trade disruptions with India (World Bank 2017l). However, in some countries, activity in 2016 was set back by a sharp decline in remittances inflows (e.g., Bangladesh; World Bank 2016g), inclement weather conditions that reduced agricultural output (e.g., Sri Lanka), and security challenges (e.g., Afghanistan).

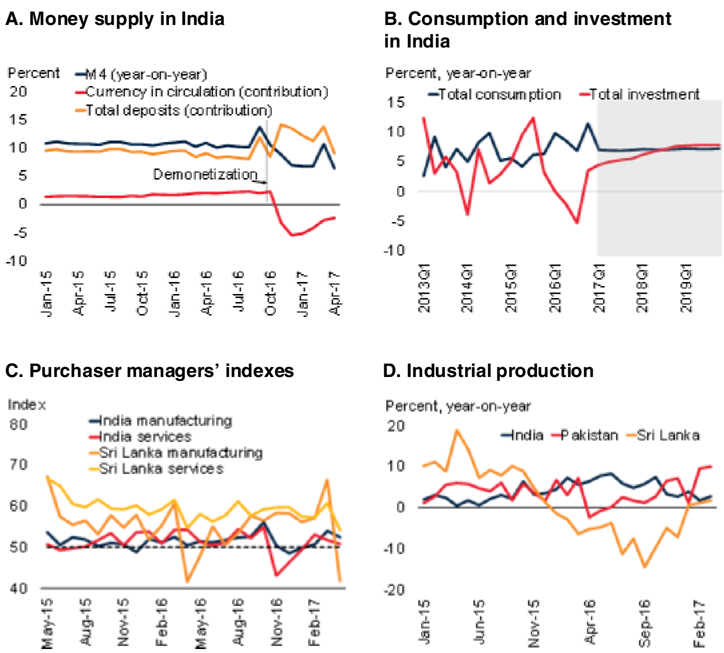
Note: This section was prepared by Temel Taskin and Boaz Nandwa. Research assistance was provided by Anh Mai Bui.

A pickup in regional growth is underway in 2017. In India, recent data indicate a rebound this year, with the easing of cash shortages and rising exports (World Bank 2017k). An increase in government spending in India, including on capital formation, has partially offset soft private investment. While manufacturing purchasing managers' indexes have generally picked up, industrial production has been mixed (Figure 2.5.1). In Pakistan, favorable weather and increased cotton prices are supporting agricultural production, and the China-Pakistan Economic Corridor infrastructure project, as well as a stable macroeconomic environment, is contributing to an increase in private investment.

Growth in Bangladesh has been supported by solid agricultural activity and robust services this year, despite ongoing security concerns. In Sri Lanka, a resumption of Chinese-funded investment and infrastructure projects such as the Colombo International Financial Centre has lifted private investment and FDI inflows; in addition, fiscal consolidation under an IMF program has helped improve investor sentiment. In Bhutan and Maldives, growth has continued to gain traction due to accommodative macroeconomic policies, as well as support from the energy and construction sectors. Nepal's growth has rebounded strongly following a good monsoon, reconstruction efforts, and normalization of trade across the southern border with India.

FIGURE 2.5.1 SAR: Recent developments

In India, the exchange of large-denominated currency in circulation in late 2016 weighed on investment, albeit temporarily. While purchasing managers' indexes across the region have generally improved in 2017, industrial production has been mixed.



Sources: Haver Analytics, World Bank.
Note: SAR stands for South Asia Region.
A. M4 stands for broad money supply. Last observation is April 2017.
B. Shaded areas are projections. Last observation is 2016 Q4.
C. Index values higher than 50 indicate expansion. Last observation is April 2017.
D. Last observation is March 2017.

Macroeconomic vulnerabilities continue to recede. Current account deficits are narrowing further amid stable oil prices and an uptick in exports. While remittances inflows declined in some countries (e.g., Bangladesh, India), foreign reserves increased and exchange rates remained stable, with rising FDI (e.g., India) and tourist arrivals (e.g., Nepal, Sri Lanka). Inflation has remained benign, hovering below target in Bangladesh, Pakistan, and India. Favorable weather (e.g., India, Pakistan) and lower oil prices have helped keep inflation low, and thereby made possible an accommodative monetary policy. Despite mixed progress with fiscal consolidation in the region, deficits generally declined.

Outlook

The regional forecast assumes that monetary policy across South Asia countries remains broadly accommodative, encouraging credit to the private sector; that fiscal policy tightens slightly to curb the increase in public debt; and that political tensions and insecurity abate. Regional growth is forecast to increase to 6.8 percent in 2017 and to strengthen to an average of 7.2 percent in 2018-19, reflecting a solid expansion of domestic demand and exports (Figure 2.5.2). Excluding India, regional growth will remain broadly stable at an average of 5.8 percent in 2017-19, as easing growth in Bangladesh and Nepal offset gains in Bhutan, Pakistan, and Sri Lanka.

India's growth is forecast to increase to 7.2 percent in FY2017 (April 1, 2017 - March 31, 2018) and accelerate to 7.7 percent by the end of the forecast horizon—slightly below previous projections. This outlook mainly reflects a more protracted recovery in private investment than previously envisaged. Nonetheless, domestic demand is expected to remain strong, supported by ongoing policy reforms, especially the introduction of the nationwide Goods and Services Tax (GST). Significant gains by the ruling party in state elections should support the government's economic reform agenda, which aims at unlocking supply constraints, and creating a business environment that is more conducive to private investment.

Pakistan's growth is expected to increase to 5.2 percent in FY2017 (July 1, 2016 - June 30, 2017) and remain strong over the forecast horizon, reflecting an upturn in private investment, increased energy supply, and improved security. The fiscal deficit should narrow further, as a result of revenue-led fiscal consolidation. Sri Lanka's growth is expected to pick up to about 4.7 percent in 2017 and accelerate to 5.1 percent by 2019, as the IMF-supported program helps improve macroeconomic resilience. Reforms initiated by the World Bank Development Policy Operation in 2016 are expected to reduce obstacles to private sector competitiveness in the medium-term and help attract FDI. Resumption of the Generalized System of Preferences Plus (GSP+) trading arrangement with the European Union will boost its export sector. Growth in Bangladesh is forecast to remain robust, averaging 6.6 percent during FY2018-FY2020. This reflects improving remittances as GCC economies recover, as well as rising business confidence and investment.

Risks

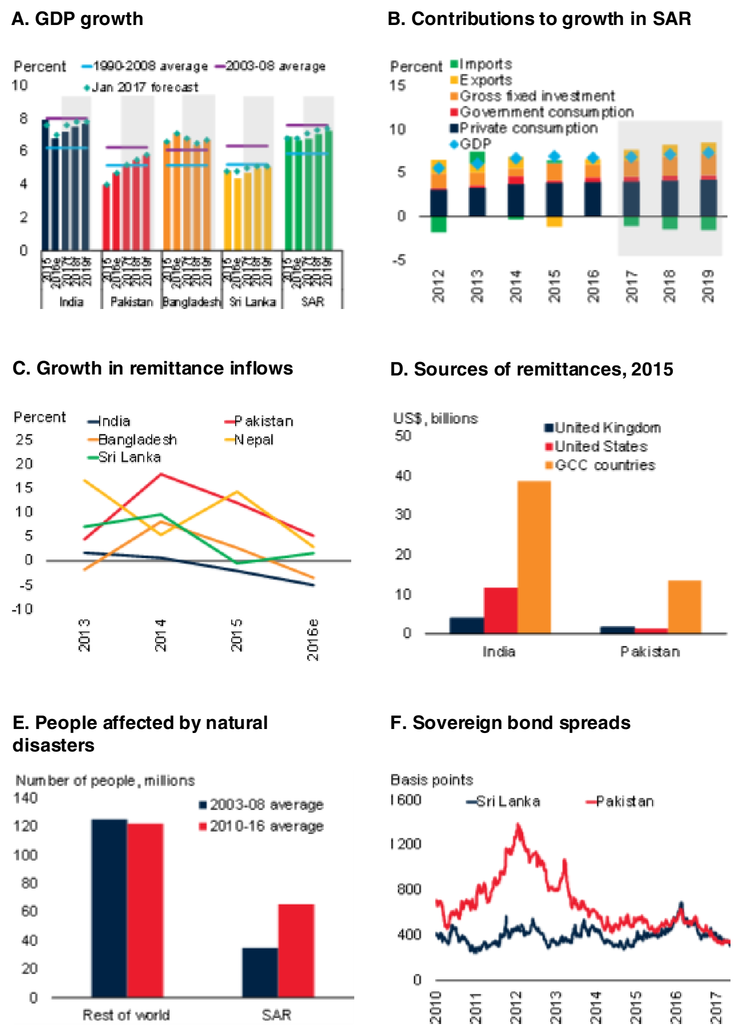
A number of downside risks continue to cloud the outlook. Setbacks to the assumed pace of structural reform would impede the unlocking of supply constraints, dampen productivity growth, and hold up integration into global value chains. This would hurt the business environment, reducing investment and FDI inflows to the region (IMF 2017d, 2017e). Security concerns in some countries (e.g., Afghanistan, Pakistan) could also hold back investment and business confidence. For several countries in the region, increased political or geopolitical tensions could pose major obstacles to economic and financial activity (e.g., Afghanistan, India, Pakistan). Upcoming elections in Nepal (between 2017 and 2019), Bangladesh and Pakistan (in 2018), and India (in 2019) could be accompanied by heightened policy uncertainty, and election results could surprise financial markets.

Despite progress in fiscal consolidation, public debt remains high across the region. In some cases debt is associated with investments that will pay for themselves (Bhutan), but in others there have been concerns about sustainability (e.g., Maldives) or about fiscal strains posed by an uneven repayment profile (e.g., Sri Lanka and, to some extent, Pakistan). In addition, contingent liabilities are building up, including from the debt of power utilities in Pakistan and prospects of debt write-offs for farmers in several states in India.

Compared to other EMDE regions, South Asia is less integrated into the global economy and, therefore, would be less affected by the materialization of a range of negative external shocks. However, two external risks remain a concern. First, weaker-than-expected recovery in external demand, or a widespread increase in trade protectionism in advanced economies, could weigh on exports (World Bank 2017n). In addition, an abrupt market reassessment about U.S. monetary policy tightening could lead to capital outflows, and hence to tighter domestic credit conditions (Rai and Suchanek 2014).

FIGURE 2.5.2 SAR: Outlook and risks

Regional growth is expected to rebound in 2017 and strengthen thereafter. Domestic demand and exports underlie this pickup. The outlook for remittances inflows is uncertain, as they could be affected by tighter immigration policies in some advanced economies and continued fiscal consolidation in GCC countries. Changing environmental patterns pose growing risks to the region, as natural events have affected an increasing number of people in recent years. An abrupt market reassessment about U.S. monetary policy tightening could lead to tighter domestic financial conditions, which have been benign of late.



Sources: International Disaster Database, J.P. Morgan, World Bank.
Note: SAR stands for South Asia Region.
A.B. Shaded areas are projections.
E. Average annual number of people affected by disasters.
F. J.P. Morgan Emerging Market Bond Index. Last observation is May 23, 2017.

Second, the outlook for remittances is uncertain. The main risks would be from tighter immigration policies in advanced economies, especially in the United States and the United Kingdom, and continued fiscal consolidation in oil-exporting Gulf Cooperation Council (GCC) countries. Any substantial decline in remittances would dampen consumption and investment in major recipients (e.g., Bangladesh, Nepal).

Finally, changing environmental patterns pose growing risks. The number of people affected from extreme weather events has increased substantially in recent years (Figure 2.5.3). Natural disasters from extreme weather conditions often adversely affect agricultural output in the region, as recently experienced in India, Pakistan, and Sri Lanka (IMF 2016g).

TABLE 2.5.1 South Asia forecast summary

(Real GDP growth at market prices in percent, unless indicated otherwise)

	2014	2015	2016	2017	2018	2019	2016	2017	2018	2019
			Estimates	Projections			(percentage point difference from January 2017 projections)			
EMDE South Asia, GDP[a, b]	**6.7**	**6.9**	**6.7**	**6.8**	**7.1**	**7.3**	**-0.1**	**-0.3**	**-0.2**	**-0.1**
(Average including countries with full national accounts and balance of payments data only)[c]										
EMDE South Asia, GDP[c]	6.7	6.9	6.7	6.8	7.1	7.3	-0.1	-0.3	-0.3	-0.1
GDP per capita (U.S. dollars)	5.3	5.6	5.4	5.5	5.8	6.0	0.0	-0.2	-0.2	-0.1
PPP GDP	6.7	6.9	6.7	6.8	7.1	7.3	-0.1	-0.3	-0.3	-0.1
Private consumption	6.2	6.5	6.6	6.6	6.9	7.1	0.2	-0.1	-0.3	-0.3
Public consumption	8.9	2.6	5.5	5.8	5.8	5.8	-1.5	-1.4	-1.7	-1.8
Fixed investment	2.7	6.3	4.6	5.9	7.3	8.0	-1.9	-1.5	-0.1	0.7
Exports, GNFS[d]	5.4	-4.9	3.0	6.0	6.3	6.2	0.8	0.4	-0.8	-1.2
Imports, GNFS[d]	1.1	-1.0	0.4	4.4	5.9	6.3	-1.2	-0.7	-0.7	-0.6
Net exports, contribution to growth	1.0	-0.9	0.6	0.1	-0.2	-0.3	0.5	0.2	0.0	-0.1
Memo items: GDP[b]	**14/15**	**15/16**	**16/17**	**17/18**	**18/19**	**19/20**	**16/17**	**17/18**	**18/19**	**19/20**
South Asia excluding India	5.3	5.5	5.7	5.7	5.8	6.0	0.4	0.2	0.1	0.2
India	7.2	7.9	6.8	7.2	7.5	7.7	-0.2	-0.4	-0.3	-0.1
Pakistan (factor cost)	4.0	4.7	5.2	5.5	5.8	5.8	0.0	0.0	0.0	0.0
Bangladesh	6.6	7.1	6.8	6.4	6.7	7.0	0.0	-0.1	0.0	0.0

Source: World Bank.

World Bank forecasts are frequently updated based on new information and changing (global) circumstances. Consequently, projections presented here may differ from those contained in other Bank documents, even if basic assessments of countries' prospects do not differ at any given moment in time.

a. EMDE refers to emerging market and developing economy. GDP at market prices and expenditure components are measured in constant 2010 U.S. dollars.

b. National income and product account data refer to fiscal years (FY) for the South Asian countries, while aggregates are presented in calendar year (CY) terms. The fiscal year runs from July 1 through June 30 in Bangladesh and Pakistan, from July 16 through July 15 in Nepal, and April 1 through March 31 in India.

c. Sub-region aggregate excludes Afghanistan, Bhutan, and Maldives, for which data limitations prevent the forecasting of GDP components.

d. Exports and imports of goods and non-factor services (GNFS).

For additional information, please see www.worldbank.org/gep.

TABLE 2.5.2 South Asia country forecasts

(Real GDP growth at market prices in percent, unless indicated otherwise)

	2014	2015	2016	2017	2018	2019	2016	2017	2018	2019
			Estimates	Projections			(percentage point difference from January 2017 projections)			
Calendar year basis[a]										
Afghanistan	1.3	1.1	2.2	2.6	3.4	3.1	0.0	0.6	0.4	-0.5
Bhutan	5.7	6.5	6.8	6.8	7.7	10.5	-0.6	-3.1	-3.9	-1.2
Maldives	6.0	2.8	4.1	4.5	4.6	4.6	0.6	0.6	0.0	0.0
Sri Lanka	5.0	4.8	4.4	4.7	5.0	5.1	-0.4	-0.3	-0.1	0.0
Fiscal year basis[a]	**14/15**	**15/16**	**16/17**	**17/18**	**18/19**	**19/20**	**16/17**	**17/18**	**18/19**	**19/20**
Bangladesh	6.6	7.1	6.8	6.4	6.7	7.0	0.0	-0.1	0.0	0.0
India	7.2	7.9	6.8	7.2	7.5	7.7	-0.2	-0.4	-0.3	-0.1
Nepal	3.3	0.4	7.5	5.5	4.5	4.5	1.0	0.7	-0.2	-0.2
Pakistan (factor cost)	4.0	4.7	5.2	5.5	5.8	5.8	0.0	0.0	0.0	0.0

Source: World Bank.

World Bank forecasts are frequently updated based on new information and changing (global) circumstances. Consequently, projections presented here may differ from those contained in other Bank documents, even if basic assessments of countries' prospects do not significantly differ at any given moment in time.

a. Historical data are reported on a market price basis. National income and product account data refer to fiscal years (FY) for the South Asian countries with the exception of Afghanistan, Bhutan, Maldives, and Sri Lanka, which report in calendar year (CY). The fiscal year runs from July 1 through June 30 in Bangladesh and Pakistan, from July 16 through July 15 in Nepal, and April 1 through March 31 in India.

For additional information, please see www.worldbank.org/gep.

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