



South Asia Economic Focus Spring 2020

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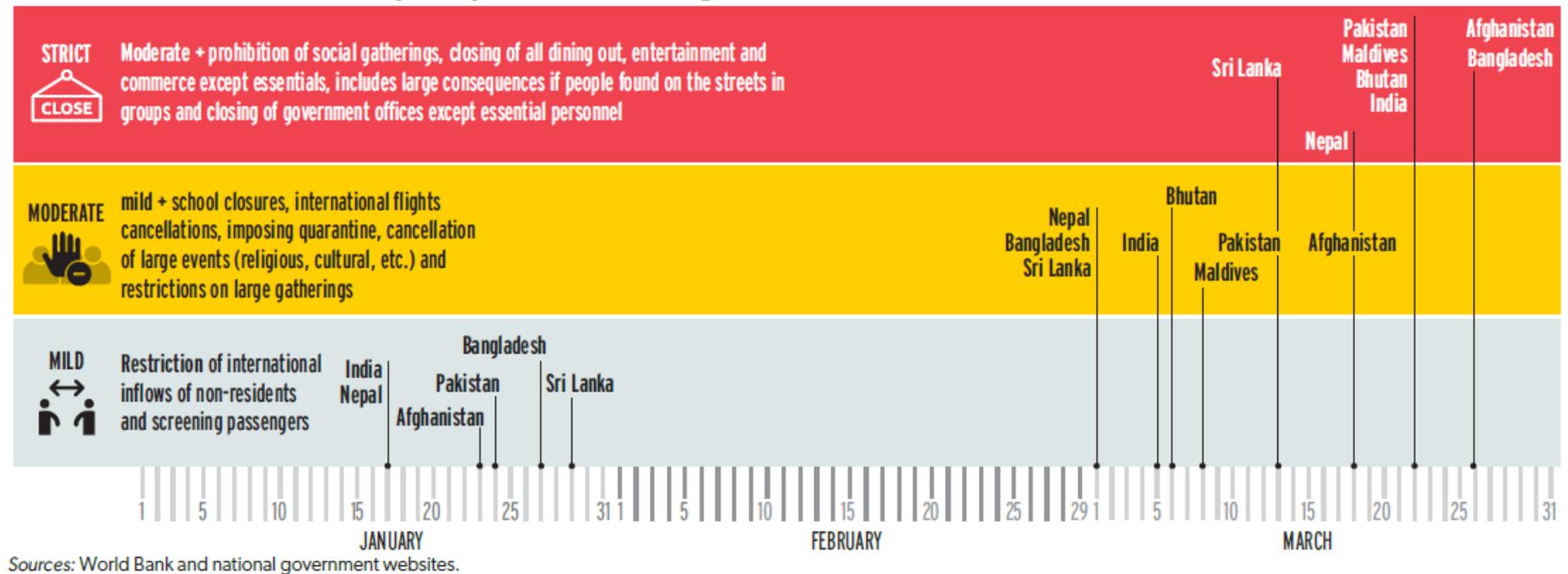
May 8, 2020



Presentation outline

1. An unprecedented crisis
2. A dire outlook
3. Public banks: a cursed blessing

South Asia ramped up social distancing measures in early March, reducing daily growth rate with some success.



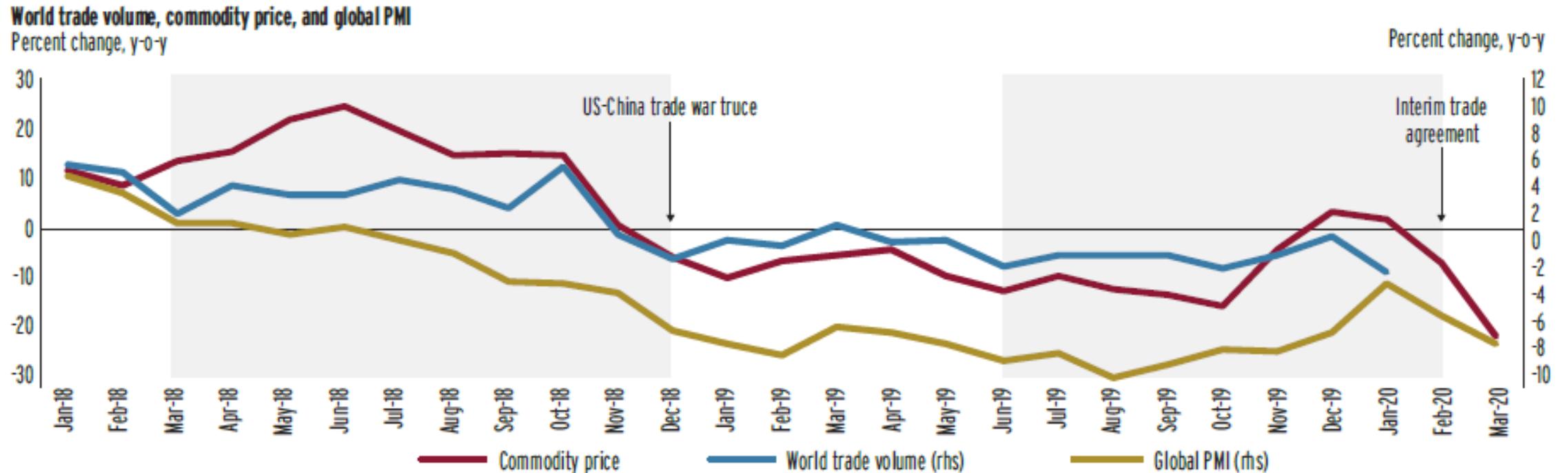
- Caseload still below other continents but rising.
- Health systems would not be able to cope with a surge.

COVID-19 incidence and health systems preparedness in South Asia and comparators (updated to May 4)

	India	Pakistan	Bangladesh	Afghanistan	Sri Lanka	Maldives	Nepal	Bhutan	China	US
Number of confirmed cases	42,505	20,084	9,455	2,704	718	527	75	7	83,964	1,158,040
Cases per million persons	31	98	56	71	33	1054	3	9	60	3539
Death rate per confirmed cases	3%	2%	2%	3%	1%	0%	0%	0%	6%	6%
Recovery rate per confirmed cases	28%	25%	11%	13%	26%	3%	21%	71%	94%	16%
Population density (persons per sq km)	455	287	1240	57	339	1719	196	20	152	36
Health outcomes										
COVID-19 tests administered per million persons	807	1,038	520	291	1,231	16,654	2,111	739	229	1,653
Number of hospital beds (per 1,000 people)	7	6	8	5	3.5	4.9	3	17	42	29
Global Health Index rank (out of 195 countries)	57	105	113	130	120	121	111	85	51	1
Share of population under 65 years of age	94%	95%	94%	97%	90%	96%	94%	92%	90%	85%

Sources: JHU CSSE Dashboard, Country Health Ministries, Central bank websites, WHO, UN Data, Global Health Index, World Bank and staff calculations. Note: Data for Covid-19 cases is reported as of May 3, 11 PM EST. Population as of 2019 and Population density as of 2018 is reported; Share of population as of 2015 is reported. For hospital beds the data for Afghanistan and Bangladesh is 2015; Pakistan is 2014 ; USA is 2013; Bhutan, Nepal and China is 2012; India is 2011; Sri Lanka is 2010 and; Maldives is 2009. The Health Index Score is calculated for 195 countries, 195

At end-2019, global trade and economic activity indicators weakened since the trade war started, but early signs of recovery at end-2019 abruptly ended with COVID-19 breakout in Wuhan, China.



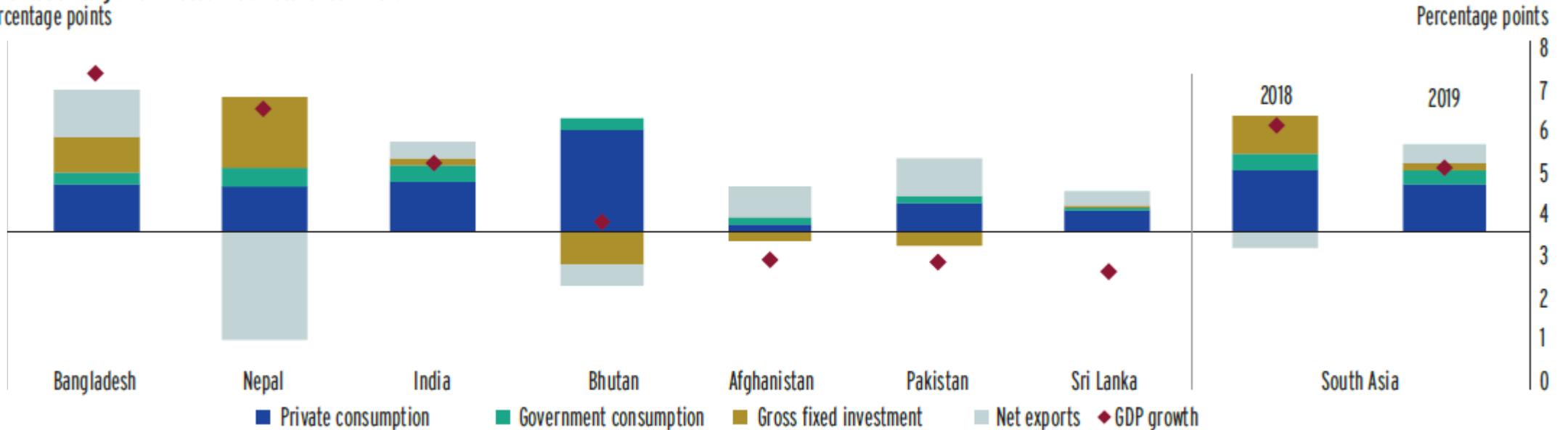
Notes: Data is shown until their last available observation. The first shaded area denotes the period between first bilateral mutual tariffs imposed by US and China (March 23, 2018) and first truce for negotiation (December 1, 2018). The second shaded area should be between May 10, 2019 (breakup of truce and new tariff increases imposed by US) and January 15, 2020 (when the so-called 'Phase 1 interim trade deal' between US and China was signed).

Sources: CPB Netherlands Bureau for Economic Policy Analysis, IMF and Haver Analytics.

Likewise, green shoots in South Asia never had the opportunity to mature.

- Investment growth weakened in 2019 amid tight supply of loanable funds.
- Consumer confidence in IND and PAK dwindled and private sector credit growth weakened.
- Imports grew less than exports; Some signs of recovery of manufacturing in early 2020 did not mature.

Contribution to growth in South Asian countries in 2019
Percentage points



Source: World Bank and staff calculations.

Policy makers in South Asia have been quick to address the many economic challenges despite pre-existing vulnerabilities...

Initial conditions mixed...

- Stubbornly high non-performing loans in India and Bangladesh, in particular.
- But sufficiently high capital adequacy ratios to absorb potential losses in normal times; capital buffers will likely be eroded during the lockdown period.
- Core inflation was relatively low in most countries, despite some temporary rise in food prices.
- Tax cuts and other fiscal stimulus in 2019 pre-COVID widening fiscal deficits, adding to public debt.

..but timely and broad-based policies to address COVID-19 economic effects.

- Direct measures to prevent bottlenecks in the supply of food
- All central banks in the region have announced their intention to boost liquidity in the wake of the crisis, following appropriate monetary policy measures over the past few months.
- Fiscal stimulus packages were also very quickly announced, with important components targeting those losing their jobs or those with loan payments

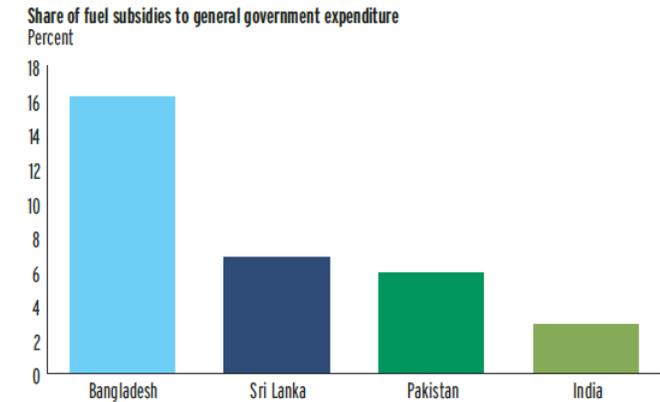
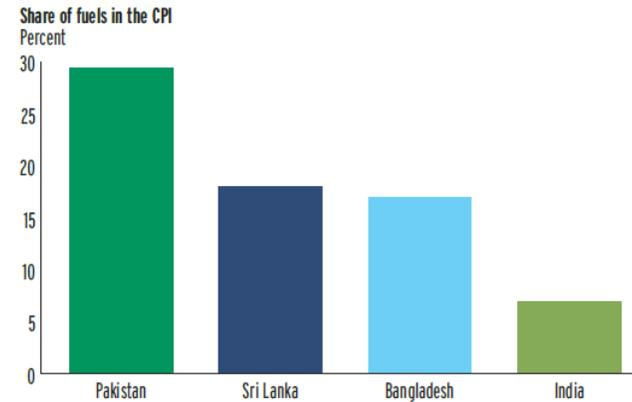
...and will benefit from lower oil prices.

- Brent oil price drop from \$64 to -\$25 will keep prices of essentials at bay.
- 8% improvement in the terms of trade and thus external balances.
- An opportunity to rethink some fuel subsidies (reallocate resources to COVID-19 or revive the economy).

BUT:

- Consumption of fuel is also low, so expenditure savings small
- Remittances will fall 22% in 2020

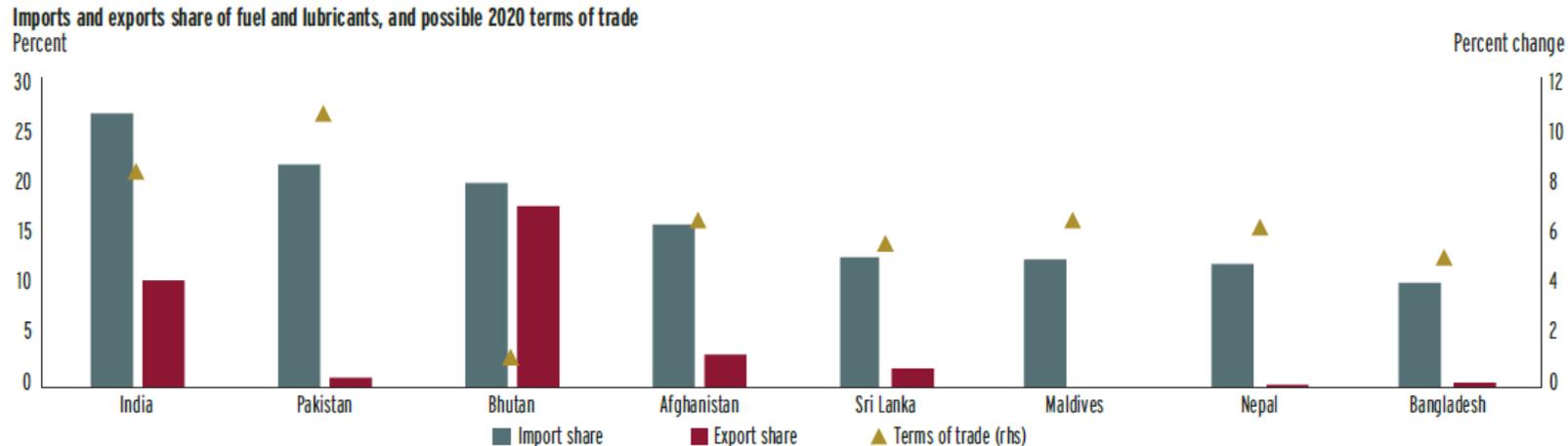
Falling oil prices are helping to keep consumer prices under control - will lead to lower government expenditure on fuel subsidies



Notes: In Bangladesh the share represents the "Gross Rent, Fuel & Lighting" category. In India it represents the "Fuel and light" category. In Pakistan and Sri Lanka, the share represents "Housing, water, electricity, gas & other fuels" items.
Source: CEIC database.

Note: Subsidies are related only to fuel.
Sources: World Bank, Statista and staff calculations.

South Asian countries are net oil importers, which will help boost their terms of trade amid falling oil prices.



Notes: Exports and imports averages are from 2015 to 2018. Terms of trade change assuming average Brent crude price declines to USD 30/barrel (right scale).
Sources: CEIC database, Haver Analytics and staff calculations.



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Growth in South Asia is projected to drop strongly this year.

1.8% growth in 2020 would be worse performance since 1980.

With falling GDP per capita in 2020, it will take a rebound in 2021 to reach the per-capita income of 2019.

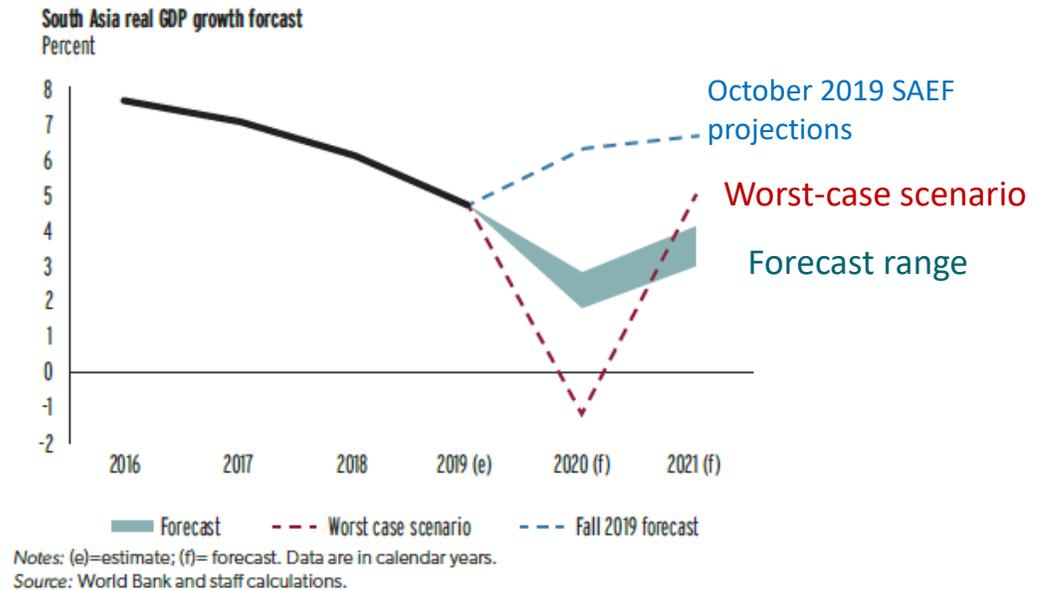
Unlike other recessions, the contribution of **private consumption** to growth is expected to halve in 2020.

Most affected is the Maldives, where tourism directly and indirectly contributes two-thirds of GDP, 80 percent of exports and 40 percent of revenues.

But Afghanistan, Pakistan and Sri Lanka will also be hit hard.

With vulnerable populations affected, poverty will widen.

A **worst-case scenario** can be envisaged, with lockdown lasting 4 months and then a second wave before end-year.



Real GDP at market prices (percent)

Country	Fiscal year	2019 (e)	2020 (f)	2021 (f)	2022 (f)
Afghanistan	December to December	2.9	-5.9 to -3.8	3.3 to 3.9	5.2 to 6.2
Bangladesh	July to June	8.2	2.0 to 3.0	1.2 to 2.9	2.8 to 3.9
Bhutan	July to June	3.9	2.2 to 2.9	2.0 to 2.5	3.1 to 3.5
India	April to March	6.1	4.8 to 5.0	1.5 to 2.8	4.0 to 5.0
Maldives	January to December	5.2	-13.0 to -8.5	6.3 to 7.3	5.0 to 5.5
Nepal	mid-July to mid-July	7.1	1.5 to 2.8	1.4 to 2.9	2.7 to 3.6
Pakistan	July to June	3.3	-2.2 to -1.3	0.3 to 0.9	3.2 to 3.3
Sri Lanka	January to December	2.6	-3.0 to -0.5	0.2 to 1.2	2.0 to 2.5

South Asia

4.7 to 4.8

1.8 to 2.8

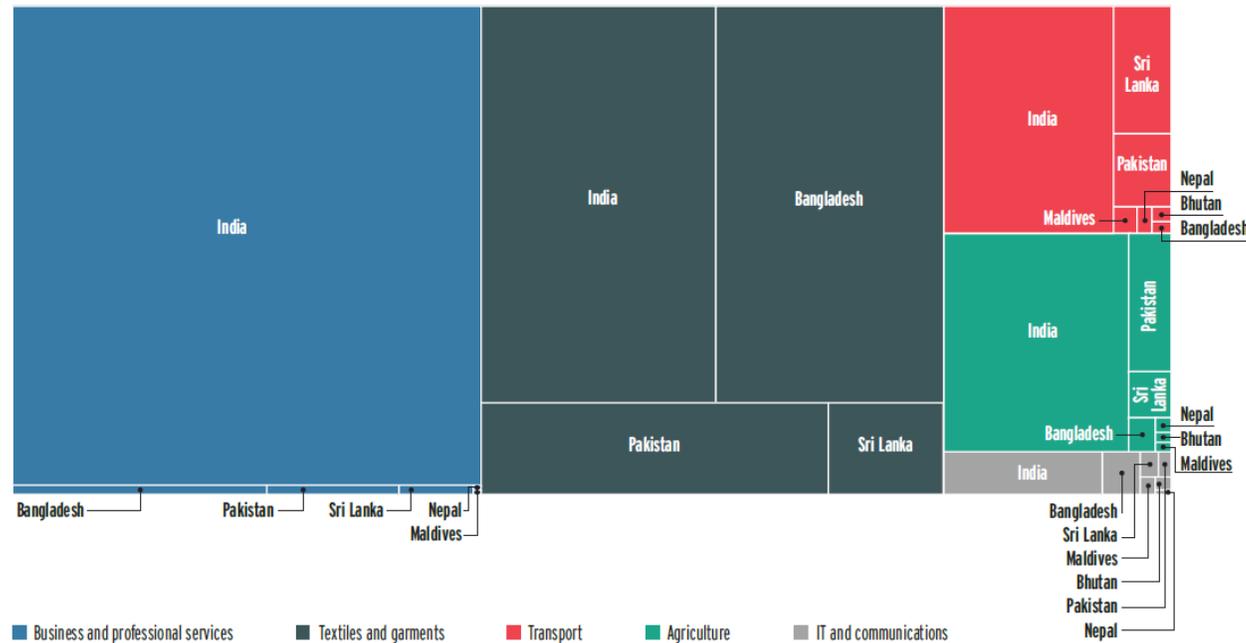
3.0 to 4.1

South Asia affected through 4 channels

Channel 1: sharp drop in external demand.

- By sector, business and IT services and textiles and garments most affected.
- Trading partners hard hit by COVID such as U.S. are important buyers of PAK, SRI, IND and BAN exports.
- Tourism receipts are important for all economies but critical for Maldives. Livelihoods in indirect tourism activities are severely impacted by COVID-19.

Major exports by sector and country, share of total



Notes: Data is from 2018 and exports shown comprise 87 percent of total goods and services exports of the region. The tree map is divided by the selected sectors which are differentiated by each color. Within each sector, South Asian countries are represented by the size of the square according to the amount of exports in USD million. The size of each country reflects the amount of exports they have within each sector.
Source: ADB MRIOT, 2018.

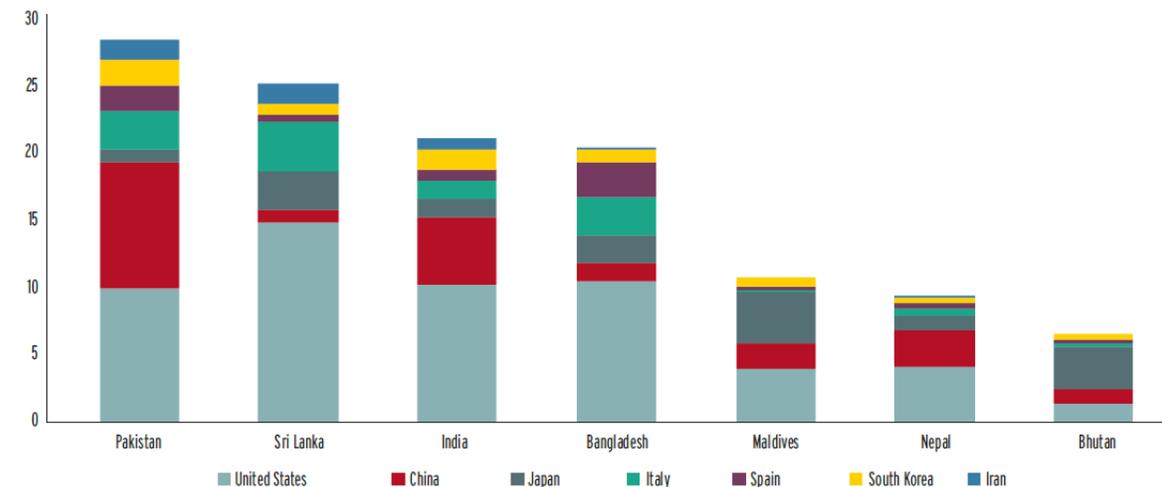
Economic Contribution of Tourism and Travel

Share of GDP (%)

Bangladesh	4.4
India	9.2
Maldives	66.4
Nepal	7.9
Pakistan	7.1
Sri Lanka	12.5

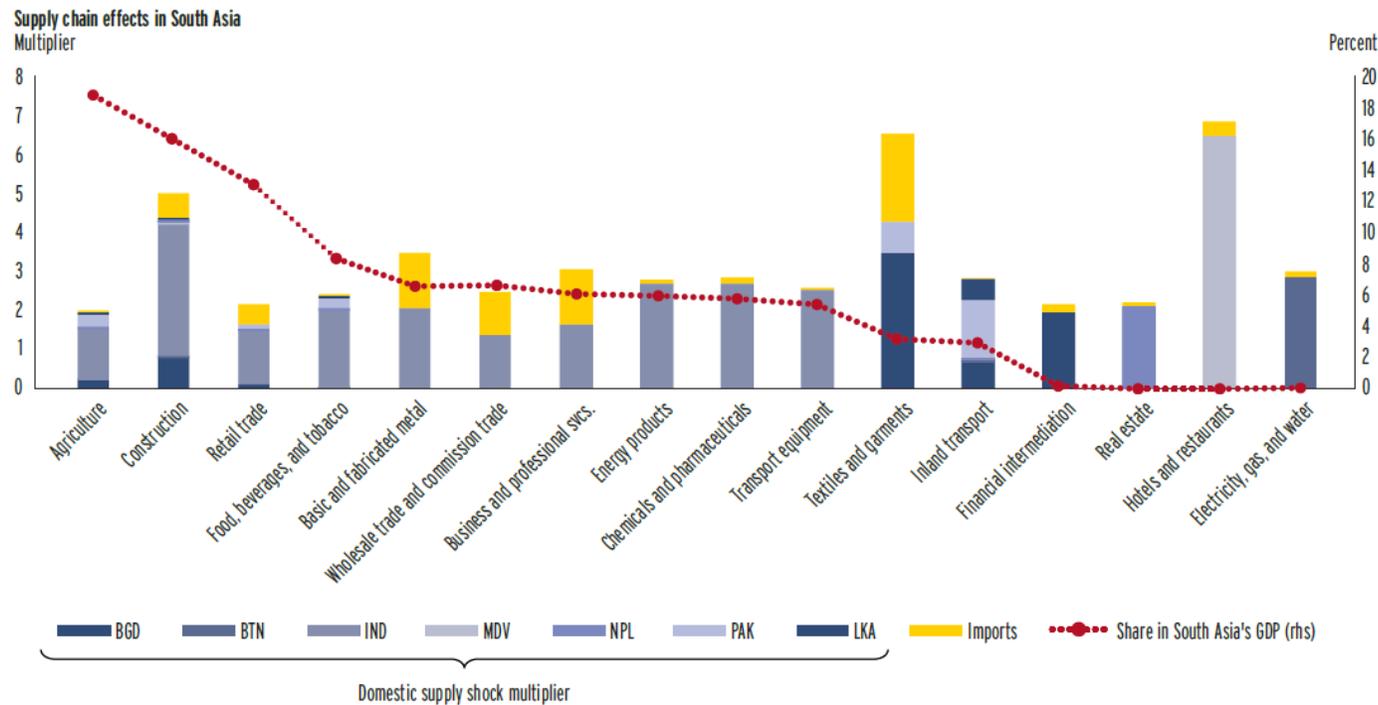
Source: World Travel and Tourism Council

Share of total exports to COVID-19 countries
Percent



Note: Data is for 2017 for Iran and for 2018 for all other countries.
Sources: ADB MRIOT and Atlas of Economic Complexity.

Channel 2: interrupted domestic and foreign supply chains.



- Supply multipliers, defined as the stoppage in production in South Asia as a result of a US\$1 supply disruption from a given sector (almost 6% for textiles and garments and over 5% for construction).
- With some exceptions, potential supply interruptions in the major sectors due to COVID in South Asia are mostly of domestic origin, reflecting the regions' low participation in Global value chains.
- Agriculture and construction sectors have the highest share of South Asia's GDP, so their halted production will reverberate economically.

Notes: Data is from 2018. The share in South Asia's GDP is excluding Afghanistan. The domestic supply shock multiplier measures the direct and indirect impact on the South Asian economy, in US dollars, from a USD 1 reduction in intermediate supplies to these sectors. The source of that supply shock can come from countries in South Asia, or externally (outside of South Asia).
Source: ADB MRIOT.

Channel 3: domestic demand effects resulting from the lockdown hit vulnerable populations, particularly those employed in mostly urban services.

- Two distinct groups identified: labor intensive, low-skilled workers and high value added services workers. In April services PMI *level* at a dismal 4.7%.

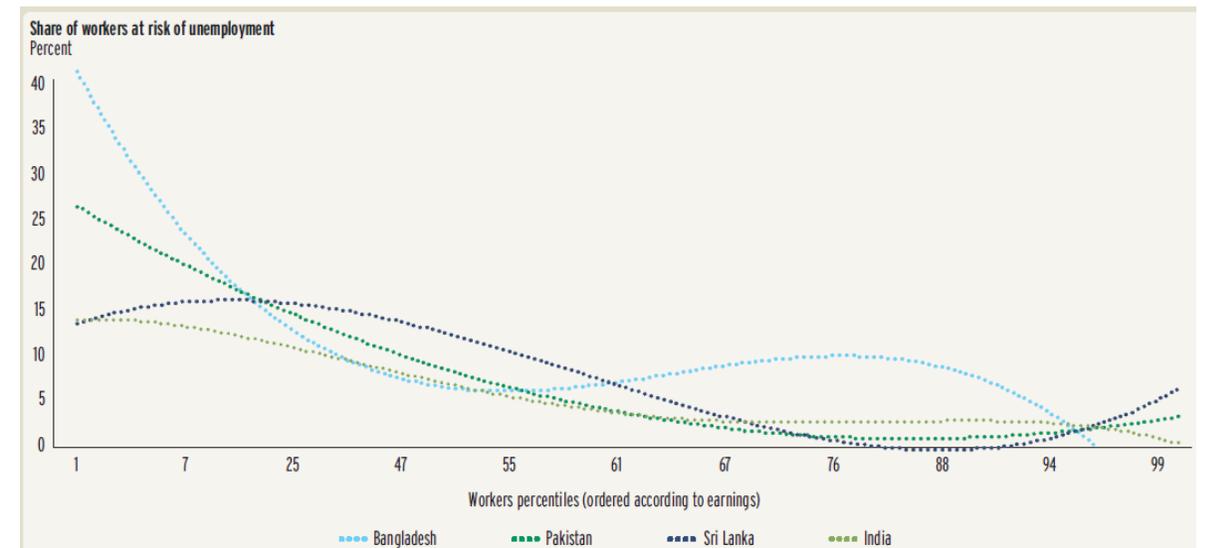
Employment characteristics of service sectors directly affected by COVID-19 in South Asia

	Employed people (thousands)	Sector share of regional employment (%)	Share of 2018 regional GDP (%)	Labor productivity (value added per worker, 2018, USD)	Average daily earnings in 2018, USD	Share of females (%) 1/	Share of employed people that are household heads (%) 1/	Average years of education 1/
All sectors in South Asia	505,895	100.0	22.5	6,376	7	25	53	6
Service sectors directly affected by COVID-19 lockdowns	88,404	17.5	22.6	8,221	4	13	59	7
Labor intensive sub-sectors	85,919	17.0	21.8	8,024	4	13	59	7
Retail trade	44,793	8.9	11.5	8,276	4	11	58	8
Land transportation	21,071	4.2	5.6	8,501	5	1	68	7
Entertainment and other personal services	11,819	2.3	3.3	8,367	3	45	46	5
Accommodation and restaurants	8,236	1.6	1.4	4,937	5	14	61	7
High productivity sub-sectors	2,485	0.5	0.8	12,820	8	6	68	10
Tourism, travel agencies and other supporting and auxiliary transport activities	1,787	0.4	0.4	7,836	7	6	66	10
Water transportation	456	0.1	0.1	14,624	11	4	74	9
Air transportation	241	0.0	0.2	46,314	12	7	73	12

Notes: 1/ Includes only Bangladesh, Bhutan, India, Pakistan and Sri Lanka, from latest labor force surveys.

Sources: Sri Lanka Labor Force Survey 2015. Bangladesh Labor Force Survey 2015-16. India NSS 2011-12. Pakistan Labor Force Survey 2014-15 and Bhutan Living Standards Survey (LSS) 2012. ADB Key Indicators for Nepal and Maldives. Value added from ADB Mriot, 2018, and staff calculations.

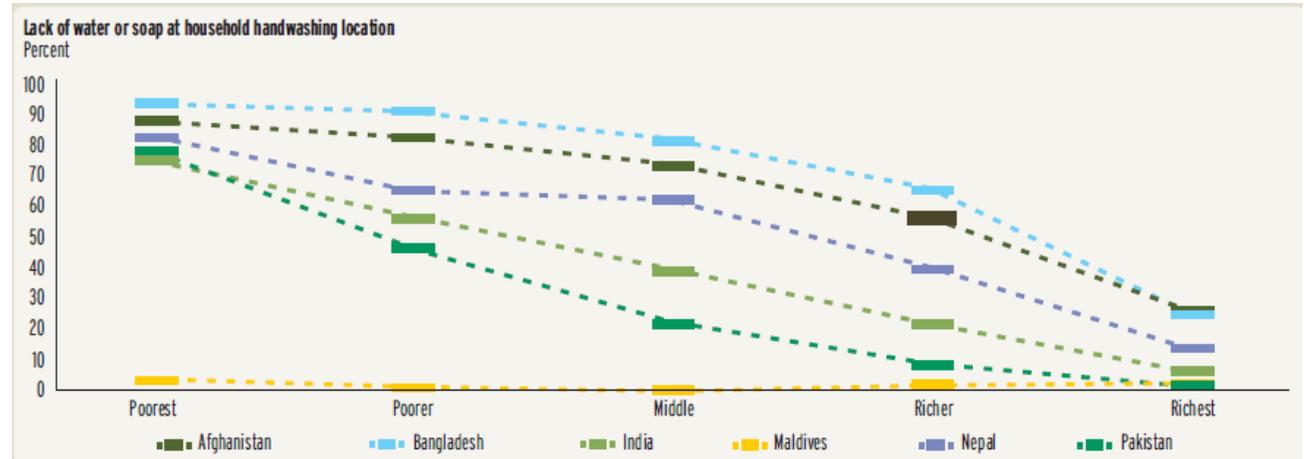
- A 2 to 4 month lockdown would increase unemployment in these affected service sectors by 5 to 25%. For the entire non-agricultural sector, the figure ranges between 13% and 25% unemployment.
- In terms of individual characteristics, the young, female and single head of households at the lower end of the earnings distribution more likely to be affected.



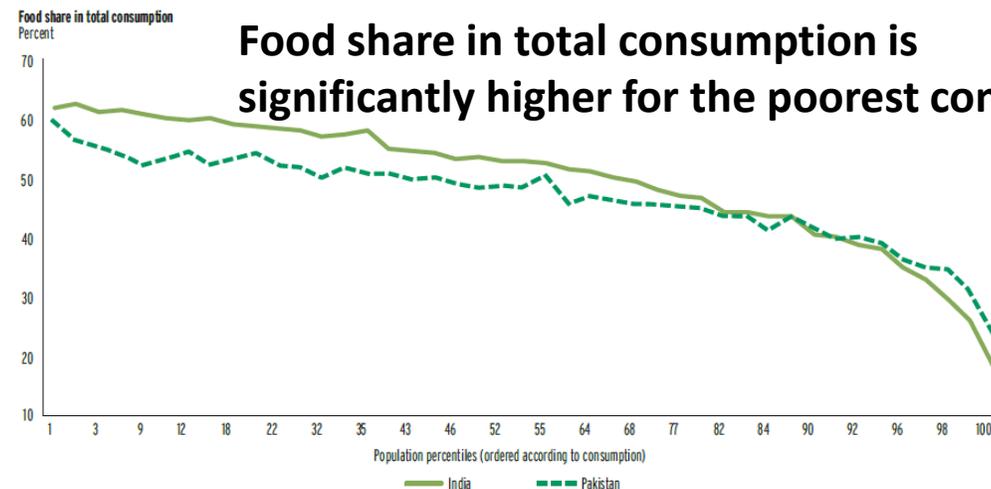
Channel 4: the poor are hit harder by the pandemic as they have fewer coping options and are harder to reach through government programmes.

- Although COVID-19 contagion does not discriminate by income, poorer people are not able to respond as quickly through containment.
- Close to 90 percent of the poorest group lacks either soap or water for handwashing in Nepal and Afghanistan. But even in India and Pakistan it is still around 70 percent.
- Urban poor living in densely-populated dwellings and neighborhoods cannot safely practice social distancing.
- Many are migrants who became unemployed and had to return to rural homes.
- Poor's share of income for necessities is higher, so food spikes could lead to hunger.
- International inequality also exacerbated: Food is 54 percent of consumer basket in South Asia (compared to 20 percent in China and 17 percent in US).
- Cash and food transfers difficult to distribute to informal workers, many without bank accounts.

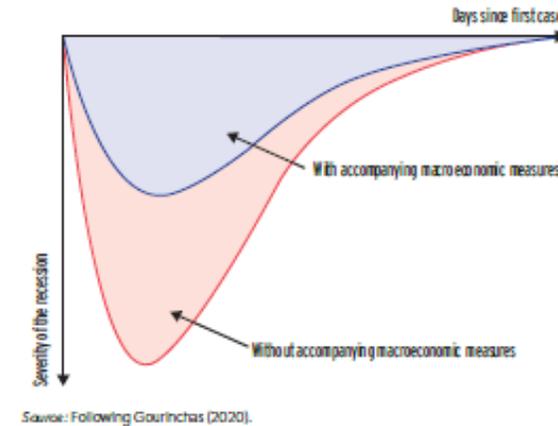
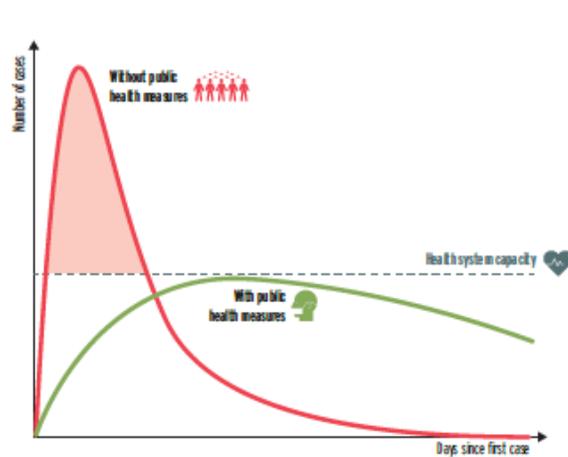
Many poor in South Asia lack water or soap for handwashing.



Food share in total consumption is significantly higher for the poorest consumers.



Policies to reduce the health costs should be complemented by policies to reduce economic costs



Source: Following Gourinchas (2020).

Policies for immediate action

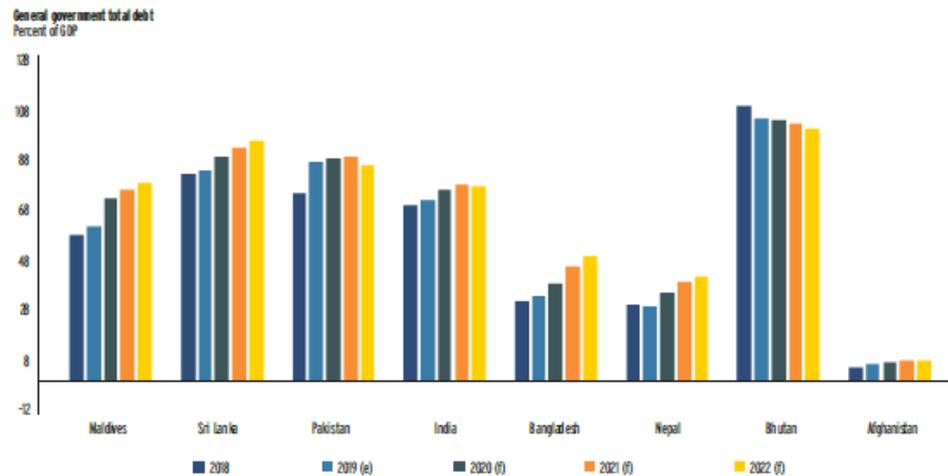
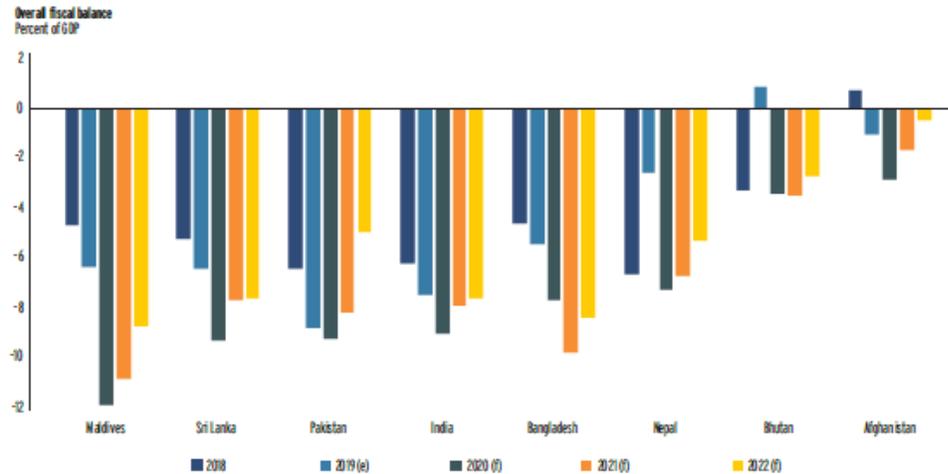
- Early and decisive measures to mitigate contagion
- Cost-effective (virtual) awareness-raising and effective communication.
- Digital technologies can also be used to monitor the spread of COVID-19.
- Promoting solidarity: Use measures that do not further endanger livelihoods.
- Firms and governments should find creative ways to quickly change their business models to survive through the crisis.
- Promote mobile and online banking platforms

Policies for the aftermath of the health emergency.

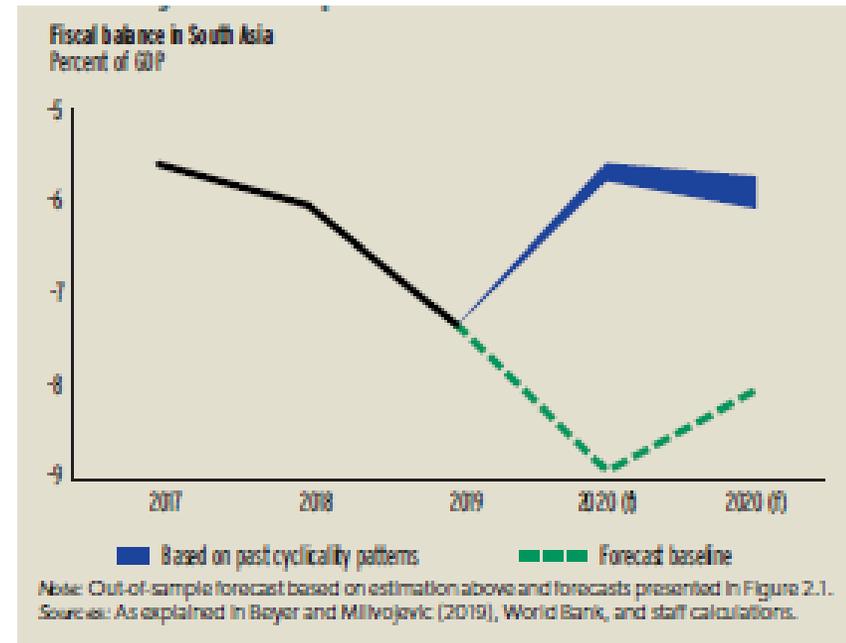
- Timely actions by central banks, both within the region and globally, are recommended for coordinated liquidity supply
- Temporary work programs and increased infrastructure expenditure can accelerate the revival of economic activity.
- Actively work with creditors for debt restructuring
- Economic and food security is better served by diversification than by autarky.
- Build back better: plan for a post-COVID world.

Fiscal deficits and debt ratios will widen, but improve in FY2021 and FY2022 amid some bounce-back in GDP.

- Fiscal sustainability in Maldives, Sri Lanka and Pakistan are of greatest concern—as in pre-COVID
- G20-led bilateral debt forbearance could help.
- Unlike past episodes, countries should use all available fiscal space—particularly development and capital spending—to make expenditures counter-cyclical.



Notes: (e)—estimate; (f)—forecast. Data is in fiscal years.
Source: World Bank and staff calculations.





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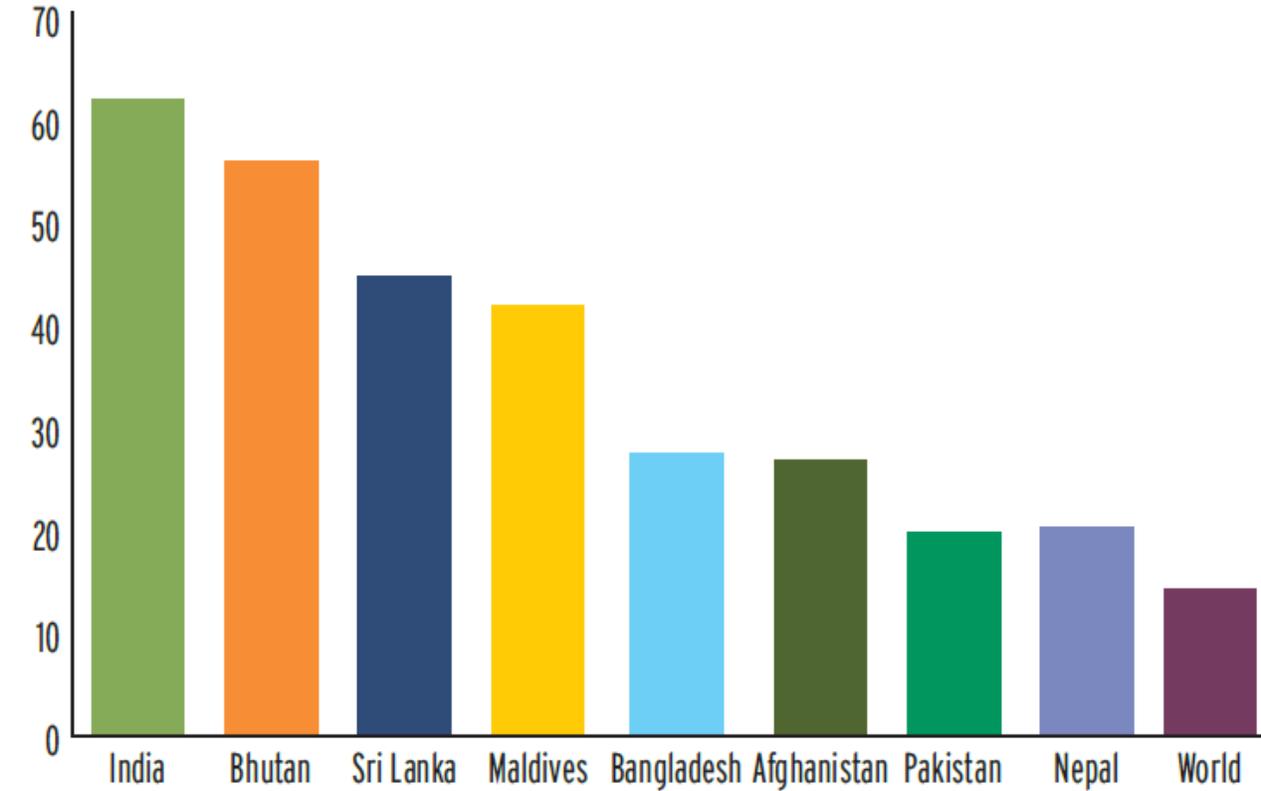
In South Asia, state-owned banks are much more common than elsewhere...



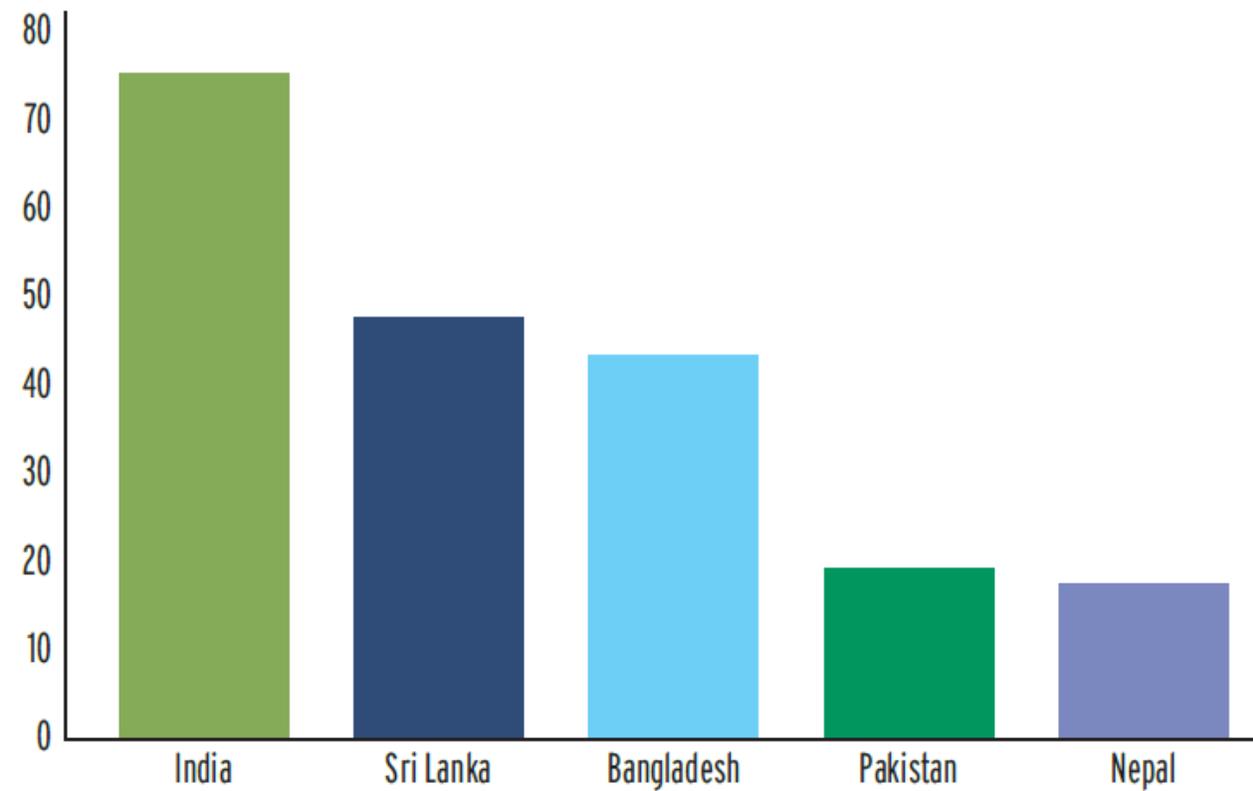
Note: Data is for 2016 and shows simple averages across countries.
Source: World Bank.

... but there is considerable variation across countries.

Share of assets owned by public banks
Percent

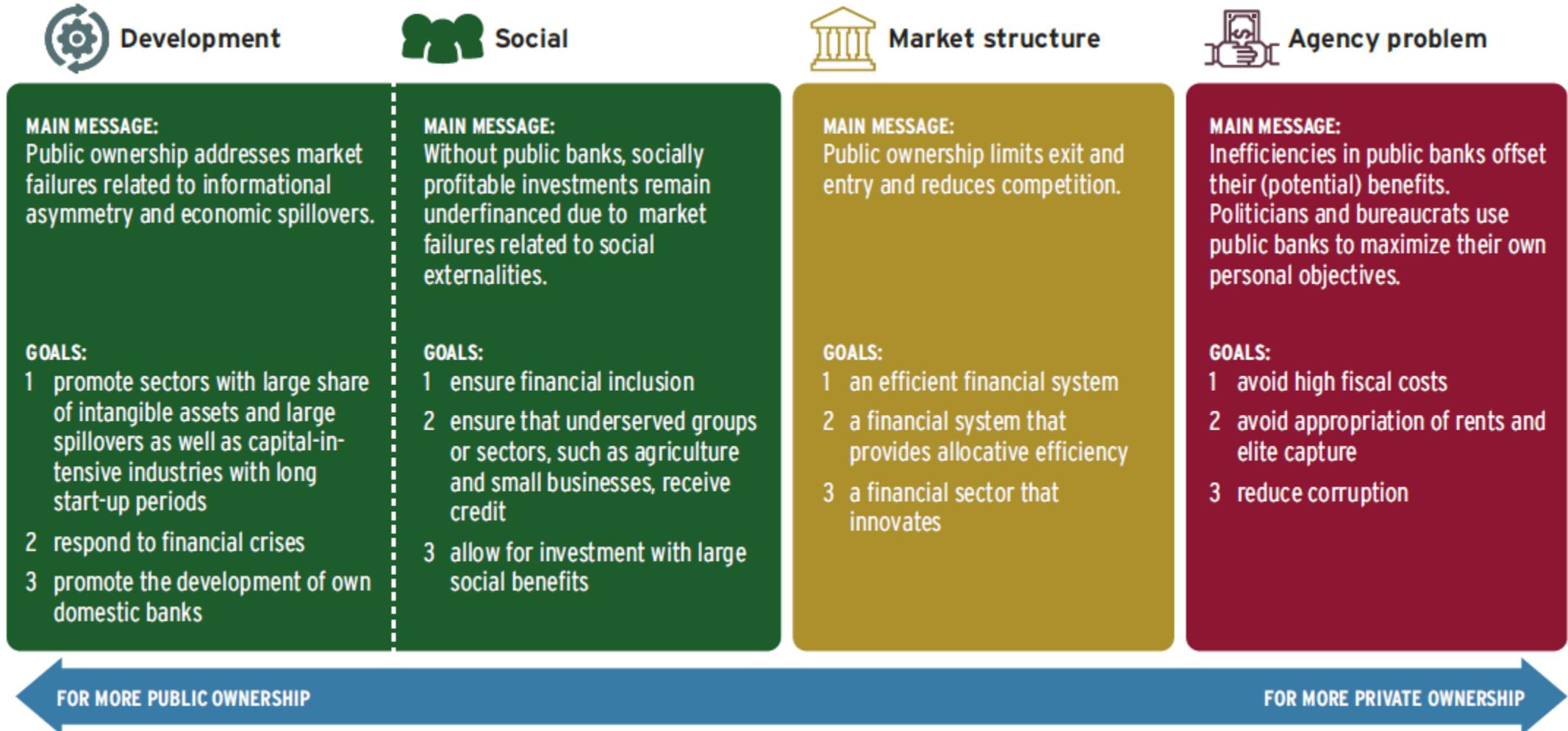


Share of public bank branches
Percent



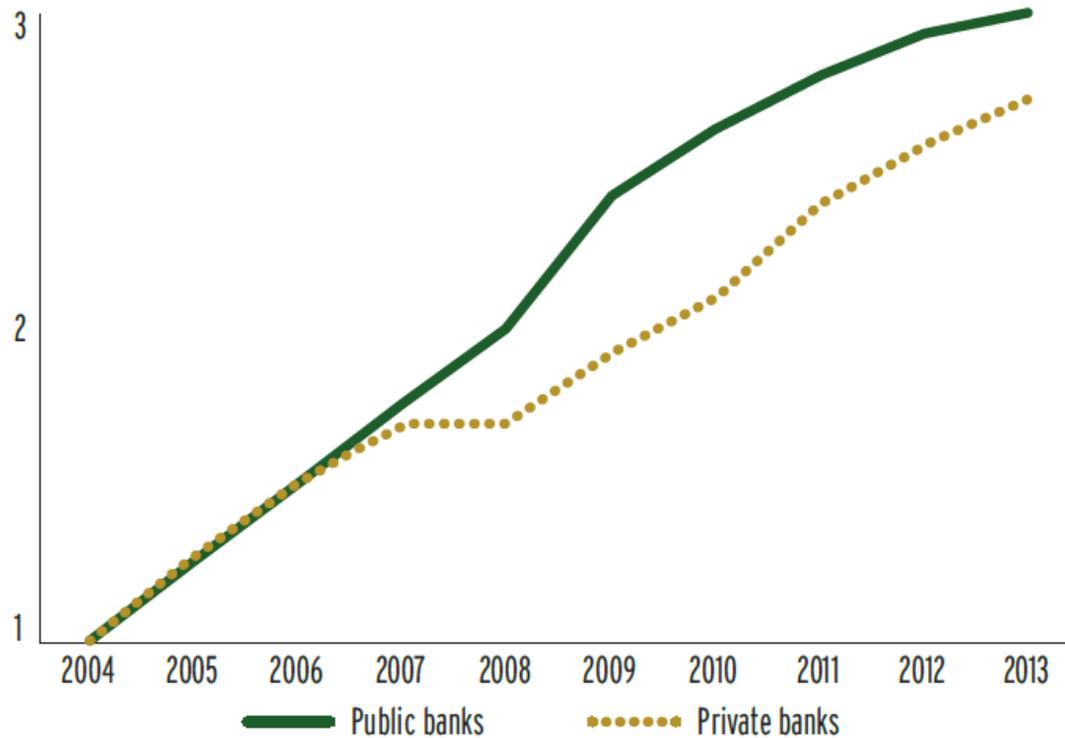
Notes: Asset data for Pakistan is 2019, for India and Sri Lanka it is 2018, for Nepal it is 2015 and for the rest it is 2016; branch data is 2019 for Nepal and 2018 for the rest.
Sources: World Bank, central bank and bank webpages, and staff calculations.

There are good reasons for and against public ownership of banks.



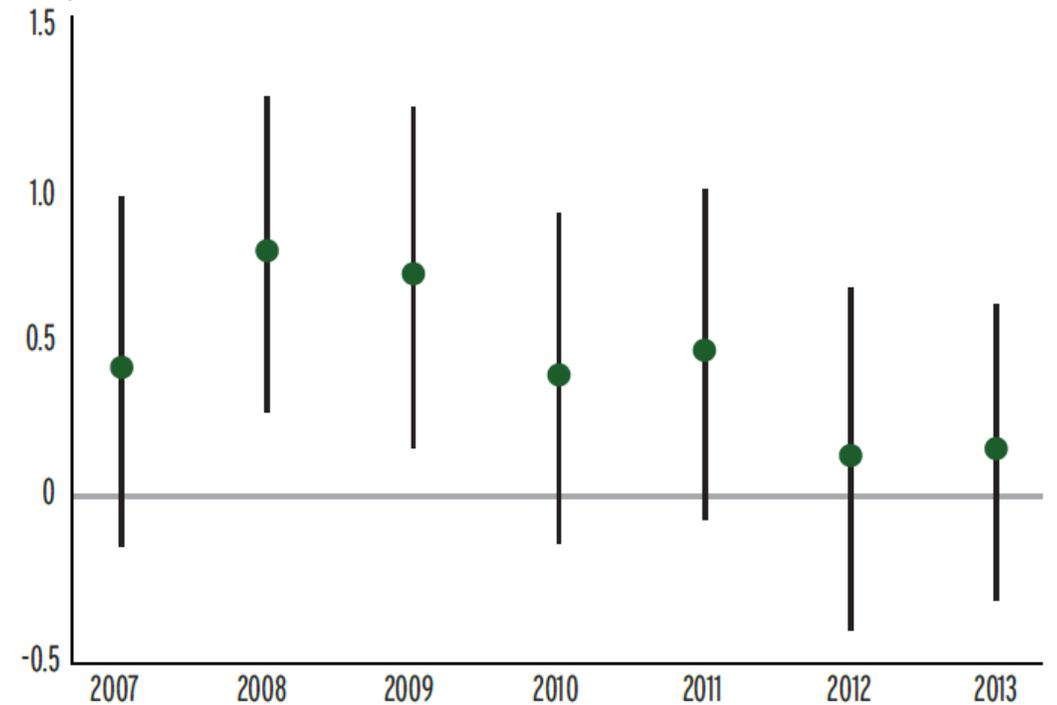
Public banks played a stabilizing role after the global financial crisis in India.

Total credit outstanding by bank type
Index, 1=2004



Source: Reserve Bank of India and staff calculations.

Treatment effect of more public banks on night light intensity
Marginal effects



Notes: The error bars represent 90 percent confidence intervals. In 2008, for example, a ten percent larger share of public banks increased the growth of nightlight intensity in a district by 8.4 percent. The share of public banks has had a significant effect only in 2008 and 2009. The estimation of the treatment effect is explained in Appendix A3.2.

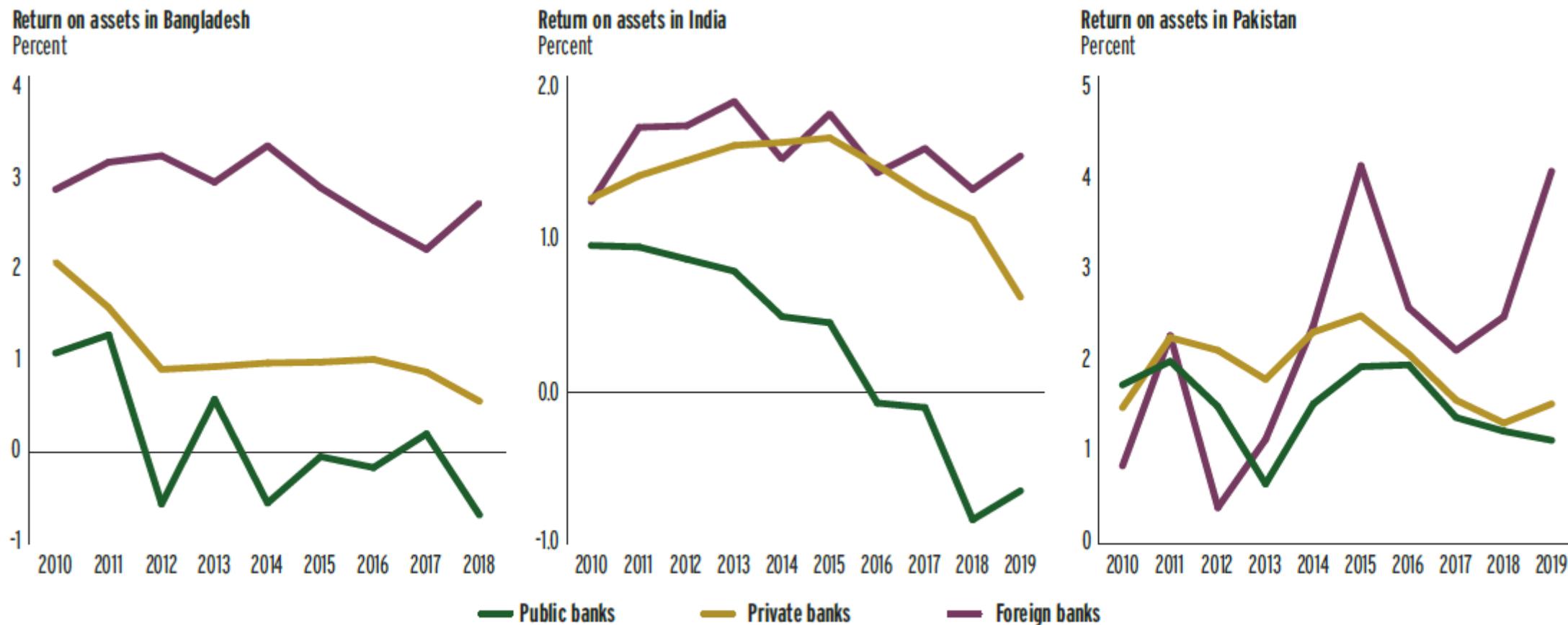
Sources: Reserve Bank of India, World Bank, South Asia Spatial Database, and staff calculations.

Across South Asia, public banks are more common in rural areas with a lot of agriculture and low literacy.

	Rural population			Agricultural employment			Literacy rate		
	Bangladesh	Nepal	India	Bangladesh	Nepal	India	Bangladesh	Nepal	India
	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)
Share of public banks	0.02*** (0.01)	1.72*** (0.10)	0.67*** (0.22)	0.02** (0.01)	0.10 (0.49)	0.57** (0.25)	-0.01* (0.01)	-1.12* (0.51)	-0.058 (0.13)
Share of non-commercial/ rural banks		0.36*** (0.07)	1.19*** (0.19)		0.60* (0.27)	1.00*** (0.22)		-0.19 (0.31)	-0.27** (0.10)
State fixed effects	No	No	Yes	No	No	Yes	No	No	Yes
Observations	64	7	626	64	7	626	64	7	626
R-squared	0.05	0.99	0.45	0.05	0.48	0.40	0.02	0.47	0.50

Notes: * p < 0.10, ** p < 0.05, *** p < 0.01. Standard errors are in parenthesis. For Bangladesh, the share of public banks is defined by deposits. For Nepal and India, the share is defined by branches.
Sources: Central bank webpages, South Asia Spatial Database, Nepal Labour Force Survey 2017/18, World Bank, and staff calculations.

Public banks in South Asia perform poorly as businesses.



Source: Central bank webpages.

Credit growth of public banks in India increases in elections years.

	Total credit			For agriculture	
	(1)	(2)	(3)	(4)	(5)
Election year	0.036 (0.90)	0.026*** (3.75)	-0.035 (-0.61)	0.031*** (3.03)	0.023** (2.06)
Controls	YES	YES	YES	YES	YES
State and district fixed effects	YES	YES	YES	YES	YES
Instrumental variable approach	NO	NO	YES	YES	NO
Sample	Private	Public	Private	Public	All
Observations	3972	4205	3972	4205	5070
R-squared	0.87	0.99	0.87	0.99	0.97

Notes: * p < 0.10, * p < 0.05, *** p < 0.01. Robust t-statistics are in parenthesis. The estimation follows closely Cole (2019) and covers the period from 2004 to 2019. Columns (3) and (4) use an instrumental variable approach following Khemani (2004). More information in Appendix A3.5.

Sources: Reserve Bank of India, Election Commission of India, South Asia Spatial Database, World Bank, and staff calculations.

Striking the right balance going forward is crucial.

- Public banks fulfill social and development roles in the region, but they are inefficient and political lending is widespread; they are a cursed blessing.
- Public banks will have a role to play in the future, and especially in the near term due to the COVID19 pandemic.
- To reap the benefits and mitigate the problems of public banks, they should be reformed according to best practices
 - Like public banks in the rest of the world, public banks in South Asia need much better-defined objectives and missions.
 - Public banks need to be more transparent in their financial results, including in the amounts of explicit and implicit government subsidies, and on contingent liabilities.
 - Stronger governance and accountability could improve the performance of public banks.
 - Financial regulation needs to consider the incentives faced by public banks.
- Governments need to create an environment in which FinTech can drive financial innovation.



Thank you
