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ECONOMIC AND SOCIAL SURVEY OF ASIA AND THE PACIFIC 2014

Regional Connectivity for Shared Prosperity

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# INDIA

*Country briefing notes*

## Economic growth picked up but remained below potential

- The economy expanded by 4.7% in the fiscal year 2013, up from 4.5% in the previous year. This rate is, however, far below the 9.5% pace registered in the years prior to the global financial crisis. Subdued output growth pushed up the measured unemployment rate by one percentage point to 4.7%.

- A fragile global economy has weighed on growth in recent years, but delays in tackling structural impediments, such as rising inequality, high inflation, infrastructure shortages and public spending effectiveness, have also been important factors.

- Tight monetary policy to contain inflationary expectations and capital flight also had an impact on domestic demand. Consumer confidence deteriorated, with car sales in 2013 declining for the first time in a decade. Fixed investment also slowed, in line with sluggish demand and higher interest rates.

- The economy is expected to enjoy stronger growth momentum of 5.5% in the fiscal year 2014, underpinned by solid expansion in the industrial and services sectors. Higher growth in the developed countries and the weaker local currency would support exports. The formation of a new Government after parliamentary elections in April-May 2014 also provides impetus to economic reforms.

## Elevated inflationary pressure

- The inflation rate remained high at 9.5% in 2013. In addition to supply constraints, the weaker currency and cuts in fuel price subsidies are contributing factors.

- High food inflation hit the poor harder, as they spend proportionally more on food purchases, especially cereals and vegetables. Food items account for close to half of the consumer price index in India.

## Exports rebounded

- Merchandise exports resumed a positive growth in 2013 after a modest contraction in 2012. The pickup was mainly fuelled by strengthening import demand from developed economies but the weaker Indian rupee also helped.

- The current account deficit narrowed to 2.4% of GDP in 2013. In addition to the export rebound, measures to curb sizeable gold imports also played a role.

## Financial market volatility

- India experienced capital outflows and sharp currency depreciation in mid-2013 on speculation of a change in the United States monetary policy stance.

- In response, capital flow management tools were introduced, such as lowering the limit on overseas investment. Moreover, after a steady decrease between January and September 2013, the policy interest rate was raised to stem capital outflows.

- Macroeconomic imbalances, such as persistently high inflation and limited fiscal space, have constrained India's capacity to weather capital flow volatility more resiliently.

- More heavily affected economies were those with large fiscal and current account deficits financed by external short-term capital flows. This highlights the need for a deeper structural transformation to drive India's dynamic competitive advantage.

## Structural reform agenda

- India's 12$^{th}$ national development plan (2012-2017) emphasized the need for the country to reverse the recent economic slowdown, while ensuring that growth was more inclusive and sustainable. Tackling macroeconomic imbalances, particularly high fiscal and current account deficits, is cited as an immediate policy challenge.

- Some of the country's recent reform initiatives include: relaxing caps on foreign investment in such sectors as retail and telecommunications; setting up an investment committee to speed up the implementation of large infrastructure projects; passing a food security act that provides subsidized food grains to two thirds of the population; and introducing clearer guidelines on the land acquisition process.

- Regarding financial reforms, there are proposals to create a new category of banks that would focus on lending to small businesses and low-income households, and to introduce a structured monetary policy framework to increase central bank independence.