

## **Regional Summary: South Asia**

### **Overview**

Following a vibrant 9.1 percent growth rate in 2010 (calendar year), real GDP growth in **South Asia** decelerated to an estimated 6.6 percent in 2011, with a sharp fall-off evident in industrial production and trade late in the year. Nevertheless, regional growth is estimated to have exceeded the long-term average of 6 percent (1998-2007), reflecting above trend activity in Bangladesh, India and Sri Lanka. GDP growth is projected to ease further to 5.8 percent in 2012 before strengthening to 7.1 percent in 2013.

Accounting for about 80 percent of South Asia's GDP, India has led the regional slowdown as its GDP growth weakened to an estimated 6.8 percent (at factor cost) in fiscal year 2011/12, ending in March 2012, from 8.5 percent in 2010/11. Growth is projected to hold steady at 6.8 in 2012/13 before accelerating to 8.5 percent in 2013/14. The slowdown reflects moderation in domestic demand, given a deceleration in investment growth that has faced headwinds of rising borrowing costs, high input prices, slowing global growth and heightened uncertainty. Household spending has been curbed by persistently rising prices cutting into real incomes and higher borrowing costs.

Economic activity in Pakistan, representing about 15 percent of regional GDP, continues to markedly lag outcomes elsewhere in the region, reflecting worsening security conditions, greater political uncertainty and a breakdown in policy implementation. GDP growth slowed to 2.4 percent in fiscal year 2010/11, ending in June 2011, from 4.1 percent in 2009/10, in part due to the economic disruptions of the devastating floods that hit in July and August of 2010. Pakistan is projected to post a rebound to 3.9 percent in 2011/12, and to firm further to 4.2 percent in 2012/2013.

The regional deceleration in growth reflects internal and external headwinds. On the domestic front, more restrictive macroeconomic policy stances, aimed at reducing stubbornly high inflation and unsustainably large fiscal deficits, have contributed to weaker domestic demand. Higher borrowing costs, elevated inflation, moderating economic activity and some local factors (e.g. policy uncertainty, stalled reforms, and deteriorating political and security conditions) have contributed to a significant slowdown in investment growth.

At the same time, the external environment has become increasingly challenging and uncertain. Although direct financial linkages, such as exposures to Euro Area banks, are limited, contagion from the European debt crisis has hit equity finance. Regional stock markets retreated in concert with the rest of the world during the second half of the year. Deteriorating international bank funding conditions have also led to a fall-off in foreign bank lending, contributing to a sharp depreciation in local currencies against the dollar in the second half of 2011. While the external environment is expected to remain difficult, South Asian governments have limited space with which to introduce fiscal stimulus measures, due to large fiscal deficits, and the possibility of monetary easing is constrained by sustained high inflationary pressures.

Demand for the region's exports of goods and services is projected to slow in calendar year 2012 and lead to a near halving of export growth to 11.6 percent in 2012, from 21 percent in 2011, due to stagnant GDP in the European Union and the projected global slowdown, including the influence of tighter monetary policy in China and fiscal consolidation in Europe.

### **Risks and Vulnerabilities**

A deepening of the Euro Area crisis would lead to weaker export growth, worker remittances and capital inflows to South Asia.

**Trade.** The Euro Area represents about one-fourth of South Asia's merchandise export market, with Bangladesh, the Maldives and Sri Lanka particularly exposed to a downturn in European demand for merchandise. Moreover, export financing from Europe, an important component of trade credit, is

particularly vulnerable to drying up, as was the experience during the 2008 financial crisis.

**Remittances.** Worker remittances remain a critical source of foreign exchange in South Asia—equivalent to 20 percent of GDP, as of 2010, in Nepal, 9.6 percent in Bangladesh, 7 percent in Sri Lanka and 5 percent in Pakistan. If the global conditions were to deteriorate sharply, remittances growth could stall, resulting in weaker incomes, weaker foreign currency earnings and slower domestic demand growth within the region.

**Finance.** Financial sector impacts through heightened global risk aversion (reversal of capital inflows, higher international borrowing costs and slowing FDI) are likely to be felt strongest in India, which is the most integrated with global financial markets, along with the Maldives and Sri Lanka, where 2012 external financing needs (current account financing and external debt repayments) are projected to reach 9.8 percent, 18 percent and 7 percent of GDP, respectively. Countries heavily reliant on foreign assistance, such as Afghanistan, Nepal and Pakistan, could be hit hard if fiscal consolidation in high-income countries were to result in cuts to overseas development assistance.

### **Policy Recommendations**

Given the lack of fiscal space in South Asia, inflationary pressures and consequent limited room for monetary policy easing, fiscal consolidation through greater revenue mobilization (particularly in Pakistan, Sri Lanka, Bangladesh, and Nepal) and expenditure rationalization (especially in India) could play a key role in helping to protect critical social programs.

Expanding the drivers of growth also holds potential. With markets in the United States and Europe expected to experience prolonged weakness, South Asian countries have the opportunity to re-think and pursue new sources of growth in both domestic and external markets. This may include focusing on export growth toward faster growing emerging markets, as well as internal market enhancements through structural and governance reforms. Such actions would help boost export demand, help raise investment, provide better jobs and generate an environment for more inclusive growth.

#### **South Asia forecast summary**

(annual percent change unless indicated otherwise)

	98-07 <sup>a</sup>	2008	2009	Est. 2010	Forecast		
					2011	2012	2013
GDP at market prices (2005 US\$)	6.0	6.0	6.1	9.1	6.6	5.8	7.1
<b>Calendar year basis</b>							
Bangladesh	5.0	6.3	6.0	5.9	6.5	6.1	6.3
India	6.4	6.2	6.8	10.0	7.0	6.0	7.5
Nepal	3.4	4.8	5.3	4.5	4.0	3.5	3.8
Pakistan	5.0	3.7	1.7	3.8	3.1	4.0	4.2
Sri Lanka	4.4	6.0	3.5	8.0	7.7	6.8	7.7
<b>Fiscal year basis<sup>b</sup></b>							
Bangladesh (July 1 through June 30)	5.0	6.2	5.7	6.1	6.7	6.0	6.4
India (April 1 through March 31)	6.2	4.9	9.1	8.7	6.5	6.5	7.7
Nepal (July 16 through July 15)	3.1	6.1	4.4	4.6	3.5	3.6	4.0
Pakistan (July 1 through June 30)	4.7	1.6	3.6	4.1	2.4	3.9	4.2

Source: World Bank.

World Bank forecasts are frequently updated based on new information.

Afghanistan, Bhutan, Maldives are not forecast owing to data limitations.

a. Growth rates over intervals are compound average; growth contributions, ratios and the GDP deflator are averages.

b. Please see regional annex for details on fiscal year reporting.