

South Asia

GDF 2003 Summary



Global themes

- Global growth is projected to accelerate steadily from 1.7% in 2002 to 2.3% in 2003 and 3.2% in 2004. Importantly, this view incorporates the effect of a relatively quick military conflict in Iraq. While very much a recovery, the expansion now underway is quite subdued by historic standards, especially given the sizeable stimulus from policy.
- The past few years has seen a fundamental shift in the pattern of private sector financing for developing countries, away from debt flows to equity-related FDI flows. The drop in debt finance has been partly driven by lower demand on the part of many developing countries seeking to lessen their vulnerability to swings in volatile debt finance, as well as a reduced supply of debt from banks and bondholders. The rise in FDI reflects greater optimism about globalization, the spread of FDI in services and heavy privatization.
- While this rotation from debt to equity should continue, the signs are that the low point in the current private debt cycle came in 2002Q3, and that net debt flows to developing countries are likely to turn positive again in 2003 for the first time in three years. While most likely, the overall buoyancy of FDI flows should not be taken for granted, however. Flows are already off their peak; privatization-related revenues have fallen sharply; and FDI in telecom and other areas of infrastructure has slumped. Moreover, rates of return on both FDI and in the corporate sectors of developing countries have generally fallen in recent years.
- Workers remittances have become an increasingly important component of global development finance, having risen to \$80 billion in 2002. They have some very attractive financial features. They are more stable than private debt flows and are less concentrated in the major middle-income countries than FDI flows.
- Aid flows to developing countries probably rose in 2002 and will continue to do so in 2003 and beyond, in line with the commitments made at the Monterrey Conference in March 2002. Emergency financial support (e.g. IMF) is likely to fall in 2003, on the presumption that no new major debt crises are in the offing. In between, official non-concessional lending (which includes the IBRD) is generally quite weak. Note that net IBRD lending was -\$4.1 billion in 2002 and is on track for an even larger decline in 2003.

Regional themes

- South Asian GDP rose 4.9 percent in 2002, below the region's potential. GDP is expected to rise to 5.3 percent in 2003 and 5.2 percent in 2004, boosted by improving exports and an agricultural recovery. Indian manufacturing showing signs of an upturn, and the Bangalore-based international services sector has experienced less disruption in demand than high-tech sectors elsewhere.

- India joined the top 10 developing country recipients of FDI (\$3.6 billion in 2002). FDI to South Asia expected to rise from \$5 billion in 2002 to \$9 billion in 2005, assuming the Indian reform program and government's efforts to attract foreign investment continue.
- Net inward debt flows were less than \$1 billion in 2002. Official sources lent the region \$1.9 billion, but private sources were repaid \$1 billion. South Asia also received \$4 billion in bilateral grants.
- Foreign exchange reserves have risen (especially in India), and now equal eight times short-term debt and nearly 10 months of imports, the highest levels among the six geographical regions.

Other key regional points to note

- India's FDI inflows are understated because, unlike many other countries, India excludes from its records on FDI: (i) earnings reinvested by foreign investors; (ii) other direct investments between investors and subsidiaries, branches, and associates; and (iii) investments by offshore and domestic venture-capital funds set up by foreigners. Including these flows would raise FDI from \$2-3 billion currently reported to as much as \$8 billion.
- External debt and equity flows are likely to rise in the medium term:
 - Tensions between Pakistan and India have eased since September 11th and progress has been made towards restoring peace in Sri Lanka.
 - Privatization transactions are likely to rise.
 - Corporate profits have held up better than in some regions.
 - The granting of dual citizenship to non-resident Indians is likely to increase investment inflows, as well as remittances, from them.
- South Asia received \$16 billion in remittances in 2002:
 - This is the second highest among developing country regions, equal to 2.5 percent of GDP, the highest among developing country regions.
 - India was the largest developing country recipient of remittances (\$10 billion) in 2001.
 - Other major recipients include Bangladesh (\$2.1 billion), Pakistan (\$1.5 billion) and Sri Lanka (\$1.1 billion).
- India's inward remittances more than offset the loss of tax revenue. Desai, Kapur, and Mchale (2001) estimate the net fiscal loss associated with Indian emigration to the United States at 0.24 to 0.58 percent of Indian GDP in 2001, but remittances amounted to at least 2.1 percent of GDP in that year.
- Inward remittances may have a positive impact on savings and investment. Household surveys in Pakistan indicated that in the later 1980s and early 1990s, the marginal propensity to save was higher (0.711) for income from international remittances than from domestic urban-rural remittances (0.49) or rental income (0.085).
- Remittance flows to South Asia are expected to rise. Efforts to reduce money-laundering since September 11 already have increased remittance receipts through official channels. The Iraq war may reduce remittance flows only slightly. For example, the 1990-91 Persian Gulf war didn't affect remittance flows to India.

Table A.6 South Asia outlook in summary, 1981–2003

Real economy (percent change, unless stated)	1981-90	1991-00	1997	1998	1999	2000	2001	2002e	2003f
Real GDP growth	5.8	5.2	4.2	6.0	5.8	4.0	4.3	4.9	5.3
Private consumption per capita	2.3	2.4	1.3	-0.3	-0.1	0.1	3.5	2.0	2.3
GDP per capita	3.5	3.2	2.4	4.1	3.9	2.1	2.6	3.2	3.6
Population	2.2	1.9	1.8	1.8	1.9	1.9	1.7	1.7	1.6
Gross domestic investment/GDP ^a	20.1	21.9	21.8	22.2	22.6	22.8	23.6	23.9	23.9
Inflation ^b	8.9	8.1	7.3	7.5	4.6	5.8	6.1	5.0	5.1
Central government budget balance/GDP	-12.6	-10.3	-9.9	-10.7	-9.8	-9.7	-10.3	-10.3	-9.8
Export market growth ^c	5.0	12.7	8.2	3.7	7.1	12.9	0.2	2.8	6.3
Export volume ^d	6.4	9.3	5.6	8.6	1.8	7.7	3.8	5.3	10.0
Terms of trade/GDP ^e	0.0	-0.1	0.3	0.9	-0.4	-0.8	0.4	0.0	0.2
Current account/GDP	-2.0	-1.5	-1.1	-1.8	-1.0	-0.5	-1.3	-1.1	-0.8
Workers remittances (billions of dollars)	—	—	14.6	13.3	15.1	13.5	14.9	16.0	—
Memorandum items									
GDP growth: South Asia excluding India	5.5	4.3	3.2	3.7	3.6	4.2	3.8	3.9	4.8
External Financing and Debt (billions of dollars unless stated)									
	1995	1996	1997	1998	1999	2000	2001	2002e	2003f
Net inward FDI	2.9	3.5	4.9	3.5	3.1	3.1	4.1	5.0	6.0
Net inward portfolio equity flows	1.6	4.1	2.9	-0.6	2.4	1.7	1.6	0.8	2.0
Net inward debt flows	2.5	2.6	0.6	4.7	0.5	3.4	-0.3	0.9	-1.0
From public sources	-1.2	1.0	0.3	2.3	2.5	0.5	2.5	1.9	-1.0
From private sources	3.7	1.6	0.3	2.4	-2.0	2.9	-2.7	-1.0	0.0
Gross market-based capital inflows	7.4	10.5	12.7	5.1	4.2	4.8	3.3	2.6	3.0
Total external debt	157	155	155	163	167	165	162	—	—
Medium- and long-term	148	145	147	156	160	159	157	—	—
Short-term	9	10	8	7	7	6	5	—	—
Owed by public-sector borrowers	140	135	135	145	150	144	142	—	—
Owed by private-sector borrowers	17	20	20	18	17	21	19	—	—
Owed to public-sector creditors	114	110	104	110	119	108	107	—	—
Owed to private-sector creditors	43	46	51	53	49	57	55	—	—
Gross foreign exchange reserves	24.2	24.8	30.0	32.9	37.9	42.6	52.8	70.8	85.8

— Not available.

Note: e = estimate, f = forecast.

a. Fixed investment, measured in real terms.

b. Local currency GDP deflator, median.

c. Weighted average growth of import demand in export markets.

d. Goods and non-factor services.

e. Change in terms of trade, measured as a percentage of GDP.

Table A.27 External financing: South Asia, 1997–2003

(billions of dollars)

	1997	1998	1999	2000	2001	2002e	2003f
Current account balance	-5.8	-9.6	-5.5	-6.1	-2.9	-7.6	-6.1
as a percentage of GDP	-1.1	-1.8	-1.0	-1.0	-0.5	-1.1	-0.8
Financed by:							
Net equity flows	7.8	2.9	5.5	4.7	5.7	5.8	8.0
Net FDI inflows	4.9	3.5	3.1	3.1	4.1	5.0	6.0
Net portfolio equity inflows	2.9	-0.6	2.4	1.7	1.6	0.8	2.0
Net debt flows	0.6	4.7	0.5	3.4	-0.3	0.9	-1.0
Official creditors	0.3	2.3	2.5	0.5	2.5	1.9	-1.0
World Bank	1.1	0.8	1.0	0.7	1.5	1.1	—
IMF	-0.8	-0.4	-0.1	-0.3	0.3	0.1	—
Others	0.0	2.0	1.6	0.0	0.7	0.7	—
Private creditors	0.3	2.4	-2.0	2.9	-2.7	-1.0	0.0
Net medium- and long-term debt flows	2.4	3.7	-2.1	3.9	-1.9	-1.6	—
Bonds	2.3	4.2	-1.2	5.4	0.0	-0.4	—
Banks	1.3	0.7	-0.5	-2.0	-1.7	-1.1	—
Others	-1.2	-1.2	-0.4	0.5	-0.1	-0.1	—
Net short-term debt flows	-2.1	-1.3	0.1	-1.0	-0.9	0.6	—
Balancing item ^a	2.6	4.9	4.5	2.6	7.8	19.0	14.1
Change in reserves (- = increase)	-5.2	-3.0	-5.0	-4.7	-10.2	-18.0	-15.0
Memo items:							
Bilateral aid grants	2.4	2.3	2.4	2.3	3.6	4.2	4.0
(ex. technical cooperation grants)							
Net private flows (debt + equity)	8.2	5.3	3.5	7.7	2.9	4.8	8.0
Net official flows (aid + debt)	2.7	4.6	4.9	2.8	5.5	6.0	3.0
Workers' remittances	14.6	13.3	15.1	13.5	14.9	16.0	—

— Not available.

Note: e = estimate; f = forecast.

a. Combination of errors and omissions and net acquisition of foreign assets (including FDI) by developing countries.